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VOLUME AND STABILITY OF PRIVATE INVESTMENT

HEARINGS

BEFORE THE

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JOINT COMMITTEE ON THE ECONOMIC REPORT

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VOLUME AND STABILITY OF PRIVATE INVESTMENT

TUESDAY, SEPTEMBER 27, 1949

UNITED STATES SENATE,
SUBCOMMITTEE ON INVESTMENT OF THE JOINT
COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to call, at 10:10 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney, and Representative Herter.

Also present: Representative Robert F. Rich; John W. Lehman, clerk to the committee; Dr. Theodore Kreps, staff director; Dr. William H. Moore, economist; and David Scoll, special counsel to the Subcommittee on Investment.

The CHAIRMAN. The committee will come to order.

This session this morning is being held under the authority of a resolution adopted by the Congress, Senate Concurrent Resolution No. 26, the text of which will be inserted in the record.

(The document referred to is as follows:)

[S. Con. Res. 26, 81st Cong., 1st sess.]

CONCURRENT RESOLUTION

Resolved by the Senate (the House of Representatives concurring), That the Joint Committee on the Economic Report, or any duly authorized subcommittee thereof, is authorized and directed to conduct a full and complete study and investigation into the following problems of the economy:

(1) The problem of investment, including, but not limited to, (A) the role of investment institutions in the investment markets, in industry, and in the economy generally; (B) changes in sources of investment funds and the reason therefor; (C) availability and character of investment funds for national, local, and independent enterprise and the effect of such investment or lack of investment upon different classes or size groups in industry; (D) and needs, by industry, for various types of capital.

(2) The problem of the effectiveness and coordination of monetary, credit, and fiscal policies in dealing with general economic policy.

(3) The problem of low-income families in relation to economic instability.

(4) The problem of unemployment trends and their significance in current economic analysis.

SEC. 2. The joint committee shall report to the Senate and the House of Representatives not later than December 31, 1949, the results of its study and investigation, together with such recommendations as it may deem advisable.

SEC. 3. For the purposes of this resolution, the joint committee, or any duly authorized subcommittee thereof, is authorized (1) to appoint and fix the compensation of such experts, consultants, and clerical and stenographic assistants as it deems necessary and advisable, but the compensation so fixed shall not exceed the compensation prescribed under the Classification Act of 1923, as amended, for comparable duties; and (2) to hold such hearings; to sit and act at such times and places during the sessions, recesses, and adjourned periods of the Eighty-first Congress prior to January 1, 1950; to require by subpena or otherwise the attendance of such witnesses and the production of such books, papers, and documents; to administer oaths; to take such testimony, to have such printing and binding done; and to make such expenditures as it deems advisable. The cost of stenographic services in reporting hearings shall not be in excess of 25 cents per one hundred words. Subpenas shall be issued under the signature of the chairman or vice chairman of the joint committee and shall be served by any person designated by them.

SEC. 4. The expenses of the joint committee under this resolution, which shall not exceed $30,000, shall be paid one-half from the contingent fund of the Senate and one-half from the contingent fund of the House of Representatives upon vouchers signed by the chairman. Disbursements to pay such expenses shall be made by the Secretary of the Senate out of the contingent fund of the Senate, such contingent fund to be reimbursed from the contingent fund of the House of Representatives in the amount of one-half of disbursements so made.

The CHAIRMAN. Our purpose as a subcommittee, delegated under this resolution to make a study of investment, is to find out what the Government can or should do to promote the investment of capital. Personally, I think the question goes a lot deeper than that. A private enterprise system depends upon the investment of private capital.

When the owners of such capital find investment opportunities and are willing to risk their money, we generally have good times. When they believe that the opportunities are not good, and when they are fearful of risking their money, and investment is not made, then we generally have bad times.

The result is that people turn to government, and government capitalism is promoted.

In the world today we have several forms of investment. We have what might be called monopoly capitalism, and competitive capitalism, and state capitalism. All sorts of questions revolving around these ideas are being raised all over the world.

This committee has requested several gentlemen to appear before it, and to do their best to tell us what, in their opinion, government should do to promote the investment of private capital. We want to make this an objective study.

I think the members of the committee enter into these hearings with free minds, except that I think it is the unanimous desire of all members of the committee to preserve and defend what we call the free-enterprise system.

The first witness this morning will be Mr. Eugene Holman, president of the Standard Oil Co. (New Jersey), who has been good enough to accept our invitation to discuss these problems from the very advantageous position which he occupies as the head of this great organization, which is known throughout the world.

Mr. Holman, would you be good enough to take the stand?

I might say that, in opening these hearings, I am reminded of an experience which several Members of Congress had several years ago. It was during the war. We were invited to Kansas City for a session with respect to livestock.

The chamber of commerce gave us a dinner. We were seated at the speakers' table. All of us, I am sure, were expecting to be called upon to make speeches and to tell this chamber of commerce audience what we had on our minds.

I noticed, however, that there was a little pulpit out in front of the speakers' table. I was not at all aware of the utility of this pulpit until after the dinner had been concluded, and then a member of the chamber of commerce arose, went to the pulpit, and he talked to the Members of Congress, instead of listening to our talk.

So, Mr. Holman, we are here this morning to listen to you, and you may lecture us, you may scold us, you may advise us, just as you please.

STATEMENT OF EUGENE HOLMAN, PRESIDENT, STANDARD OIL CO. (NEW JERSEY); ACCOMPANIED BY DAVID A. SHEPARD, EXECUTIVE ASSISTANT TO THE PRESIDENT, STANDARD OIL CO. (NEW JERSEY)

Mr. HOLMAN. Thank you, Mr. Chairman.

My name is Eugene Holman. I am president of the Standard Oil Co. (New Jersey), with headquarters at 30 Rockefeller Plaza, New York City.

Mr. Chairman, we appreciate the opportunity to appear before you and give any views that our company has on this important subject of investments.

I have a prepared statement that will take me about 20 minutes to read, which I would like to do, sir, with your permission.

The CHAIRMAN. We will be very glad to have you do it.

Would you prefer to go through the statement first, before answering any questions?

Mr. HOLMAN. I would, if that is convenient, sir.

The CHAIRMAN. Very good. That will be quite satisfactory.

Mr. HOLMAN. Jersey Standard is an American company which has engaged actively in business in the United States and in many parts of the world for many years. Since the end of the war, Jersey Standard and its affiliates have spent for capital purposes amounts equivalent to approximately 1½ billion dollars here and in foreign countries. On the basis of wide experience we recognize certain principles and influences affecting investments. Some of these factors are peculiar to oil. Our product, for example, is one requiring heavy capital outlay just to find. And its discovery is only the beginning of the need for capital investment. Many of the factors I shall mention, however, apply to all American enterprises conducting business at home or abroad.

Of course, the fundamental basis of investment is the making of profits. Profits both create and attract capital funds which are the source of investments.

It seems plain that economic well-being is directly dependent on the flow of capital funds. These funds make jobs for those who build productive equipment. They make jobs for those who operate the equipment and who distribute the products to consumers. And they give consumers more and better goods. Investment creates both goods and, no less important, the purchasing power to buy goods.

Investment, even in established businesses, must be relatively continuous. What are the reasons behind the need for a continuing flow of investment funds into our economy? There are many, among which I would name these as important:

1. The rise of consumer demand: As populations grow and as living standards rise, consumer demand is increased. To keep pace with consumer demand calls for more capital investment with which additional productive capacity can be built.

This continuing need to meet rising consumer demand has been one of the main factors influencing my company's decisions to make unusually heavy investments for productive facilities in the recent past. Consumers in the United States, for example, want 86 percent more petroleum products now than they did in 1938. In areas where affiliates of our company operate abroad, they want 61 percent more.

2. The replacement of worn-out and obsolete equipment: Even apart from the growth of consumer demand, there is a need for investment just to replace worn-out plants. It is a case of having to run just to stand still.

3. The insurance of adequate raw-material supplies: You are aware of the time, money, and effort required to find oil and get it into the hands of consumers. As oil from a given field is used up, new fields must be found. We know there is enough oil in the world for generations to come, but we would not consider ourselves as meeting our obligations unless we made every effort to continue to locate this oil.

4. The necessity to meet competition: The American oil industry has been characterized by great technical vigor. Much as we would like to, we do not have all the good ideas in the business. When one of our competitors puts a new idea into practice, we often must make heavy investments to meet the new competition. Conversely, when we develop something new, our competitors must also invest to meet our advantage. This characteristic of American industry is not found to so high a degree anywhere else in the world. We believe it accounts largely for our Nation's industrial leadership. The highly competitive nature of the oil industry is one of the great stimulants to its large capital outlays.

5. The need to provide new products or services developed by research: Petroleum is a complex raw material. Our company is always looking for—and sometimes finds—useful new products which can be made economically from it. Large new sums must be invested to manufacture and distribute such a new product.

The oil industry in the postwar period has been engaged in the greatest capital expenditures program in its history. The magnitude of its undertakings is measured by the fact that from 1945 through 1949 the industry will have spent for additions to property, plant, and equipment in the United States a total of over $11,000,000,000, equal to about two-thirds of the industry's entire gross investment in this country at the end of 1944.

I gather that this committee is interested in the specific as well as the broad principles influencing investment policies, and I think it will be of interest to you gentlemen to have a description of some of the points considered by our board when contemplating a possible investment. Many of these considerations apply to domestic investments. But, because I understand this subcommittee is presently interested in the opinions of those companies active in foreign areas, I shall speak mainly of investment problems abroad.

Foreign investment by Jersey Standard and its affiliates, in some cases, involves placing dollar funds in a foreign affiliate. Such dollars, of course, eventually find their way back to the United States to pay for exports of American goods. In other cases, equipment may be purchased in this country and sent to the affiliate abroad. In still other instances, the affiliate may plow back its own earnings, or funds may be raised abroad either through loans or by selling stock to local investors. Often a combination of methods is used.

In the oil business, we must, of necessity, make large investments abroad. One reason is the nature of our supplies. Oil deposits have been placed by nature in many sections of the globe, often far from the main centers of use. We have to invest money to find and produce from these scattered areas.

Not only in the producing end of the business but in refining also, the place of investment is affected by the location of crude supplies in relation to the markets for products. For example, as a result of rising European demand and the development of Middle East sources of crude, our affiliates are building increased refining capacity in Europe. Expanding United States refineries to supply these markets would be inefficient. It would mean bringing crude from Eastern Hemisphere sources, refining it, and shipping the products back to customers in Europe, Africa, or Asia.

A good example of this kind of activity is the present refinery development at Fawley, England, by Anglo-American Oil Co., an affiliate of Jersey Standard. The Fawley refinery is presently undergoing expansion from its previous capacity of 18,000 barrels of crude per day to 110,000 barrels. Jersey Standard and Anglo-American are jointly making a $150,000,000 investment in this refinery expansion.

The most obvious consideration for our board in studying a prospective investment, of course, is whether it will make a profit.

This involves a large number of factors including the level of sales which seems likely for our products and getting paid for those sales. Of Jersey's total sales about half are made overseas. To a large extent, the oil sold overseas is produced and refined outside the United States. Consequently the problem of getting paid for oil sold abroad is vital to us. Today one of our main worries is caused by the difficulties actual and prospective—in getting paid for our goods in currencies which we can use or which we can convert into useful funds.

This problem is not new, but it has grown much worse during the past 10 years or so, mainly because sterling is no longer convertible into dollars. Foreigners would like to buy from the United States generally far more than Americans are interested in buying from them. Because of the unbalance which results, foreign nations have set up a complex network of regulations. In most countries it is impossible for an American company to sell its goods freely, to arrange for payment freely, or to invest freely. Dividends from a foreign affiliate may often not be convertible to dollars or only in limited amount.

These exchange-control regulations are strangling international trade. Their tendency is exactly the opposite of the sound ECA purpose to restore world economic health by stimulating and freeing the flow of goods. Not only is the well-being of a particular country lowered by today's operation of exchange controls, but the effects spread out to the rest of the world. Western European customers, for example, cannot import today as much petroleum as they would like because they cannot pay for it. Their countries have set up import restrictions and exchange controls. Obviously this hindrance to sales reduces the willingness to make investments.

Exchange controls are not used in all cases simply as an aid to the rationing of petroleum or the conservation of dollars. In certain cases the operation of exchange control places American companies at a disadvantage compared with foreign companies. For example, American companies are unable to sell oil for sterling today. Some-countries, though unable or unwilling to pay dollars for petroleum, would be able and willing to pay American companies in sterling. We on our side would be willing to accept sterling payment provided we were able to put these funds to use. We do not believe that permitting us to operate in sterling would occasion any important dollar drain on the United Kingdom. We hope that the current intergovernmental discussions of financial aspects of oil will establish a basis on which American Oil companies can work out with the British Government a solution to these problems.

Another question our board will consider in studying investments concerns political risk—whether continuity of government may be so completely broken that contracts entered into under one government may be abrogated under a succeeding one, or whether there may be danger of actual expropriation.

To give an illustration, an affiliate of Jersey Standard had been active in Hungary since 1934. It discovered and produced the only petroleum ever found in commercial quantities in that country. It paid substantial royalties to the Hungarian Government. During the war the property was severely damaged. Last year our affiliate was expropriated by the Communist government of Hungary, which tried to justify its action by false accusations. At the time of the seizure of our properties this affiliate had invested amounts with a book value of $20,000,000—not including the crude discovered but not produced—and had taken only $206,000 in dividends from its investments.

Another question will be whether a particular nation, even though it does not break the contracts nor seize property, may impose so many burdens and restrictions upon an enterprise as to make investment unattractive. Such measures might be the fixing by law of unrealistic price or wage levels, thus making it impossible to operate at a profit; import or export barriers; high taxes. With respect to the latter, we all know that a government attempting to increase its revenue by higher and higher taxes may actually decrease its revenue by weakening the enterprises upon which taxes are levied.

The burdens I refer to may arise from ideological causes, or they may be expedients adopted as apparent—and I emphasize "apparent"—solutions to economic difficulties which a nation is going through. In either case, however, they will obviously discourage investment. Also, such burdens may not be actually in existence but merely threatened. In this case, although the possibility of burdensome controls and taxes may not wholly prevent investment, it certainly will act as a retarding factor.

Then there is the problem of government monopoly. Some of the nations of Latin America furnish illustrations. For example, the government may forbid private business concerns to explore for, or produce, petroleum in the country. The country's economic problems probably cannot be solved without the liquid energy provided by oil. Yet the absence of an atmosphere healthy to free investment prevents development of its oil resources.

In contrast with such a situation, you gentlemen are all aware of the current development of Canadian oil resources by private enterprise. Imperial Oil, Ltd., our affiliate in that country, spent over $20,000,000 before finding oil. But oil was found and Imperial now contemplates an additional investment of several times that amount to develop its find. Already substantial reserves have been located. This development will be a great contribution to the Canadian economy.

In summary, the two most important deterrents to Jersey's investment abroad nowadays are: First, increasing difficulty in trading among nations which arises from restrictions on convertibility of currencies, and, second, the nationalistic tendency of some governments not to allow Americans or other foreigners to take part in the oil business.

Countries in the process of raising their living standards offer choices as to where investments will be made. Our board, like the board of any other United States enterprise, is inclined to make investment where it is most welcome. Often this may mean passing up the chance to invest in a country where exchange problems are too complex, where taxes are too high, or where nationalism is rampant. Instead, we will pick a nation where the economic climate is more favorable to capital investment.

Even when an investment opportunity, whether domestic or foreign, looks good, there is still the question, Where shall we get the money?

As you know, there are several avenues open to a corporation seeking funds. It can use equity financing or issue notes or bonds. It can sell some of its assets. It can use retained earnings. We have no rigid idea about how our company should be financed, but choose the method most desirable at the time when the money is needed. Since the war we have used all these methods. In recent years, when the oil industry has had to meet tremendous demands all over the world, an important factor in providing the enormous amounts of capital required has been a favorable level of earnings. These earnings have helped productivity and employment. In addition to reinvesting earnings, however, we have issued notes and bonds, and increased our outstanding stock, and sold assets.

As members of an industry that provided four-fifths of the private investment made by American interests abroad last year—totaling 1½ billion dollars—we are disturbed by the worsening of the investment climate in many countries. It seems to us that such factors as the inconvertibility of currencies—particularly the pound sterling—and the growth of restrictive controls on private enterprise are steadily working against private investment.

Speaking as oilmen, we are specifically concerned by the world-wide problems of "dollar" oil and "sterling" oil. We know that part of the solution is up to us, but the final solution can only come with the cooperation of the governments involved. If this final solution does not provide full protection to American companies but results in substantial losses in their foreign business, it will strike a hard blow against American private investment abroad and, as you gentlemen realize, one of the most important means of balancing the position between the dollar and nondollar areas is through the outward flow of American investment capital.

In our opinion, other actions by the United States Government can aid in improving the foreign investment climate. Many good ones have been suggested under the point 4 program. One of the best is for arrangements between this Government and others to insure fair treatment for American private investment abroad. This would help to strengthen friendly nations and to lessen their social and political problems.

We know that such actions would greatly increase our interest in putting money to work in other countries, to the benefit not only of those nations but our own. We feel that some salutary action by the United States Government is urgently needed if companies like ours are going to be able to continue foreign investment—if other companies are going to be attracted to a policy of foreign investment which is so badly needed and which now presents a very discouraging prospect indeed. We strongly support a United States Government policy which will encourage private investment abroad of American funds and techniques.

Upon the assessment by Jersey Standard's board of the many factors I have mentioned depends our decision concerning investment of stockholders' funds. Usually each question cannot be answered by a straight "Yes" or "No." If it could be, investment would not be the complex subject that it is.

Naturally, we try to make every investment a good one, but being human, we sometimes make mistakes. Further, there are conditions affecting investments over which the investor has no control—actions by other companies, wars, changes in tax rates, imposition of controls which, while perhaps well-intentioned, may have the result of actually depressing business. We believe that in our company we have able men who make as good forecasts as any that can be made. But the conditions existing at the time an investment decision is taken may change in a way that is entirely unforeseeable. In such circumstances, an investment may result in loss.

In this connection, I should like to emphasize that the profit expected from an investment cannot be precisely known in advance. In some instances, an investment may turn out to be more profitable than was anticipated. In others, the return may be less than expected, or longer in arriving. In still others, the investment may prove to be a losing proposition. A successful investment policy is one under which a company can sustain losses but make a profit on the whole.

Plainly, we should like nothing better than to be able to read the future so clearly that every investment decision would be to the greatest possible benefit of our stockholders, our customers, our employees, and society as a whole. But in this world, risk is inevitable. It is, perhaps, what makes human life human. By careful study, we do our best to minimize risk, but to think we could eliminate it entirely would be unrealistic.

The matter of careful study relates not only to the "where" of investment but also to the "when." We should like nothing better than to make our investment at periods when our money would buy the most—in other words, at times of low price levels. Under the profit system, managements have every incentive to minimize capital outlays when the costs of what they have to buy are high and maximize them when such costs are low.

But here again, many factors which a company cannot foresee, or over which it has no control, come into play. For example, during the war Jersey Standard and its affiliates were not able to undertake normal investments for replacement and for expansion to take care of the normal growth in civilian demand. Thus, at the end of the war, there was a great backlog of work to be done. A similar situation faced other oil companies. Materials were hard to get then, and prices were high. Yet the industry felt obliged to embark on major capital projects to meet consumers' wants. To have deferred investment in the hope of lower prices would have imposed hardship on consumers.

Finally, let me repeat what I have said earlier—a continuing flow of investment funds is basic to the health of our economy. It is vital to employment, production, and the creation of purchasing power. It is my earnest conviction that in America we have proved that the system of private competitive economy, providing many different centers of imagination, initiative, and judgment, and offering the incentive of reward for success, is by far the best way to assure investment flow.

So far as Jersey Standard is concerned, I can say that we believe that people's use of oil will continue on an upward trend far into the future. Under this circumstance, and while we continue to operate in a free private economy, Jersey Standard and its affiliates expect to continue investing on a very substantial scale in productive facilities here and overseas. We believe that such investment will be of real benefit to society.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Holman.

Congressman Herter, would you care to ask any questions?

Mr. HERTER. Yes, I would, if I may.

Mr. Holman, you have put quite properly, in connection with your company's business, a very large emphasis on the foreign end of investment, and I notice that you have stressed particularly the desirability of our Government's taking affirmative steps to secure, if possible, a favorable climate to investment in foreign countries.

I think that in connection with the discussion on point 4 that matter has now almost reduced itself to a question of bilateral agreements with foreign countries in an effort to secure as great a degree of assurance for fair treatment for American investment capital as it is possible to secure in a very hazardous world.

Specific legislation is now before the Congress on that very subject. Would you care to comment at all on specific legislation on the subject or, perhaps, would you feel that this is a matter of purely administrative discretion rather than something that the Congress itself should embark on?

Mr. HOLMAN. Well, Congressman Herter, as I said in my testimony, we think that it is absolutely essential for a better climate to exist in the foreign countries so far as American capital is concerned, and obviously, we are in favor of any legislation leading to that conclusion.

As to the best way of bringing that about, I am sure that Congress would know more about that than I would.

I have not studied in detail some of the bills, but I am under the impression that they are certainly headed in the right direction. I have nothing to suggest at this time.

If this committee would like us to give comments specifically on the bills, of course, we would be very glad to do it, but I would say, in general, they are headed in the direction in which we would like very much to see them go.

Mr. HERTER. Those bills, of course, are not before this committee, but by a curious coincidence they are scattered around. Some of them are before the Banking and Currency Committee; some of them are before the Foreign Affairs Committee.

Mr. HOLMAN. So I understand.

Mr. HERTER. There seems to be no central point to which they add up at all in dealing with that subject.

But there is one phase of it that you might want to talk about, and that is the dual question of taxation on income.

Mr. HOLMAN. Well, we hear a lot from our stockholders on that. I think it is pretty universal among our stockholders—and there are about 200,000 of them—I hear it at our annual meetings frequently. Naturally they do not like double taxation.

Mr. HERTER. I was not thinking so much of double taxation on corporate earnings. I was thinking of taxation in a foreign country, and then the taxation of that same income when it is returned to the United States.

Mr. HOLMAN. Well, let me see, from a corporation standpoint, I am under the impression—I am not a tax expert, I would have to confirm this—if one of our affiliates abroad pays taxes there, I think we get credit in this country on our income-tax return. I am not sure of that, but I think that is the case.

Mr. HERTER. Yes; I think you get a limited credit, but I know the Treasury Department made a statement the other day, in line with some of the legislation that is now pending, that it was going to favor for the first time a larger allowance for taxes paid in the source from which the wealth to produce is obtained, as against this country, in the event of earnings and income being brought back to this country; and I am wondering to what extent that would assist, from the point of view of making foreign investments interesting?

Mr. HOLMAN. Well, if I recall correctly, Congressman, I think that there is some tax provision applying to the Western Hemisphere, which gives some additional credit. I am just not familiar enough to express it completely, but I would think that as a general answer to your question, of course, any relief from taxation we can get—after all, taxation is a part of costs, as we look at it—we would welcome.

Mr. HERTER. One other question in connection with foreign investment: With the World Bank and the Export-Import Bank in a position to make certain types of loans to foreign governments or to businesses operating in foreign countries, do you feel that the competition, you might say, of governmental funds—which the World Bank funds are, or the Export-Import Bank funds are—with private investment, with the almost inevitable necessity of having priority on a limited exchange resource in these countries for repayment of these loans, is a deterrent to rather than an impetus to private investment?

Mr. HOLMAN. Well, as I pointed out in my statement, Congressman, I think a good general climate is a desirable thing. I think business should be willing to take ordinary business risks.

Certainly, I feel basically that as long as private capital is available, it is rather senseless to use Government money for making these investments.

As far as guaranties are concerned, maybe the situation is different in some companies. We have never felt very strongly about guaranties on these things, assuming the right climate prevailed; if we had the right climate, we would be willing to take the normal business risks.

Some businesses may be different, and I think that the idea of guaranties should be studied carefully by you gentlemen, and it may be helpful for you to hear different people's expressions on that, but I would say, as a general thing, what we prefer most is a favorable climate. We are willing to take the ordinary business risk.

At the present time, the thing that worries us most is the inconvertibility of currencies, and the likelihood of discrimination against foreign companies in a particular area, American as well as other companies.

But I would not want to say that we would never take advantage of guaranties. I think we would have to examine every situation that came up. I do not think that such guaranties are the whole solution. I think that I would consider that as a kind of palliative, rather than a basic solution.

Mr. HERTER. Well, insofar as the inconvertibility of currencies is concerned, that is something that cannot be done by a purely paper transaction.

Mr. HOLMAN. No.

Mr. HERTER. Nations have got to be able to earn enough to make convertibility possible, and where there is a shortage, I would say they have got to set up priorities.

Mr. HOLMAN. Yes; and I think in that case, Congressman, that people doing business abroad should do everything they can to help.

There are quite a few things we can do. Of course, this inconvertibility of currencies is no new problem with us. It was with us before the war; and we realize, of course, that you have to have an exact balance of trade before it can be converted freely, but certainly through triangular trading, and so on, I think you can get a good deal of help on that.

In our own case, for example, we have always followed the general policy in a foreign country of utilizing as much material as we could buy locally there, and we have always followed the general policy of utilizing the personnel available in that country, to the fullest extent possible; and, of course, materials and labor costs are two of the biggest costs.

To the extent that you do that, then, you are helping your conversion problem. So we think that the companies themselves, doing business abroad, can be of assistance on a good many of these things.

In the immediate period following the war, we have not been able to do that as much as we would like to, because, of course. foreign manufacturing facilities were pretty well shot and reassembling an organization at different places was very difficult. It was much easier to get capable Americans than to get capable Europeans or capable other people. I think that to the extent possible the company should do everything it can along the lines I have been discussing, and I think that with a reasonable amount of convertibility, American business can get along pretty well abroad.

Mr. HERTER. You have spoken in your testimony here of the impossibility of converting sterling that you would be willing to accept for a part of your sales.

Does that mean that the British Treasury has refused to allow any sterling that might be offered to you by foreign nations in France or Italy or elsewhere to be used elsewhere in the sterling area?

Mr. HOLMAN. That is correct, sir.

Mr. HERTER. You cannot use it, for instance, in connection with the plant that you speak of, the refining plant in England?

Mr. HOLMAN. Let me divide this currency thing into about three different situations, Congressman: You have the normal sterling bloc countries. Those are countries such as the United Kingdom, Australia, New Zealand, South Africa, India, which are pure sterling bloc countries, as we look on them, and they are generally so regarded.

Then, of course, we have the pure dollar areas in which there is no problem of convertibility—the United States, Canada, Venezuela, and Cuba would be examples in that case.

In the dollar area, naturally, there is no problem for us in convertibility.

In the sterling bloc area that I defined, we have been able to work out with the British Treasury, the British Exchange Control Board, and so on, satisfactory arrangements. In a place like the United Kingdom, for example, we are going ahead on plans for the Fawley refinery that are quite satisfactory to us. There are similar situations in other British "sterling bloc" areas.

The CHAIRMAN. Mr. Holman, may I interrupt at that point, to ask you, in order to clarify the record, to define the dollar area, as you have found it, and the sterling bloc area as you have found it? You may do that at your convenience.

Mr. HOLMAN. All right. We will do that, for the record.[1]

The problem giving us difficulty now is in what we usually look on as the "twilight" countries, or "fringe zone" countries, let us say. I would define those as, in general, the western European countries, the Scandinavian countries, some of the South American countries, such as Argentina, which is a good example.

In such countries we would be quite willing to sell oil for sterling, assuming that we could take that sterling and use it for (or partly for) projects like the Fawley refinery or other investments in sterling areas, but under the situation that exists today we are not permitted to do that by the British Currency Control Board. You can use Argentina as an example: The Argentine Government made a trade with the British Government, trading oil for meat.

We have been in business in Argentina for many, many years; we have had a very substantial business there. We supply requirements there from Western Hemisphere sources, mainly from Venezuela.

We found overnight that we could not continue to do that; that even if we were willing to sell them oil for sterling, we were not permitted to take that sterling and convert it for uses in places where we could use sterling. Now, we think that is pretty tough.

The CHAIRMAN. What do you do with it?

Mr. HOLMAN. We do not take it.

The CHAIRMAN. Yes, but what do you do with the payment you do receive?

Mr. HOLMAN. Well, we just are not selling in Argentina. Right at the moment we are still selling 10 percent of the business that we did, maybe, because they have not been able to get a sufficient amount of sterling oil, but eventually it just means that we are completely out of business in Argentina.

[1] See attachment A, pp. 43, 44.

The CHAIRMAN. Where does Argentina get its oil?

Mr. HOLMAN. From this British source.

The CHAIRMAN. What is the British source?

Mr. HOLMAN. They have gone to British companies and told the British companies to furnish this oil to Argentina.

The CHAIRMAN. Is Anglo-American a British company?

Mr. HOLMAN. Anglo-American is; that is our company.

The CHAIRMAN. Yes.

Mr. HOLMAN. But it has no crude oil to sell. It is a marketing company in the United Kingdom.

The CHAIRMAN. Well, are you not affiliated with British companies in the Middle East?

Mr. HOLMAN. No. We have some interests in which they own an interest and we own an interest, but we have no available sterling oil there. The only available oil we have from the Near East is the Aramco oil that comes from Arabia, and that is all dollar oil.

The CHAIRMAN. What is the source of the oil of the British companies which is sold in Argentina?

Mr. HOLMAN. Well, it comes from the Near East, I think, largely; some from the Near East and some from Venezuela. It comes from Shell in Venezuela, and the Anglo-Iranian from Persia or Iran.

The CHAIRMAN. Is the Anglo-Iranian Co. affiliated in any way with Anglo-American?

Mr. HOLMAN. No; none whatever.

The CHAIRMAN. I am sorry, Congressman, for interrupting.

Mr. HERTER. In effect, in the Argentine, they are paying for oil in meat?

Mr. HOLMAN. That is right.

Mr. HERTER. And you are not in a position to accept meat and market that meat around the world?

Mr. HOLMAN. That is right.

Mr. HERTER. Presumably, the British Government is acting as intermediary between the Shell Oil, or whatever it may be, the Anglo-Iranian, or some other company, and they in turn pay sterling to that company, and take the meat and market it in Great Britain?

Mr. HOLMAN. That is right.

Mr. HERTER. Does that not come down again to the question as to what can be taken in exchange? Currency, merely representing goods, you have got to move, and then that has got to be converted into exchange that you can use.

Mr. HOLMAN. We would be quite willing to take sterling, as I said before, for some of this oil, if we were permitted to use it, invest it where we had need for sterling, which we do. We have substantial need for sterling and a good many investments in sterling countries. For pay rolls and materials, and so on, we could use quite a bit of that.

Mr. HERTER. I take it from what you say that that matter is being negotiated at the present time?

Mr. HOLMAN. Yes. Our State Department is very familiar with it, and we have had very good cooperation from the State Department in understanding our problem, and some of those talks are going on now. I do not know what the outcome of them will be.

The CHAIRMAN. Then you have made representations to the State Department?

Mr. HOLMAN. Oh, yes.

The CHAIRMAN. In harmony with what you have testified to here?

Mr. HOLMAN. That is right.

The CHAIRMAN. What has been the attitude of the British Government to date?

Mr. HOLMAN. Well, the British Government has said, "We will talk to you next month." We have not had very much success in really having a serious talk about this particular thing.

Of course, it is true they have been going through some pretty troublesome times. We hope to work out something with the British Government, but we have to sit down and talk to them, and explain our situation very fully, in order to do that.

Mr. HERTER. When you made arrangements for your refinery, for instance, which you are putting $150,000,000 into in England, did you make arrangements at that time for a certain amount of convertibility from the earnings in the refinery?

Mr. HOLMAN. Yes.

Mr. HERTER. So there is a commitment of a certain amount of dollars coming back to you as a result of that investment?

Mr. HOLMAN. We have no particular kick about that. It was negotiated out, and we think the British Government was quite considerate of our problem and their problem and we have no complaint to make.

As a matter of fact, I would say that in general at the present time, in all the so-called sterling-bloc countries, we have no complaint; for example, in such places as South Africa, Australia, or New Zealand. Of course, we do not know what will happen in the future, but certainly the situation for the present, and for the past several years, is and has been quite satisfactory.

I do not know the situation of other American companies in oil, but I suppose they have been able to make similar arrangements.

But the point is, Congressman, if this nonconvertibility of funds acts to run an American company out of business, we do not like that. I think our Government feels very sympathetic—certainly, the administrative branches of our Government are very sympathetic—with our viewpoint, and they are presenting the case quite strongly to the British.

Mr. HERTER. I do not know whether you would care to comment on a phase of foreign investment that I notice there has been a good deal of newspaper discussion about, and that is whether or not our Government through the Export-Import Bank should finance or help to finance the development of oil in Mexico.

Mr. HOLMAN. As a basic thing, I feel the same about Mexico as I would about any other country. I feel that as long as capital is available from private sources to do that, there would be no occasion for our Government to do it, and I think that would be the case in Mexico.

The CHAIRMAN. You think, then, that private capital is available?

Mr. HOLMAN. I am sure it is.

The CHAIRMAN. In Mexico and in Europe, too?

Mr. HOLMAN. Well, yes. I am limiting my discussion to oil now, because that is the only thing I am supposed to know anything about. I would think that American industry has shown that pretty well over the years. I suppose the oil industry has been very venturesome in going abroad to develop oil and sell oil and refine oil and transport oil, and we notice that we have plenty of competitors in the business. So I would say that private capital has been available in the past, and I do not have any reason to believe it would not be available today. Certainly, as far as our own company is concerned, within our means, we are always willing to go abroad wherever we can work out satisfactory arrangements with the Government or people in the country to do business.

Mr. HERTER. Up to now, the Export-Import Bank has taken that same position with respect to this particular situation, the same way with making loans to Brazil for the development of pipe lines and refineries, and so on.

Mr. HOLMAN. I think that is right, sir. Yes. Secretary Acheson made a very strong declaration a few weeks ago in a speech he gave in New York. The position he stated was something that we would support very strongly.

Mr. HERTER. Mr. Chairman, I assume that the domestic phases of the investment situation are something that you will be questioning on. I have been limiting my questions to the foreign phase of it.

The CHAIRMAN. You do not need to limit yourself, Congressman Herter.

Mr. HERTER. Perhaps if I could ask one very general question: I take it that the studies of this Subcommittee on Investment are not going to be limited to the foreign field but are going to be fairly exhaustive from the point of view of the domestic field, sources of investment, and so on, and I am wondering if you could tell us a little, where you have your board considerations of large investments, how you make your determination as to how much you think should come out of current earnings that are withheld from stockholders; and capital investment, how much should be done by a borrowing operation, how much should be done through the sale of stock. What are the factors that enter into a determination of that kind?

Mr. HOLMAN. Well, as I point out, Congressman, in my statement we have no fixed ideas—certainly, no set ideas, let me say—as to how capital should be raised when you need it. We take advantage of the money market as it exists at that time.

Now, as a basic principle, our company has leaned very much toward the equity market rather than through loans. We have never been big borrowers of money. We have traditionally financed ourselves largely from our earnings, and I think over a period of time we have paid out, oh, roughly 50 percent in dividends and retained 50 percent for our business.

In the recent past, when we had very abnormal expenditures because of the postwar situation, we retained a larger percentage of our earnings, and also in order to finance that tremendous program we also borrowed money, and we also sold some assets.

As you recall, I pointed that out in my testimony on profits last year, or the early part of this year. So, we have no set idea about that.

I think that fortunately our company has been in a reasonably strong financial position, and we have been able to get the money that we needed without a great deal of difficulty.

I think that, as a matter of principle, we lean very strongly toward the equity market. We think that business should finance—certainly, in our company that is the way we feel—through the equity market to the fullest extent possible. But the equity market has not been too good in the past few years.

Mr. HERTER. I was just wondering whether you would develop that point a little bit, the difficulties that you have had in the equity market.

The CHAIRMAN. Before he does that, may I ask him this question, Congressman Herter?

You speak of three sources of capital, as I recall it: The sale of assets, equity financing, and borrowing.

Would you care to say what the relationship of those three has been in your operations; in other words, how much, relatively, have you borrowed; how much, relatively, have you taken from equity financing, and to what extent have you had to sell assets in order to obtain the amounts needed for investment?

Mr. HOLMAN. Well, in the sale of assets, that would be in the overall picture relatively small, although it was rather substantial for the past couple of years.

Percentagewise, I do not know, but I would be glad to get exact figures on that.

(The following information was supplied by Mr. Holman:)

The increase from December 31, 1911, to December 31, 1948, in the invested capital in Jersey and its consolidated affiliates came from the following sources in the proportions indicated:

	Percent
(a) Equity capital additions	12.35
(b) Reinvested earnings	76.92
(c) Loans	10.73

Sale of assets sold at book value (as many of them were) does not affect the invested capital. Therefore, the cash provided by the sale of assets is not indicated in the above tabulation. The proceeds from sales and retirements of assets over the calendar years 1944 through 1948 amounted to a total of about $146,000,000.

Mr. HOLMAN. But at any rate, the sale of assets would be the smallest of the sources. Retained earnings is where most of it has come from; and then borrowings would be in between, I would say. Perhaps I can develop those.

The CHAIRMAN. An equity where? How much was that?

Mr. HOLMAN. Actually, we have not done any equity financing recently, unless you would call retaining a larger percentage of earnings, by paying out stock dividends, equity. We paid out a stock dividend—we paid three stock dividends within the last 3 years, I think it was, and you might call that equity financing—in a way I suppose it is.

The CHAIRMAN. Well, it is not obtaining new money; it is just distributing retained earnings or distributing your earnings.

Mr. HOLMAN. That is right.

The CHAIRMAN. So that would not be equity financing in the sense that we are talking about.

Mr. HOLMAN. No; in the general sense of the word, I do not think it would be equity financing. We have done no equity financing in the sense that you are defining it, Senator.

The CHAIRMAN. Well, then, the sale of assets is the smallest?

Mr. HOLMAN. That is right.

The CHAIRMAN. The retained earnings is the largest?

Mr. HOLMAN. That is right.

The CHAIRMAN. And the borrowing?

Mr. HOLMAN. Would be in between.

The CHAIRMAN. In between, and probably smaller rather than larger; that is to say, nearer the sale of assets?

Mr. HOLMAN. No.

The CHAIRMAN. No?

Mr. HOLMAN. I would not think so. But I think we can develop that, can we not?

Mr. SHEPARD. I am sorry. I do not have the figures with me, but we shall be glad to get them together and send them to the chairman. (See percentages supplied above by Mr. Holmån.)

Mr. HERTER. I have just one question in connection with your borrowing. What form are they likely to take, or do you vary those also? Are they in the form of bank loans or debentures or bonds?

Mr. HOLMAN. Generally, long-term borrowing——

Mr. HERTER. Long-term bonds?

Mr. HOLMAN. Yes. We may make some for a short term, but they are generally long-term borrowings. I think the last borrowings were 20 years—I think the last two were 20 years.

The CHAIRMAN. Were those bonds bond issues?

Mr. HOLMAN. Bond issues; yes, sir.

The CHAIRMAN. How were they disposed of?

Mr. HOLMAN. They were sold on the market.

The CHAIRMAN. In the open market?

Mr. HOLMAN. In the open market.

The CHAIRMAN. That would mean that the borrowing was in the United States?

Mr. HOLMAN. That is right.

Now, in addition to that, I might add, Senator, in some of our foreign operations there is local borrowing and perhaps bond issues, but they are relatively small compared to the parent company's.

As a general principle of the parent company, the Jersey company attempts to finance these operations through the affiliated companies themselves.

The CHAIRMAN. You made a very interesting statement at the outset to the effect, as I recall, that during the 5 years since the end of the war, the oil industry has expended $11 billion in the United States for plant expansion, and then later on in your testimony you stated that the oil industry has contributed four-fifths of the expenditures abroad.

Do you have any figure of the total expenditures abroad?

Mr. HOLMAN. A billion and a half, I think it is.

The CHAIRMAN. Of all industry or just the oil industry?

Mr. HOLMAN. The oil industry.

The CHAIRMAN. So that the billion and a half is four-fifths of the American investment abroad?

Mr. HOLMAN. No. The billion and a half, I believe, is the total.

Mr. SHEPARD. That is right.

Mr. HOLMAN. It is the total.

Mr. SHEPARD. That is right.

Mr. HOLMAN. Of which, four-fifths of it came from the oil industry.

The CHAIRMAN. That was all American capital expended abroad?

Mr. HOLMAN. Yes; that is right.

The CHAIRMAN. What type of restrictions has been imposed abroad upon the investment of capital by the Government?

Mr. HOLMAN. Well, the two main things as deterrents I would say now are the questions I was discussing with Congressman Herter, the inconvertibility of currency—the fear of inconvertibility—plus nationalism on the part of a good many of the countries. They appear not to want foreign capital to come in.

The CHAIRMAN. Well, those are the two principal things?

Mr. HOLMAN. Those are the two basic things.

The CHAIRMAN. Nothing else, no other restrictions that you can speak of?

Mr. HOLMAN. Well, of course, there are several subdivisions to these nationalistic trends.

As I pointed out in my statement, there are different acts of a government that will gradually shrivel you up: unfair price controls, maybe urging higher labor rates, or maybe export or import duties, things like that; but that is all part of the nationalistic trend, I would say.

The CHAIRMAN. Do you have any questions, Congressman Rich?

Mr. RICH. Yes. I would like to ask Mr. Holman a few questions if I may.

We are interested, Mr. Holman, in trying to determine how we can encourage private enterprise to invest in local business enterprises.

Would you invest in any enterprise in our own country or any other country, if you thought you were going to lose?

Mr. HOLMAN. No; I do not think we would.

Mr. RICH. In other words, you want to be sure, pretty sure, that you are going to make a profit in the conduct of your business if you are going to establish a business in any location.

Mr. HOLMAN. I am sure that would be the case or we would not be on the job very long. The stockholders would look after that, I imagine.

Mr. RICH. That is right. In other words, private enterprise has to make a profit in order to exist?

Mr. HOLMAN. Right.

Mr. RICH. In this country, you have stated that we have increased since 1938 our production in oil, or consumption of oil, 86 percent.

Mr. HOLMAN. Yes.

Mr. RICH. And, in foreign countries where you are interested, the oil industry has increased about 61 percent.

Mr. HOLMAN. The consumption.

Mr. RICH. Do you find that the oil industry has any difficulty now in keeping up with the consumption, either here or abroad?

Mr. HOLMAN. No. I think that the oil industry has done a magnificent job in meeting consumer demands. As a matter of fact, the chairman of our board made a very appropriate remark at a board meeting one day. He said it seemed to him that the industry knocked a two-bagger and over-ran second base.

Mr. RICH. What profit, on the average, should a business make on its invested capital in order to be successful?

Mr. HOLMAN. Well, of course, that is a very difficult question to answer. I think about the only index you could use on that is probably the past history of business. I do not know just what that is, but I am sure that some of your staff here know.

Mr. RICH. Well, you have to make enough profit to pay a dividend?

Mr. HOLMAN. Surely.

Mr. RICH. You have to make enough profit to continue on in the wear and tear and obsolescence of your machinery?

Mr. HOLMAN. Surely.

Mr. RIGH. You have to make a profit in order to carry a surplus to take care of any contingencies?

Mr. HOLMAN. That is right, sir.

Mr. RICH. Is it proper for the Federal Government, we will say, in our country, under section 102 (a) I think it is, requiring you, as a corporation, to pay out, I think it is 75 percent of your earnings, or else be taxed 25 percent additional for not doing that? Do you think that is a good law for us to have on our statute books?

Mr. HOLMAN. Well, I would say that in the operation of our own company, to the best of my knowledge, it has never interfered with our operations particularly, but I think that every situation is a little bit different. Maybe it has been a hindrance in other cases. I would not know.

All I can say is that in our own business I have not, I do not think——

Mr. RICH. You made the statement a while ago that you pay out about 50 percent of your earnings in dividends, and you retain the other 50 percent for future development, as I understood it. Now, according to the law, the Government can come in and take the difference between 25 percent of that, and compel you to pay 25 percent of it back to the Government because you do not distribute it to your stockholders; can they not?

Mr. HOLMAN. Well, I am not familiar enough with the operation of the law to answer that question. Certainly, that problem has not come up, and I do not think that we would be doing it.

Mr. RICH. It hangs over the business enterprises of this country like a club in case they want to use it.

Mr. HOLMAN. I think that is right.

Mr. RICH. I think it is a very unjust and unfair club.

Mr. HOLMAN. That is right.

Mr. RICH. To hang over a business that wants to be successful, and I was anxious to know just what you thought about that.

Mr. HOLMAN. Well, I think I would agree with you, Mr. Rich, on the general thing. All I can say is that, in the actual administration of our company, I do not think that particular problem has come up.

Mr. RICH. In your investments abroad and with the difficulties that you have, knowing what is happening, are you at all anxious about the Anglo-American Oil Co.'s investing $150,000,000 in Britain at the present time? Are you fearful that they might come in and take our company over?

Mr. HOLMAN. We certainly worried about that a lot before we decided to do it.

Mr. RICH. Were you ever worried about that happening in this country?

Mr. HOLMAN. We have not certainly had that.

Mr. RICH. You have not got to that point yet?

Mr. HOLMAN. No. [Laughter.]

The CHAIRMAN. You let Congressman Rich do your worrying on that point. [Laughter.]

Mr. RICH. I am; I am worrying a lot about it, because we do not know now how soon the Government will step in and take over the coal mines. You do not know how soon they will come in and take over the railroads, and I am very fearful about it.

Mr. HOLMAN. We certainly do not want that.

Mr. RICH. We cannot continue on the way we are going now, in my judgment, without the same thing happening to us that has happened over in England.

If you are fearful of it in England, we want to protect ourselves in this country so that it does not happen here.

Mr. HOLMAN. That is certainly true.

Mr. RICH. If you ship your oil to this country from a foreign country, you are permitted to ship all the oil in here that you choose? Are you restricted in any way?

Mr. HOLMAN. No.

Mr. RICH. Are you allowed to take the money from this country back to the countries whence the oil came?

Mr. HOLMAN. Yes.

Mr. RICH. You can take it back?

Mr. HOLMAN. With the exception, of course, as I pointed out before, if we want to make certain investments in certain places, it would have to depend on a given country.

In some countries, I do not think we could take it back and invest it in the thing we would like to invest it in, because of the nationalistic trend I mentioned.

Mr. RICH. If you made a profit in Great Britain on the Anglo-American Oil Co., can you bring your profits back to this country?

Mr. HOLMAN. Yes; we have been able to work out arrangements with the British Government so that we have been getting reasonable returns on our business in the United Kingdom up to the present time. We cannot do it freely. We have to go through exchange control boards, and so on, to do that.

Mr. RICH. Is that permitted in all lines of business; do you know?

Mr. HOLMAN. I think it depends—you have to make application and work it out with the British Government on the particular subject. We have been able to work it out. What success other companies have had, I do not know.

Mr. RICH. Do you feel that the change in currency now, with the reduction in value of the pound, would influence in any way our doing business between Great Britain and this country?

Mr. HOLMAN. Oh, I think it is bound to have some influence. In a general way, I think it is bound to have some influence on both the imports and exports.

Mr. RICH. Will you be able to sell oil that originates in the Far East here cheaper than we could sell American oil?

Mr. HOLMAN. No; our experience is—and we think, incidentally, the experience of foreign companies also—that there is not much difference in their total cost of producing oil if you look at it either from the dollar or sterling areas. So, in our case, we have followed the policy, with the devaluation of the pound, of recommending to our affiliated companies doing business in those particular areas that they would have to raise their prices to cover the dollar costs involved in the cost of producing and transporting and selling and marketing oil.

Mr. RICH. That does not interfere in your business relations with any foreign country and our own concerns?

Mr. HOLMAN. No. In most of these foreign countries they have price controls; so, whether or not our affiliates will be able to get their permission to raise the prices will depend on negotiations with the foreign authorities.

Mr. RICH. Do you have any price controls in those countries at the present time?

Mr. HOLMAN. Yes. I do not think there are any of them but what have price controls in them.

Mr. RICH. Do you have any price controls in this country?

Mr. HOLMAN. No.

Mr. RICH. Is that the reason why about 10, 15, 20 years ago I could buy gasoline for 10 cents and now I have to pay 28?

Mr. HOLMAN. Now, if you go back 20 years, I think you were paying more than 10 cents.

Mr. RICH. Well, it might have been 30, 40 years ago.

Mr. HOLMAN. No. The price of gasoline, and all petroleum products, has fluctuated up and down; but, as far as petroleum products are concerned, I think that the prices of petroleum products, as basic commodities, compare very favorably with any other commodity. The price is probably cheaper than any other commodity, compared with any other basic commodity.

Mr. RICH. The increase in cost of your commodity is because of the great increase in cost of your production.

Mr. HOLMAN. That is right.

Mr. HERTER. Plus taxes.

Mr. HOLMAN. Taxes are a big factor, too.

Mr. RICH. Well, are your profits today proportionately larger than they were, we will say, back 20 years ago, in percentage?

Mr. HOLMAN. No.

Mr. RICH. About the same?

Mr. HOLMAN. Last year was a particularly good year. This year it will be down quite a bit, but we have swings of ups and downs.

While last year was one of our best years, I suppose we could go back to periods where we had higher returns than that.

Mr. RICH. You have in your average annual earnings some years greater earnings and some years less, but you try, as nearly as you can, to keep an average annual earning over 10, 15, 20 years?

Mr. HOLMAN. Of course, that depends a good deal on the competitive forces. What we would like to do is to have steady earnings, but a great many business factors enter into that.

Mr. RICH. Well, it is necessary, is it not, for you to have earnings in order that you can be safe in your business?

Mr. HOLMAN. No question about that, sir.

Mr. RICH. And to take care of contingencies, so that when you get big earnings in one particular year there is no reason why you should not retain that for the benefit of the company because you may get a year, as you say is this year, which is a great deal less.

Mr. HOLMAN. That is right.

Mr. RICH. So, in order for private enterprise to invest its capital, it has to be conservative in seeing to it that it is going to take care of its business. That is the reason why I object to this section 101. I think it is an unjust tax and ought to be repealed.

Mr. HOLMAN. Well, certainly, basically, you will make investments when you have the money to do it. If you do not have the money to do it, you will not; or if you do not have the credit.

Mr. RICH. One other question I would like to ask you, and that is: Is the oil that the Federal Government is now developing in a number of its experimental stations, such as taking oil from shale—do you do any developing in that line?

Mr. HOLMAN. Yes, sir. We have done a lot of experimental work on that going over a period of many years.

We look on it as purely a research project. Our general feeling is that what we want to do is to use the cheapest raw material for manufacturing liquid energy that we can; and certainly our views are that crude oil has been, is, and will be for a long time, the best source for that. So, while it is technically possible to make liquid fuel from oil shales, or coal, or various other sources, we think it is a long time in the future. We think it is very well for the industry to do research, which we are currently doing. I suppose we are spending quite a bit of money, several million dollars over the past several years, on research along that line, but we look on that as a research job that we might need sometime in the future but not in the foreseeable future.

Mr. RICH. In other words, you are looking now for the production of oil to keep your business in operation for years in advance?

Mr. HOLMAN. That is right, sir.

Mr. RICH. Do you feel that we have enough oil or the prospects of oil to continue in our business enterprises and our automobile uses for gas for years to come?

Mr. HOLMAN. Yes. I feel that way very strongly, and our company does.

Mr. RICH. Would you care to state any number of years?

Mr. HOLMAN. No; I do not think I would want to be that exact about it.

Mr. RICH. What I mean is this: For 50 years?

Mr. HOLMAN. I like to use "the foreseeable future," whatever that means. [Laughter.]

I would go even further than that.

Mr. RICH. What I am trying to get at: I have heard people say, the way we are using up our oil that eventually we will not have any; we will have to find some other means of propelling our automobiles.

You are one of the largest men in the oil industry, and I just would like to get an idea as to what you think for the next 50 years, whether America should worry or should not worry about what is going to happen in our oil development.

Mr. HOLMAN. I would say this: America never has to worry, in my opinion, about having liquid fuel for running its automobiles or anything else.

Mr. RICH. That is the answer.

Mr. HOLMAN. Period.

The CHAIRMAN. When you say "liquid fuel," you mean——

Mr. HOLMAN. I mean by that, that if by any chance we optimists sound maybe too optimistic, we certainly have other sources. We can go to coal; we can go to shale; we can go to tar sands; the techniques have all been worked out. We know how to make gasoline from coal, make it from wood, and it is purely a question of economics. Technically, the problem has already been solved.

Mr. RICH. In other words, if our Government let private enterprise go ahead and operate its business in a good sound business way, we do not have to worry about how we are going to get things to propel our vehicles. But if the Government gets into it itself, we do not know where we are going, do we?

Mr. HOLMAN. Well, I am sure business can do it.

Mr. RICH. That is right; that is the answer. I am through. That satisfies me.

The CHAIRMAN. Mr. Holman, may I read this statement from your testimony?

Mr. HOLMAN. Yes, sir.

The CHAIRMAN (reading):

> The oil industry in the postwar period has been engaged in the greatest capital expenditures program in its history. The magnitude of its undertakings is measured by the fact that from 1945 through 1949 the industry will have spent for additions to property, plant, and equipment in the United States a total of over $11,000,000,000, equal to about two-thirds of the industry's entire gross investment in this country at the end of 1944.

That statement of yours, I take it, means that in 5 years, from 1945 through 1949, the oil industry has expended in capital equipment two-thirds of as much as it expended in its entire history up to and including 1944?

Mr. HOLMAN. That is right, sir.

The CHAIRMAN. Then, would you say whether or not in your opinion the Government policies have been an impediment to the investment of capital by the oil industry?

Mr. HOLMAN. I think those figures speak pretty well for themselves, as far as the domestic oil industry is concerned.

The CHAIRMAN. Yes; I am talking only about the domestic, because that is what you were dealing with.

Mr. HOLMAN. That is right, sir.

The CHAIRMAN. In other words, the oil industry has done pretty well under the system and the laws that are now existing; is that right?

Mr. HOLMAN. Yes; I would think, though, that there would be this qualification: This tremendous expenditure was not a normal expenditure, Senator. I am sure that everyone in the oil business—I am sure that our company—spent a lot of money of that $11,000,000,000—a pretty good slug of it is ours. Our company did that not because we wanted to do it. We would have preferred easing this thing out over a long period of time. But the consumer demand during that period, the rapid mechanization of the United States, was such that we felt, to retain our customer acceptance, we just had to go in and spend money, so that——

The CHAIRMAN. Well, you do not think that expenditure was unsound, do you?

Mr. HOLMAN. No; because we built up a customer acceptance. If we do not satisfy these customers they are going to quit buying our products.

The CHAIRMAN. In other words, it follows that this greatest expenditure in history was the result of the fact that you had a consumer demand which you had to satisfy.

Mr. HOLMAN. That is right.

The CHAIRMAN. Or else you would have fallen back in the competitive struggle.

Mr. HOLMAN. That is right.

Mr. HERTER. Mr. Chairman, might I interrupt there?

Is it entirely in the competitive struggle? Two and a half years ago or 3 years ago, as I recall it, there were real spotty shortages throughout the country in gas and fuel oil, and was not there a great deal of talk at that time that unless private industry made these very large investments and increased their capacity that the Government might step into the picture and become a competitor itself? Is there not always that threat hanging over behind the scenes?

There similarly has been a great deal of talk in connection with steel as late as a year ago.

Mr. HOLMAN. That is right. It had some influence, no doubt, Congressman. I think the basic thing though was that we had to convince the American people that private enterprise could do the job.

Mr. HERTER. Yes.

Mr. HOLMAN. And some of us were down here frequently before various congressional committees convincing them that that was the thing to do; that was the way to do it.

The CHAIRMAN. You said you had to convince the American people that it had to be done or that could be done?

Mr. HOLMAN. I think the performance is the best way to sell a product such as this, don't you?

The CHAIRMAN. I am trying to develop what obstacles there were to your doing this.

Mr. HOLMAN. I think there was a fear on the part of some people in the industry that we would have Government interference if we did not do it.

The CHAIRMAN. But the record that you have laid before us clearly indicates that those fears had no effect at all; that, as you said in your own words, in 5 years, from 1945 through 1949, the oil industry invested the greatest amount in history.

Mr. HOLMAN. That is right.

The CHAIRMAN. Well, do you wish to imply that there were any Government impediments to that that had to be overcome?

Mr. HOLMAN. We wanted to convince everybody that we had the courage to do it.

The CHAIRMAN. Well, that is another matter.

Mr. RICH. Mr. Chairman, was it not a fact that in January of this year the President said that we would build steel plants, and your committee so recommended, but it was not long before we found out that the steel industry began to run slack, and they are running slack today, and the Government is out of steel.

Now, if we had gone ahead with the statement made by the Government, we would have had another steel plant, and they were afraid when they suggested the building of steel plants, they would go ahead and take the oil industry.

The CHAIRMAN. You and I have debated this, and now we will try to get the benefit of Mr. Holman's testimony. [Laughter.]

Mr. RICH. A lot of the people are afraid because they are afraid the Government will step in and punish them in their business enterprise, and they are scared of the Government. I am not afraid of it.

The CHAIRMAN. How have the profits of the oil industry been running during the period that has scared the lights out of Congressman Rich?

Mr. RICH. And the lights are not out yet. [Laughter.]

Mr. HOLMAN. I do not think the oil industry's lights are out either.

The CHAIRMAN. I am glad to have the Congressman admit that he is not nearly as scared as he pretends to be. [Laughter.]

Well, were not your profits running pretty high?

Mr. HOLMAN. Last year was a very good year in the oil industry. This year, we are estimating in the case of our own company that our profits will be off around 25 percent.

The CHAIRMAN. But during this period profits were running pretty well?

Mr. HOLMAN. Yes; we had a pretty good period.

The CHAIRMAN. In other words, most of this investment of which you speak, according to your testimony, has come from retained earnings?

Mr. HOLMAN. Yes; some of those were retained during the war period when we could not do that expansion, of course.

The CHAIRMAN. Oh, yes, certainly, but American industry was not doing so badly during this 5-year period, was it?

Mr. HOLMAN. No; that is right.

The CHAIRMAN. Now, then, with respect to this investment at a period of high prices, what was the inducement for that?

Mr. HOLMAN. To meet the consumer demand.

The CHAIRMAN. So that the existence of a lively consumer demand is a stimulus for investment, is it not?

Mr. HOLMAN. No question about that, in my opinion.

The CHAIRMAN. Does it follow from that that Government should adopt policies designed to maintain consumer demand?

Mr. HOLMAN. Well, we think our product is a pretty good product.

The CHAIRMAN. I know it is, surely. There is no question about that.

Mr. HOLMAN. But we think it is our job to sell those goods to our people.

The CHAIRMAN. Surely. There is no question about that. That is not my question.

We are trying to find out whether you have any recommendations with respect to Government policy. Therefore, I ask you, since you explain this tremendous expenditure during this 5-year period on the basis of the very large consumer demand, does it not follow from that, or does it, that there should be a Government policy designed to maintain consumer demand? Would that not be good for business?

Mr. HOLMAN. We want to see the consumer demand stay up, of course. We think it is largely our job to sell our goods, though.

The CHAIRMAN. Surely. I am not talking about having anybody else sell your goods, and nobody is making any such suggestion. I would much rather have you sell your goods than have anybody else sell them, and I do not know anybody who proposes anything different from that, do you?

Mr. HOLMAN. No, sir.

The CHAIRMAN. So that your testimony is clear that consumer demand has created the incentive for this investment by the oil industry. You agree with that statement, do you not?

Mr. HOLMAN. That is right, sir.

The CHAIRMAN. Now, then, I made a few notes on some of your statements as we went through here, and if you have no objection, Dr. Kreps and Mr. Scoll may participate in this questioning, because we are just trying to get the facts laid out on the table, as I think you know.

You said that the Jersey Standard and its affiliates have spent for capital purposes amounts equivalent to one and a half billion dollars here and in foreign countries.

Would you care to give us the ratio of what proportion in the United States and what abroad?

Mr. HOLMAN. Yes. Can we break that down, Mr. Shepard? If you can break it down, we can give that to you.

Mr. SHEPARD. Yes, sir. I can have it in just a moment.

The CHAIRMAN. Very good.

With respect to the meeting of the consumer demand in the United States and abroad, you said that consumers here want 86 percent more petroleum products now than they did in 1938; but abroad they want 61 percent more.

I wanted you to clarify that a little bit, because I am sure that these two percentages are not figured from the same base——

Mr. HOLMAN. That is probably right.

The CHAIRMAN (continuing). And the meaning would probably be misunderstood.

Mr. HOLMAN. I think you are probably right. Actually those statistics are based on the actual consumption in those countries.

The CHAIRMAN. Now, the per capita consumption in the United States is vastly greater than that abroad.

Mr. HOLMAN. Oh, yes; by far; and furthermore abroad a great many countries still have rationing, so actually the consumers abroad, I am sure, wanted more than 61 percent, but statistically they just got 61 percent, because of rationing and so on.

The CHAIRMAN. Have you any idea what the per capita consumption abroad is now?

Mr. HOLMAN. Yes, we have that. I think we can give you that by countries.[1]

The CHAIRMAN. I think it would be very helpful.

Mr. HOLMAN. We will be very glad to do that.

The CHAIRMAN. The reason I ask you that question is that the oil reserves abroad, particularly in the Near East, are so tremendous that there are many persons engaged in the oil industry here in the United States who are fearful that that oil will preempt the European market, the Eastern Hemisphere market, and then tend to cause Latin American oil to back up into the United States, to the detriment of the sales of domestic producers.

You have heard that statement, have you not?

Mr. HOLMAN. I heard that statement, Senator. [Laughter.]

The CHAIRMAN. Do you think there is any basis for that?

Mr. HOLMAN. Well, my general idea about the oil business is this: That if we can continue in the future, which I think we can, to stimulate sales throughout the world, we have a good enough product so that everybody will be pretty busy supplying that demand. I think,

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[1] See attachment B, p. 44.

in connection with some of these broader subjects we have been talking about if the restrictions can be removed to a point where oil can be made available to a lot of these places, you can stimulate demand so that you can find a home for all the oil. That is my theory of it.

The CHAIRMAN. In other words, anything that can be done to stimulate consumer demand abroad will tend to increase the consumption of foreign-produced oil in the foreign areas without any disadvantageous effect upon production in the United States?

Mr. HOLMAN. That is right. There is a very wide region to work on there, too. These figures that we will furnish to you will indicate that to you. As you point out, consumption per capita abroad is very low as compared to that in the United States.

The CHAIRMAN. So that I will ask you: Do you support the Government programs that are designed to raise the consuming capacity of Europe?

Mr. HOLMAN. Well, every place.

The CHAIRMAN. Every place.

Mr. HOLMAN. That is one of the primary jobs that the oil industry has done, I think, in practically every country they have gone into for the purpose of producing the raw materials. There are many examples, I think, that you would find where it contributes very greatly to the raising of standards of living in those particular countries.

The CHAIRMAN. You have indicated your support of point 4 of President Truman's program laid down in his inaugural address, have you not?

Mr. HOLMAN. That is right.

The CHAIRMAN. And that is on the theory that it would increase consumption abroad and would create a larger market for the products of private industry?

Mr. HOLMAN. That is right.

The CHAIRMAN. And an opportunity for the investment of private capital?

Mr. HOLMAN. Yes.

Mr. RICH. May I ask a question right there?

The CHAIRMAN. May I ask the witness to answer the question because his nod is not recognized on the record.

Mr. HOLMAN. Yes, sir.

Mr. RICH. May I ask a question, because I am going to leave in a minute?

Do you believe that the Federal Government should guarantee any corporation in this country against loss for the operation of its private business?

Mr. HOLMAN. Well, as a general principle, Congressman Rich, I think business should take its normal business risks.

As I mentioned, I think to Congressman Herter, even in the foreign business where you have unusual risks, I would much prefer seeing our Government trying to work out a favorable climate rather than to offer guaranties.

Now, I think that perhaps we are unusual in that respect, and I am certainly not against guaranties. If some company or some individual feels that he needs a guaranty to do something—to get started some place, well, I would not say that was not a good thing to do.

I would say that our experience is, however, that we would prefer seeing these broader problems settled, such as convertibility of funds, urging against nationalistic tendencies, and so on; and, if that good climate is created, then I think the average businessman would be quite willing to take the business risk in foreign countries.

Mr. RICH. The point I was trying to get at is: Why should we in this country subject our taxpayers to a guaranty that you or any of your companies going over abroad should be guaranteed against loss in operating a business in a foreign country?

Mr. HOLMAN. Certainly, in a normal business risk, I think that is right, sir.

Mr. RICH. You think it is right?

Mr. HOLMAN. I do.

Mr. RICH. That this Government should guarantee——

Mr. HOLMAN. No; I think what you say, that we should not guarantee.

Mr. RICH. That is right.

The CHAIRMAN. But you qualified by saying "the normal business risk."

Mr. HOLMAN. The normal business risk; that is right, sir.

Mr. RICH. Anyone who assumes the responsibility of going into some foreign country to build a plant and operate it ought to know what he is doing before he starts over there, and he would not go there if he did not take a normal business risk, would he?

Mr. HOLMAN. Well, with this exception: At the present time we have these impediments that I think are somewhat beyond normal business risks. I think if we were to exert our efforts in trying to remove those impediments normal business risks would remain.

Mr. RICH. In other words, our Government cannot even guarantee what some other government is going to do in the matter of confiscation of any business that they might decide to confiscate.

Mr. HOLMAN. That is perfectly true, but I would think that through treaty agreements, and so on, you could improve the atmosphere quite a bit, Congressman.

Mr. RICH. Would it not be a greater impetus to the foreign country if they want business enterprises in their country, to give proper incentives to business than it would be if our country guaranteed it?

Mr. HOLMAN. Absolutely, by far; and I think that every businessman would prefer that.

Mr. RICH. That is right.

Mr. HOLMAN. Certainly, we would.

Mr. RICH. Thank you very much.

The CHAIRMAN. You are very welcome.

We are glad to have you, Congressman Rich, and we are sorry you cannot stay with us.

Mr. RICH. It is always a pleasure to be with you.

The CHAIRMAN. I gather now, from your testimony, that you do believe that Government guaranties to support American investment abroad are not objectionable under present circumstances, but that you would prefer to see convertibility established throughout the world, and you would like to see nationalistic tendencies abroad curbed?

Mr. HOLMAN. Correct, sir.

The CHAIRMAN. Now, when you speak of nationalistic tendencies, do you mean the tendency of one nation to encourage the activity of its own people, or do you mean the nationalization of industry?

Mr. HOLMAN. I mean discrimination against foreign investors, whether they are American or others.

The CHAIRMAN. Then what is your concern about this other matter, the nationalization of industry by foreign governments?

Mr. HOLMAN. Well, naturally, if we were in business in X country, we would not want to see our business nationalized there, Senator.

The CHAIRMAN. But, in response to Congressman Rich, you stated that before you made the investment with Anglo-American in the building of an oil refinery in England, you gave great weight to the present policies of the British Government, and in spite of those policies, you proceeded with that investment.

Mr. HOLMAN. Yes, after working out an agreement with the present government that they would not nationalize the oil business, among other things.

The CHAIRMAN. Then, the British Government agreed with Anglo-American that the oil industry would not be nationalized?

Mr. HOLMAN. Well, our plant, our business, would not be nationalized.

The CHAIRMAN. I see. What is the structure of the Anglo-American Oil Co.?

Mr. HOLMAN. It is a British company, 100 percent owned by the Jersey Co.

The CHAIRMAN. It is 100 percent owned by the Jersey Co.?

Mr. HOLMAN. Yes, sir.

The CHAIRMAN. The British Government, itself, has no interest it?

Mr. HOLMAN. That is right, sir.

The CHAIRMAN. It is not an affiliate of the Anglo-Iranian Oil Co. at all?

Mr. HOLMAN. No, sir.

The CHAIRMAN. Was there any period of guaranty by the British Government with respect to that refinery?

Mr. HOLMAN. Mr. Shepard, my assistant, happened to be the one who worked out that agreement. Could I ask him to testify on that, sir?

The CHAIRMAN. We would be very glad to have him testify on that.

Mr. SHEPARD. Sir, the statement was made on behalf of the present government that they had no intention of nationalizing the refinery or other oil industry facilities.

I suppose like many other governments, they said, obviously, they could not commit future governments.

The CHAIRMAN. Yes.

Mr. SHEPARD. So that the statement covered only the actions of the present government.

The CHAIRMAN. But the statement was sufficient to make your company feel that this investment could safely be made?

Mr. SHEPARD. As one of the many factors, Senator, affecting the decision, that statement was sufficiently encouraging to us when put with all the other factors, so that the decision was made to proceed with the investment.

The CHAIRMAN. Was the possibility of profit from investment one of the factors that induced you to make the investment?

Mr. SHEPARD. It was one of the factors. I think the necessity, as we saw it, to make the investment and to remain in business there over a long period, under the difficult currency circumstances which are prevailing and which we are afraid will prevail for some time longer, was a more important factor in the decision than the expectation of profits from this particular investment in a refining facility.

The CHAIRMAN. What will be the market for the product of this refinery?

Mr. HOLMAN. It will be in the United Kingdom.

The CHAIRMAN. What is that?

Mr. HOLMAN. It will be largely limited to the United Kingdom.

The CHAIRMAN. What will be the output?

Mr. HOLMAN. 110,000 barrels a day.

The CHAIRMAN. Do you expect to sell all of that regularly in England?

Mr. HOLMAN. Yes. That was our hope and expectation, Senator.

The CHAIRMAN. What competition do you have?

Mr. HOLMAN. Well; there is pretty substantial competition there. There are three or four British companies selling there, and three or four American companies.

The CHAIRMAN. What is the total of consumption in that market?

Mr. HOLMAN. I would say around four or five hundred thousand barrels a day in the total United Kingdom.

The CHAIRMAN. Now, then, after discussing consumer demand, you discussed the replacement of worn-out and obsolete equipment as one of the objectives for which expenditures are made, and the assurance of adequate raw material supplies, namely, the purchase of oil reserves, I suppose the acquisition of them, and the necessity to meet competition.

Here you say: "When one of our competitors puts a new idea into practice, we often must make heavy investments to meet the new competition."

Can you give us some examples of that type of investment to meet new competition?

Mr. HOLMAN. Oh, it happens practically every day, Senator.

Everyone marketing petroleum products is trying to sell more products and get more consumer acceptance, and obviously quality is one of the determining factors of a consumer making up his mind to buy a product.

The CHAIRMAN. Then, there is a difference in the quality of the output of the various refineries?

Mr. HOLMAN. Yes, sir. Always buy Esso, Senator.

The CHAIRMAN. I wondered if I could not get you to lead up to that. [Laughter.]

Mr. HOLMAN. For lubricants, gasolines, Diesel oils, various other things, waxes, numerous things, our engineers are continually trying to design better equipment, make costs cheaper, make goods cheaper and also better.

The CHAIRMAN. Are there any suggestions that you desire to make to this committee with respect to Government policy having effect upon investment of private capital in the United States, beside this agreement that I think you have expressed that consumer demand ought to be maintained?

Mr. HOLMAN. I think that certainly Government policy should be directed toward encouraging business in continuing to put more and better products on the market.

The CHAIRMAN. Do you agree that Government should take such action as ought to be calculated to prevent the great variability in private investment, which in the past has produced depressions?

Mr. HOLMAN. I think it should be the objective of every businessman and of Government and everyone else to level off the peaks and valleys to the fullest extent possible. I do not think that you can guess the future with sufficient exactitude to hope to eliminate all of them, Senator.

The CHAIRMAN. Well, we are not prophets, of course, but is it desirable to have governmental policy that would prevent depressions, if possible? I say that merely because, of course, we are sitting here under the full-employment law, the objective of which was to develop Government policy to prevent the great booms and great depressions.

Mr. HOLMAN. Surely, I think that is desirable. I think that anything that either business or Government can do to remove the large peaks and valleys is desirable.

The CHAIRMAN. Are there any other restrictions in foreign nations or are there any restrictions in the United States which inhibit the sale of goods freely and the payment for them freely? Do foreign governments have any other restrictions, in addition to the problems of inconvertibility and nationalization which you have mentioned?

Mr. HOLMAN. I think we have mentioned all that we could think of at the time I prepared that statement, Senator.

The CHAIRMAN. Is there any prospect of an understanding with the British Government now with respect to this sterling area? You are asking for the opportunity to sell for sterling. Are you making any progress?

Mr. HOLMAN. Yes. As I say, as far as the British bloc of nations is concerned, we have been able to work out satisfactory relations there, which we think are all right.

It is more or less in the "twilight" or "fringe" areas that we are dealing with the British now. We do not know what the outcome will be, but we hope to work out something. We hope favorable results will come from the talks that the British are having with Americans here now.

The CHAIRMAN. You have spoken about losses abroad, particularly the loss that was sustained in Hungary.

How serious have these losses been for the entire petroleum industry?

Mr. HOLMAN. Well, I do not think I could give you a figure. In our own company, we have a pretty substantial investment behind the iron curtain, and while we have not given up the hope of recovering something, I suppose that we would sell out at pretty much of a discount. We still have our claims in, of course, and only time will tell whether we will salvage anything out of that or not.

The CHAIRMAN. But your operations, on the whole, abroad have been successful?

Mr. HOLMAN. That is right.

The CHAIRMAN. You have been amply able to sustain whatever losses have been incurred?

Mr. HOLMAN. Well, we have sustained them. I will say that, Senator.

The CHAIRMAN. Of course, you do not like them. [Laughter.]

What would be the effect upon the investment of private capital here in the United States and the development of our own resources in the United States of a broad program of stimulating the investment of American capital in the backward areas of the world? You support that?

Mr. HOLMAN. Yes. All I can use is my own experience, the company's experience, in going into these areas; and I think it would be very substantial.

Naturally, I think that anyone who would go to western Canada today would get some idea of what it means. Actually every dollar spent will come back to the United States in some form or another, and I think it would mean a lot to those countries.

The CHAIRMAN. Then, you have no apprehensions, so far as the strictly domestic American economy is concerned, about the investment of American dollars in the development of Canadian resources, through the Imperial Oil Co., Ltd., or the development of resources elsewhere?

Mr. HOLMAN. Well, I used Canada as an example. Certainly in some places today we are holding back very seriously because of the reasons I mentioned.

The CHAIRMAN. You are holding back in Canada, too?

Mr. HOLMAN. No. I said in other countries. Argentina is an example. We would not want to spend money in Argentina.

The CHAIRMAN. But my point was that the investment of American capital in Canada and in other countries, in your opinion, would be injurious to the American domestic economy?

Mr. HOLMAN. No; on the contrary, I think it would be just the reverse.

The CHAIRMAN. Well, how? I would like to have you put that into the record.

Mr. HOLMAN. Well, every dollar exported from this country, whether it is by tourists or whether it is by a company or what not, eventually comes back to this country in some form or another; does it not?

The CHAIRMAN. So that your belief is that we should do everything we can to break down international trade barriers?

Mr. HOLMAN. That is right, sir, most emphatically.

The CHAIRMAN. With respect to the oil industry abroad, and the ownership of the foreign sources of petroleum, is there not a pretty well defined concentration of ownership of those resources? Let us take the Near East, for example.

Mr. HOLMAN. Well, there are several—let me see—in the Near East there are four or five American companies, and there are three or four European companies, and there are others negotiating, of course.

The CHAIRMAN. Well, Standard of New Jersey, Socony Vacuum, Standard of California, Texas, have pretty well united their reserve interests, have they not?

Mr. HOLMAN. Well, I do not know what you mean by "united."

The CHAIRMAN. I mean you have a common ownership or a common interest together with the foreign countries in the Near East oil.

Mr. HOLMAN. No. In Arabia that is true. We own a joint company there, which is owned 30 percent by the Jersey Co., 30 percent by the Texas Co., and 30 percent by the California Co., and 10 percent by the Socony Vacuum.

The CHAIRMAN. And the reserves in Arabia amount to how much?

Mr. HOLMAN. Well, they are very substantial.

The CHAIRMAN. What is the present estimate?

Mr. HOLMAN. The last figure, official figure, I saw was 6 or 7 billion barrels or something or other like that.

The CHAIRMAN. How much?

Mr. HOLMAN. Six or seven billion barrels of sufficiently proved reserves. But the potentialities are no doubt larger than that.

The CHAIRMAN. The potentialities are much greater than here in the domestic United States, are they not?

Mr. HOLMAN. When you start talking potentialities, Senator, you have been around oilmen enough——

The CHAIRMAN. I know, but I know we have drilled a great many more wells in the United States than have been drilled anywhere else and, particularly, a great many more than have been drilled in the Near East.

Mr. HOLMAN. Well, certainly as far as quantity of oil is concerned, it is very, very substantial, both actual and potentially; that is a good deal more, certainly.

The CHAIRMAN. Let me put the question bluntly: So far as the Near East is concerned, competition in the production of oil has been pretty well eliminated, has it not?

Mr. HOLMAN. I do not think so.

The CHAIRMAN. Well, where is the competition?

Mr. HOLMAN. There is a lot of land over there. People can——

The CHAIRMAN. Well, I mean, insofar as the 6 or 7 billion barrels of proven reserves are concerned?

Mr. HOLMAN. Well, we do not have—this particular company does not have all the land in Arabia.

The CHAIRMAN. Oh, no; I know, but there is a little on the edge, that is about all, is it not?

Mr. HOLMAN. Well, certainly there is enough so that if anybody wants to get some, to get their feet wet, there is a possibility to do it, all right, which they are doing.

Mr. HERTER. Is there not a group of seven American oil companies outside of those mentioned which have quite a large possession in Arabia?

Mr. HOLMAN. Yes. There is negotiation going on for more, so I do not think that your assumption is right. There is land available for people who want to explore if they want to take a shot at it.

The CHAIRMAN. Dr. Kreps, have you any questions? We are getting along.

Dr. KREPS. I got the impression, Mr. Holman, that most of your investments abroad are direct investments rather than lending money or buying minority interests, without managerial control; is that correct?

Mr. HOLMAN. Well, they are all direct investments in the sense that we put money directly into those companies. In some of these companies there are minority interests; some of them we own 100 percent.

Dr. KREPS. Do you find that opposition to direct investments in companies in which you control the management, in countries that do not oppose, say, the lending of capital via either governmental institutions or even private institutions?

Mr. HOLMAN. Well, most of these companies are very old companies. They were formed and started operation many, many years ago. The general policy we have followed on that has been that we have never felt we were justified in going to any foreign country unless we had managerial control of our operations.

We have always felt that we had our stockholders' money in trust, and that if we were going to put our capital and know-how into it that we had to have managerial control of those operations.

Dr. KREPS. It would be possible then, I judge, to go into some countries if you did not more or less have the policy of going in on a direct basis?

Mr. HOLMAN. Well, I think that these prohibitions that I speak of in my statement, and later on in some of the questioning, would hold true even if you wanted to do that.

Dr. KREPS. Yes.

You do not believe then that there is any real development or capital investment possible, or additional investment possible, if companies are not really interested in managerial control, and merely want to lend money and let the native producers——

Mr. HOLMAN. We are quite willing to take nationals into the business. As a matter of fact, we have done that in a great many places, so there is certainly, as a matter of policy, no objection. As a matter of fact, in some cases we prefer having local capital in our operations.

In the last year or so, we have formed companies in which nationals of particular countries are participating in a particular project.

Dr. KREPS. Now, in other areas, I noticed that you have invested about $400,000,000 a year, on the average, in the last 4 years. Do you anticipate—I understand that is the highest level you have ever attained—that that level is likely to be maintained, plus or minus 10 percent or so in the next period, or are you anticipating that this will be a high level for some time to come?

Mr. HOLMAN. Well, our level, peak level, was a good deal over the $400,000,000. I suppose you got that by dividing the total amount by the number of years.

Dr. KREPS. That is right.

Mr. HOLMAN. Our peak year, I suppose, was last year. This year we would anticipate maybe a 10-percent or 15-percent falling off, because we feel as if we have passed the crest of this rehabilitation program after the war, and also that we have caught up with the consumer demand pretty well, so that we would anticipate maybe a 10-percent falling off, a 10- or 15-percent falling off this year, and we would anticipate some further reduction next year.

We have not studied our budget for next year yet; so, we do not know what it will be, but there will probably be some falling off next year.

Dr. KREPS. Now, if industry, in general, anticipates that falling off, and general investment goes down, will that bring with it the reduction in the general level of employment and consumption?

Mr. HOLMAN. Well, certainly in our own company, we do not anticipate any serious reduction in employment, if any.

Dr. KREPS. You do not anticipate it would, so far as the economy as a whole is concerned, if business investment goes off, say, 20 percent or 25 percent next year, result in increased unemployment?

Mr. HOLMAN. Well, I have not really given much study and thought to that particular over-all question. I limited my testimony largely to what I really know something about.

I suppose, as a general thing, that if investment falls off there would be some falling off in employment.

Dr. KREPS. You see, the worry there would be what the Government ought to do if private investment does fall off, as it has in the past. What should the policy of the Government be in trying to keep up the level of private capital investment? And I wondered whether you had any general policy, general ideas, on what the Government should do in such a case.

Mr. HOLMAN. Well, I personally feel, Dr. Kreps, that we still have quite a backlog of consumer demand in this country.

I frankly think that it is good for us to have a little falling off of this. I know that in our own company, and I am sure this is true in the industry, that we were kind of falling all over ourselves in trying to get a job done, and I think we welcome some falling off.

I think our general feeling is—and again I am limiting my opinion largely to what we know in the oil business—we expect consumer demand to keep up pretty well, and we expect the oil industry will have a pretty good job laid out for it to keep that demand met; so we are not anticipating any big drop in any of the phases of the economy in the oil industry.

Dr. KREPS. Relative to a question we are discussing, I would like to ask you, sir, whether or not the pay-out period for your investments is the same. To get your money back in the same period of time, or at certain times, do you say, "Well, if we pay out in 5 years, we will put the money in"?—and other times you say, "These conditions are so bad, we must get our money back in 2 or 3 years."

The second question related to that is: Have you varied your idea about the safe kind of pay-out period, say, between 1946 and, let us say, 1949?

Mr. HOLMAN. No. Actually the way we lay out an investment program, which is done largely through a budget, is by our estimating the consumer demand for petroleum products. Fortunately, we have been in a business where we have been in a rising demand ever since I have been in it, anyhow, and we expect that to continue; so we will see how much capacity we have to meet that business in order to hold the business we have. Obviously none of the investments are made unless we think they are profitable investments, but I do not think, as a rule, on our general broad investments, that we try to figure out the exact return on investment.

Now, we will have a situation coming up, such as having a ship that is 15 or 20 years old, and maybe it is a pretty expensive ship to operate. Our engineers have plenty of designs, and we find our spenders always have plenty of ideas on how to spend; they will want to build a new ship. So, we will match the cost of this old vessel against a new one; and, if it shows a good, fair return, we will buy the new ones and junk the old one.

But that applies, that general principle of getting a return on investment, I think, more to specific pieces of equipment. It may be a drilling rig. It may be a ship; it may be a cracking coil in a refinery. It may be a bulk plant. Then, on that particular thing, we will try to figure out the return on the new investment versus the cost of operating the old one.

I would say on capital, such as where we have needed capital to meet normal expansion, that we have passed up some pretty good opportunities this year because we figure we could use our money better to supply our consumer demand, and to retain our customer acceptance.

Now, of course, we will do a good deal more in trying to reduce costs, getting more efficient operating machinery, and so on, and I suppose that the decision on those is usually a question of judgment. But I do not think that we have any set rule, whether it is 10 percent or 20 percent or 5 percent, or what not; it depends a good deal on the situation. We have to do a lot of investment, of course. Take some of our foreign operations. We might have to build a hospital. Well, of course, the return on that from a monetary standpoint is something you cannot figure very well, and we have a lot of that sort of investments that we have to make to go along with the rest of our investments.

Dr. KREPS. Thank you very much.

Those are all the questions I have, Mr. Chairman.

The CHAIRMAN. Thank you, Doctor.

Mr. Scoll, do you have any questions?

Mr. SCOLL. I have a couple of questions on this point of the replacement of obsolete equipment.

These investments that you make in plant and equipment constitute, in large part, purchases of machinery and various types of equipment of all kinds; do they not?

Mr. HOLMAN. Yes.

Mr. SCOLL. Now, how important from a profit standpoint is it for you to operate up-to-date plant equipment? Do you have to keep it up to date or can you let it operate for long periods of time?

Mr. HOLMAN. Well, the oil industry is not a static industry. It is a pretty dynamic industry, and people are finding out how to do the job better all the time, so that the question of obsolescence with us is a pretty large factor.

We discard a lot of stuff that, as far as the workability of it is concerned, will run all right, but we can do a much better job by installing more modern equipment. That holds true for every branch of our business, I would say.

Mr. SCOLL. Now, let us take the refineries, as an example. How many refineries does Jersey have in the United States, offhand?

Mr. HOLMAN. Oh 10 or 12 refineries, I suppose.

Mr. SCOLL. How many of those refineries are under 10 years old?

Mr. HOLMAN. Well, the refineries are a kind of peculiar piece of equipment. Some of it may be very old, some of the buildings, for example.

So far as the refinery equipment itself is concerned, it is changed very rapidly. I suppose the average life—I am just guessing—but I would suppose the average life of a piece of refinery equipment, if you consider the obsolescence factor, is pretty short.

I would be glad to give you a more exact figure for the record, but I hesitate to guess at just what it would be.

(The following information was supplied by Mr. Holman:)

It is difficult to generalize on this subject, because of the heterogeneous character of a whole refinery. We think the best figure we can give for the average life of refining equipment is provided by the fact that depreciation of a wide variety of such pieces of equipment varies from about 6 percent per year to about 7 percent per year. Thus, one may say with reasonable assurance of correctness that the average life of refining equipment is in the neighborhood of 14 to 17 years. Of course, there are a good many exceptions to this general rule.

Mr. SCOLL. But, generally speaking, obsolescence is pretty fast in refinery equipment.

Mr. HOLMAN. Yes; that is right.

Mr. SCOLL. Does that hold true of the other equipment that you use in the business?

Mr. HOLMAN. Yes. You go into the producing end of it, take drilling rigs: We used to use drilling rigs that would drill two or three thousand feet deep. Now, they go 12,000 or 15,000 feet deep. That is changing very rapidly.

I would say in practically all branches of our business that is the case. We find we can design more efficient filling stations or in the shipping end of our business, pipe lines, and so on.

Mr. SCOLL. Do you replace this equipment as far as your engineers determine that it is not as efficient as some other new piece of equipment to do the same job, or do you keep it on even though you know it is obsolete?

Mr. HOLMAN. Well, in general, we replace it.

As I just explained to Dr. Kreps, the conditions existing at the time have some influence on us. Over the last 4 or 5 years we have been so busy meeting our consumer demand, so far as volume is concerned, that we have not replaced as much obsolete equipment as we would like to and as I think we will attempt to do more and more during the next few years, since we have caught up on consumer demand.

But, in general, we try to figure out how much reduction in costs we can get by replacing this piece of equipment; and, if it looks favorable and if our bank account is such that we can go ahead and do it, why, we can do it.

Mr. SCOLL. If the Bureau of Internal Revenue were to permit you to accelerate depreciation for income-tax purposes on new equipment, would that affect your decision to replace equipment sooner, or would it make any difference to you?

Mr. HOLMAN. As a matter of general principle, we look on the depreciation rates as serving the useful life of that piece of equipment.

Now, normally, it requires a lot of business judgment to determine that. I think that what we feel as a company is that it would be most useful in the Internal Revenue implementation of the revenue laws to permit a little broader base for interpretation on the part of business. In other words, we would like a little bit wider latitude in deciding whether a piece of equipment was going to wear out through either wear or through obsolescence in a period of, say, 10 years. We would like more latitude on the part of the Internal Revenue Department for the managers of business, because we cannot guess what the life of these things is going to be. Probably, over a period, we would take advantage of that at times; but the main thing, I think, is to have more latitude on the part of business to interpret these things to the best of their judgment.

We do not like a rigid rule for depreciation on some particular piece of equipment because maybe after the time we have agreed that is fair, something will come up so that it is not fair; so, we would like more latitude, I think.

Mr. SCOLL. If you had that latitude, would you replace your equipment faster?

Mr. HOLMAN. Yes; I think it would have some effect on that, certainly.

Mr. SCOLL. In your statement, you refer to investment in the manufacture and distribution of new products.

Is it Jersey's policy to manufacture and distribute every new product which its scientists develop?

Mr. HOLMAN. No; it does not have enough money.

Mr. SCOLL. Which ones do you handle yourself, which ones do you farm out?

Mr. HOLMAN. Well, in general, petroleum, of course, is a very complex base material, as you gentlemen know, and you can make a lot of things out of it.

In general, our business is what we usually refer to as the energy field; that is, residual oils, heating oils, kerosenes, gasolines, and so on.

Well, the energy field is where we started, and that is where we think we can do the best job. But, obviously, in trying to make better gasolines or better lubricants, we find out how to make other things; and our scientists are constantly bringing to our attention the fact that you can do a pretty good job on these.

The CHAIRMAN. May I interrupt at that point?

When you say that you do not have enough money to develop all the new products which are discovered by your research experts, does that mean that Jersey's research facilities have developed a large shelf of new products which are awaiting appropriate and proper times for future development?

Mr. HOLMAN. No, sir. I am going to come to that here—the next part in answering that question, Senator.

The CHAIRMAN. Well, I think Mr. Scoll's mind and your mind and my mind have been heading toward the same objective.

Mr. HOLMAN. The chemical field, of course, has been an attractive field. Naturally, we find out a lot about that in working out our normal field, and our general policy is that if we develop a product that we think we can make cheaper and better than someone else, we do it. I could use alcohol as an example: We think that we can refine and make alcohol pretty much the same as we do gasoline, and make it in big quantities. We do make quite a bit of alcohol and sell it to the different chemical companies.

Generally, it is in the manufacturing field, I think, that we will go ahead. If it is not related to the oil field and we think that the chemical companies or other people can probably do a better job than we can of merchandising it or in taking alcohol as a raw material and making it into other products.

In general, if we discover a new product that we do not feel that we can market effectively, we will sell the rights to that to some other company, or if we feel that we can manufacture it and do the primary conversion job, we will do that. If we have no interest in it, of course, it is readily available for anyone else who wants to use it.

Mr. Scoll. Now, is it your policy, to get a little closer to what Senator O'Mahoney, I think, had in mind—do you have a policy of putting to work all the new products that your various laboratories discover in their work in petroleum, as fast as they can be put to work?

Mr. Holman. Oh, surely. Any patents that we have are available to anyone else on, we think, very reasonable terms.

Mr. Scoll. Well, now, when you find a byproduct that has interesting possibilities, but which you think could be better handled by some other company than Jersey, how do you go about selecting the other company that you want to offer it to?

Mr. Holman. It is usually very well known. Patents, of course, are public property.

Mr. Scoll. Assume John Jones knows, through a friend of his, that one of your laboratories has developed a brand new perfume essence out of kerosene, we will say, to make it a little absurd; and John Jones finds out about this from a friend of his who works in the laboratory, and he comes to Jersey and says, "Look here, I would like to have the patent rights, and I will pay you a royalty. I want to make perfume."

Mr. Holman. We would be glad to let him have it. We had a little experience in the perfume business ourselves, and we were glad to get out of it. Other people could make money on it, and we could not.

Mr. Scoll. What I am getting at is, do you have any standards?

Mr. Holman. That is one of the assets that we sold, incidentally, Mr. Scoll.

Mr. Scoll. Well, I did not realize I was so close to home. [Laughter.]

What I am getting at is, let us take a product that has a wide application in the plastic field, for example, a new plastic, a new resin of some sort, that may have a potential market of, say, in the millions.

Now, how do you go about finding a company, or deciding whom you want to handle that? Do you pick an affiliated company, or do you go out and pick somebody who is completely independent, or how do you do it?

Mr. Holman. Well, you have to take each one separately. So far as I know we have not any brilliant ideas in the plastic field, but if we did, naturally, if we had patents I suppose some of the people who are in that business would come to see us. It would simply be a question of negotiating a trade with them.

The Chairman. Do you take the initiative with respect to the disposal of patents that you do want to use?

Mr. Holman. Oh, surely. If we have something we do not want to use, anybody else wants it, we will be glad to sell it to them.

The Chairman. Well, my original question was, so to speak: Do you have a shelf of new products which are not being utilized?

Mr. Holman. No, sir. There is no shelf of unknown products.

The Chairman. Well, what did you mean when you said that you did not have money enough to develop all the things that have been discovered or invented?

Mr. Holman. Well, going back to the alcohol business as an example, we can make the primary conversion on alcohol, which is still a raw material, for a lot of chemical companies.

Now, to go out and compete with some of the chemical firms, these chemical laboratories, for further conversion on a thing like alcohol requires a tremendous investment.

In the first place, we need our money in the energy field in which we feel we are best qualified to do the job.

In the second place, we do not have the managerial talent or the ability, we think, to do as good a job as some of the chemical companies could.

The CHAIRMAN. All right. Now, then, is that alcohol discovery lying idle because you do not want to go into competition with the chemical companies or is it being turned over to some chemical company?

Mr. HOLMAN. Surely.

The CHAIRMAN. Or to some other person or corporation to develop?

Mr. HOLMAN. That is right.

The CHAIRMAN. It is?

Mr. HOLMAN. Yes. Anything that we have is available to anyone else if they want to use it and we do not want to use it.

The CHAIRMAN. That is a little different statement. You say anything that you have is available for use by any other person. That implies that unless some other person or corporation asks for the opportunity to develop, and you do not want to develop, it lies idle.

Mr. HOLMAN. Well, it depends on the commercial value of that. If we thought that someone——

The CHAIRMAN. Certainly.

Mr. HOLMAN. If it was worth the sales effort to try to go out and sell it, why, we would sell it.

The CHAIRMAN. The reason I am asking these questions is that we are trying to find out whether there exists here, by reason of the discoveries of your scientists, an opportunity for the investment of American capital, which is not presently being invested.

Mr. HOLMAN. If anybody thinks we have got anything, or if we thought anybody wanted anything, we would be glad to sell it. If they think we have it, we would be glad to negotiate.

The CHAIRMAN. Let us create an opportunity for the investment of private capital in these discoveries. How many patents and discoveries have you made which are not presently being used?

Mr. HOLMAN. Oh, I would not even venture a guess.

The CHAIRMAN. Of course, all of the patents are public property?

Mr. HOLMAN. Surely.

The CHAIRMAN. They are available at the Patent Office.

Mr. HOLMAN. Surely.

Mr. SCOLL. By the payment of a royalty.

The CHAIRMAN. You can find out what they are.

Mr. SCOLL. Where its existence is to be determined.

Excuse me, may I ask a question along your lines, Senator?

The CHAIRMAN. Yes.

Mr. SCOLL. Do you have any special department or division of Jersey which has the particular responsibility of seeing to it that new unrelated products are farmed out or manufactured by other people?

Mr. HOLMAN. That is right, Standard Oil Development Co.

Mr. SCOLL. The Standard Oil Development Co.?

Mr. HOLMAN. They are constantly dealing in just the thing that you gentlemen are talking about.

Mr. Scoll. Just what we are talking about, fine.

Now, how would Standard Oil Development Co. decide whom to license, say, to make alcohol or some other product?

Do they take the size of the potential customers into consideration?

Mr. Holman. No; I do not think so.

Mr. Scoll. Do they pick their friends?

Mr. Holman. No; I do not think so.

Mr. Scoll. Well, how do they decide?

Mr. Holman. If you want to make a trade with the fellow, you naturally want him to live up to his obligations and if it is on a royalty basis, of course, you want to assume that he would use it.

The Chairman. Well, does not the Standard Oil Development Co. actively promote the utilization of those products which the managers of Standard Oil Development Co. regard as having a potential market, and the probability of making a profit?

Mr. Holman. That is right.

The Chairman. You do that by the creation of additional subsidiaries, do you not?

Mr. Holman. Well, they may, if it is related to the oil business itself. Of course, if that were the case the Standard Oil Development would go to one of the affiliated companies and make it known, by saying: "We have a new way of doing this," or "We can make a new product. What do you think about it?"

Well, they look it over and they decide if this is something which can be utilized in the area in which they are operating and if it would be a good business proposition for them to go into. If not, they would go to some other affiliate.

The Chairman. That is true with respect to discoveries that have a close relationship to the oil industry?

Mr. Holman. That is right.

The Chairman. To the production of energy?

Mr. Holman. Yes.

The Chairman. How about these nonrelated discoveries?

Mr. Holman. Well, they would promote those in the same way—going to people outside the Jersey group of companies to see if they had any interest in them.

Mr. Scoll. Well, to come back to the same line or to continue on the same line of questioning, what I am trying to get at is: What factors Standard Development Co. takes into consideration in deciding who they are going to license? And what I am aiming at particularly is this: Are there any considerations other than the straight business profit consideration? For example, if the Standard Development Co. had to choose between two competitors, each of whom were after a licensing arrangement for the manufacture of some byproduct, let us say alcohol, and one of them was a company that already dominated the alcohol field, the other one being a smaller company, equally solvent, but not nearly so important in the field, would the board of directors or would the company consider that it had any—shall we say—public responsibility in the farming out of its patents with respect to the general problem of the concentration of industry?

Mr. Holman. In the first place, it would depend upon the reliability of the firm with which you are negotiating, whether they be small or large.

Mr. Scoll. Suppose they were both good?

Mr. HOLMAN. We do not follow exclusive licensing; both could have it, so far as I know, in a case like that; that is, I am sure that is true in the case of oil—things applying to oil.

The CHAIRMAN. Would you say that any responsible corporation or individual which would express a desire to obtain a license to use any of your patented processes or discoveries not related with the energy field would be received on an equal basis?

Mr. HOLMAN. Right. That would even hold true in the oil field—in the energy field—because we license our competitors currently.

The CHAIRMAN. So, would it be possible for these newspapermen who are gathered here today listening to this testimony to write a lead to this story: "Standard Oil of New Jersey has a large number of undeveloped patents and processes for which applications may be received—will be received—by Standard Oil Development Co."?

Mr. HOLMAN. Well, in the first place, I do not think there are a large number, but certainly for anything that we have available we are open to negotiation. We might put an ad in the paper to that effect, Senator. You have given me an idea. [Laughter.]

The CHAIRMAN. And that will promote investment of private capital.

Mr. SCOLL. I have one final question: Does Jersey ever help other companies finance the purchase of Jersey products or supply Jersey with materials or equipment? I am not talking now about joint ventures where Jersey and some other company go into an oil field. I am talking about the distribution field or the supply field.

Mr. HOLMAN. Certainly, there are instances of that case. I remember when I was in the operating end of the business we sometimes made loans to a producer. If he wanted to develop his lease, we would make loans to a producer and take his runs as security on the loan.

Frequently a dealer will want to remodel his station, and he will make a dealer loan with one of the marketing companies whose products he is marketing. This past year in the case of shipping, some people wanted to buy some ships, and we had bought all the T–2s that we wanted in our fleet at that time. Although some of the companies did not actually borrow the money from us, we made a charter with them and they, in turn, used the charter as a means of financing their loans with the banks or insurance companies.

Those are some instances of it. In general, over-all, I do not think it amounts to so much in our total capital structure, but I think you could probably find some examples of that in practically every branch of our business.

The CHAIRMAN. To what extent does your experience offer a pattern for small business in this investment field? Are you willing to venture an answer on that?

Mr. HOLMAN. I do not know.

The CHAIRMAN. Suppose you think that over, and after you have——

Mr. HOLMAN. I think the same principles of business apply, whether you are small, middle-sized, big, or what not. It is all the same principles.

The CHAIRMAN. Do you agree that Government should do everything in its power to encourage the development of new independent competitive enterprises?

Mr. HOLMAN. Yes. I think that all forms of business should be encouraged to get more people into the business.

The CHAIRMAN. Thank you very much, Mr. Holman.

Both in the House and in the Senate, there is a demand for the presence of the committee.

Your testimony, as always, has been very interesting. I am sorry we do not have more time to talk things over with you.

Mr. HOLMAN. Thank you very much, sir.

I have the answer to one of the questions.

Jersey's investment in plant, property and equipment since the war, totaling about $1,500,000,000, was about two-thirds in the United States and one-third in foreign countries.

The CHAIRMAN. Yes. Thank you very much.

Mr. HOLMAN. Thank you, sir.

The CHAIRMAN. The committee will reassemble tomorrow morning at 10 o'clock, when Dr. Kaplan will be the witness.

(Whereupon, at 12:45 p. m., an adjournment was taken until 10 a. m., September 28, 1949.)

[Attachment A]

A. THE STERLING AREA

I. BRITISH COMMONWEALTH AND EMPIRE COUNTRIES

(a) United Kingdom:
- England
- Scotland
- Wales
- Northern Ireland
- Isle of Man
- Channel Islands

(b) Dominions:
- Australia
- Burma
- Ceylon
- Eire
- India
- New Zealand
- Pakistan
- South Africa

(c) Principal colonial territories:
- Aden[1] (colony and protectorate)
- Bahamas
- Barbados
- Basutoland
- Bermuda
- British Guiana
- British Honduras
- Cyprus
- Falkland Islands and dependencies
- Fiji Islands
- Gambia[1] (colony and protectorate)
- Gibraltar
- Gilbert and Ellice Islands
- Gold Coast:[1]
  - (1) Colony
  - (2) Ashanti
  - (3) Northern territories

(c) Principal colonial territories—Con.
- Hong Kong
- Jamaica (including Turks and Caicos Islands and the Cayman Islands)
- Kenya[1] (colony and protectorate)
- Leeward Islands:
  - Antigua
  - Montserrat
  - St. Christopher and Nevis
  - Virgin Islands
- Maldive Islands
- Malta
- Mauritius Island
- Nigeria:[1]
  - (1) Colony
  - (2) Protectorate
- North Borneo
- Sarawak
- St. Helena and dependencies
- Seychelles Island and dependencies
- Sierra Leone[1] (colony and protectorate)
- Southern Rhodesia (self-governing colony)
- Trinidad and Tobago
- Windward Islands:
  - Dominica
  - Grenada
  - St. Lucia
  - St. Vincent

[1] Colonies contiguous to protectorates of the same name or within the same administrative unit.

A. THE STERLING AREA—Continued

(*d*) British mandated territories:
- Cameroons (British)
- Nauru
- New Guinea
- Papua
- Tanganyika
- Togoland (British)
- Southwest Africa
- Western Samoa

(*e*) British protectorates and protected states:
- Bahrein Islands
- Bechuanaland protectorate
- British Solomon Islands protectorate
- Malay States
  - (1) Federated Malay States:
    - Negri Sembilan
    - Pahang
    - Perak
    - Selangor
  - (2) Unfederated Malay States
    - Johore
    - Kedah
    - Kelantan
    - Perlis
    - TreggANU
    - Brunei
- Northern Rhodesia
- Nyasaland protectorate
- Somaliland protectorate
- Straits Settlements
- Swaziland
- Tonga
- Uganda protectorate
- Zanzibar protectorate

(*f*) Condominiums
- New Hebrides
- Anglo-Egyptian Sudan

II. INDEPENDENT COUNTRIES

(*a*) Iceland
(*b*) Iraq
(*c*) Kuwait

B. THE DOLLAR AREA

- Canada
- Cuba
- Haiti
- Dominican Republic
- Guatemala
- Honduras
- Panama
- Panama Canal Zone
- Philippines
- Puerto Rico
- United States
- Venezuela

[Attachment B]

Per capita demand, crude and products, year 1948

[United States barrels of 42 United States gallons each]

ECA countries:	
Austria	0.5
Belgium-Luxemburg	1.5
Denmark	2.1
Eire	1.2
France	1.4
West Germany	.4
Greece	.7
Italy-Trieste	.5
Netherlands	2.1
Norway	3.2
Portugal	.7
Sweden	3.3
Switzerland	1.4
Turkey	.2
Iceland	6.2
United Kingdom	2.3
Total ECA countries	1.2
Certain other countries:	
United States	14.4
Canada, excluding New Foundland	8.4
India-Pakistan	.1
Poland	.1
China-Hong Kong	.03
Russia	1.1

VOLUME AND STABILITY OF PRIVATE INVESTMENT

WEDNESDAY, SEPTEMBER 28, 1949

UNITED STATES SENATE,
SUBCOMMITTEE ON INVESTMENT OF THE JOINT
COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:10 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney, Representatives Patman and Herter.

Also present: Representative Robert F. Rich; John W. Lehman, clerk to the committee; Dr. Theodore Kreps, staff director; Dr. William H. Moore, economist; and David Scoll, special counsel to the Subcommittee on Investment.

The CHAIRMAN. The committee will come to order, please.

Dr. Kaplan, you were unfortunately unable to get to the stand yesterday. We appreciate the fact that you postponed the engagement which you had for this morning, and we will be very glad to have you testify now.

STATEMENT OF A. D. H. KAPLAN, SENIOR STAFF MEMBER, THE BROOKINGS INSTITUTION, WASHINGTON, D. C.

Mr. KAPLAN. Would you want me, for the record, to state that my name is A. D. H. Kaplan, and I am senior staff member of the Brookings Institution?

The statement that I have for the committee is based partly on a study of small business and small business financial requirements that was made for the Committee for Economic Development about 3 years ago.

I have brought a formal statement, Senator O'Mahoney, of which I can give a brief summary, if you wish.

The CHAIRMAN. Just as you please. If you want to put the statement as a whole in the record and summarize it, and then discuss the whole problem with the members of the committee and the staff, you may do so.

(The statement is as follows:)

INVESTMENT CAPITAL FOR SMALL BUSINESS

The share of our national output going into private investment or capital formation mounted to unprecedented levels over the years 1946 to 1948. Prior to the war we had been wont to look back upon 1929 as the peak year of peacetime capital growth; that year gross private domestic investment accounted for 15.2 percent of the Nation's total expenditures for goods and services. In 1932 it hit a low point of 1.5 percent, and for the decade 1931–40 it averaged less than 9 percent of the gross national product. In the record total of our gross national product for 1948—estimated by the Department of Commerce at $262,-

000,000,000—17.2 percent of that total was accounted for by gross private domestic investment.

The present magnitude of our private domestic investment stands out even more sharply if compared with the total of private national income (that is, national income less compensation of Government employees). A thumbnail table which accompanies this statement indicates that whereas in 1929 gross private domestic investment came to 19.2 percent of the private national income, fell to 2.4 percent in the depressed year of 1932, and recovered to 15.4 percent in 1939. But it rose to 21.7 percent of our total private national income by 1948.

The record rate of capital formation we have experienced in the years immediately following World War II represented a catching up with requirements accumulated over the war years. Having replenished its more urgent requirements in plant, equipment, and inventories, American business will need new attractive stimuli to sustain the investment volume of the last 3 years. As you well know, the Council of Economic Advisers took the position, in its report of January 1949, that we should not expect such a rate of capital investment to continue, that a normal investment rate would be something closer to 11 percent than 15 percent of the gross product and that, by inference, more emphasis must be placed on consumer purchasing and publicly sponsored activity. I would not care, on this occasion, to take up the question as to what is a "normal" ratio of capital expenditure to total national expenditure. But obviously it becomes more difficult to sustain a high level of employment if the rate of capital formation sustains a decline. And, conversely, whatever incentives can be added to new investment will be that much help toward making jobs and sustaining pay rolls.

This problem applies to all branches of business, large and small; but in keeping with the request of this subcommittee, I shall from this point on confine myself largely to a consideration of capital formation as it applies to small business. I then come to the question whether facilities for equity capital to support small business are adequate.

If we follow the number of firms listed by Dun & Bradstreet since the beginning of the century, we find that the business population kept pace rather consistently with the increase in general population. Even in the depression of the thirties the pattern of business births and deaths did not vary significantly from what it had been around 1900. Since Pearl Harbor we have witnessed a greater than normal decline, followed by a greater than normal rise in the birth rate on business ventures.

Between December 1941 and December 1943 the withholding of new enterprises made for a net loss of some 600,000 firms in the business population. With the latter part of 1944, the reverse trend set in. By the middle of 1946, new businesses were springing up at the rate of almost 60,000 per month; by December 1947 the losses of the war period had been made up, and the business population curve was again in line with the general population. During the first quarter of 1948 the estimated number of businesses in this country exceeded 3.8 million; this was a net gain of a million since December 1943, and was a half million above the largest number attained prior to World War II. The business units in operation at the end of 1948 equalled one for every 38 persons in the population. Ten years before, it was about 1 firm for every 39 persons.

The rapid influx of new enterprises after the war is easily explained. It reflected (a) the accumulation of savings during the war period on the part of a great many people who had long hoped to enter business on their own; (b) the return to their proprietorships by persons who had to shut down during the war period either because they were drawn into the armed services, or because merchandise had not been available; (c) the new opportunities that developed as a result of the brisk demand for all kinds of civilian goods following the war; (d) the special provisions for the financing of war veterans and others desiring to enter business, coupled with the new skills and outlooks acquired by former employees during the war experience.

During the 3½ years immediately behind us, when enthusiasm for new business was high, and the determining factor was the ability to get enough supplies to meet the brisk demand, the new businesses fared much better than the long-time record of new business ventures would lead one to expect. The percentage of drop-outs during the first year was smaller than normal; that is to say, less than the traditional one-fourth of those that entered failed to stick out the first year. The evidence tends to the belief that a majority of the new enterprises got off to a vigorous start and that an unexpectedly large percentage found themselves in a favorable credit position by the end of their first year. Comparatively little was heard, under those conditions, about the lack of availability of funds for entering business.

The Department of Commerce estimates that for those who entered business with less than $50,000 (and of course that represents the great majority of the new ventures), at least two-thirds of the original investment came from the personal savings of the proprietors. The indications are that the majority of the new firms financed their businesses solely through savings. The savings of the others were supplemented mainly by commercial bank loans (about 14 percent of total investment in the case of trade firms), merchandise credit, and personal loans. Security flotations played a relatively negligible part in the starting of small enterprises, especially at the retail level.

We are now beginning to hear more of small businesses being more closely held down by their banks, especially on the amount of long-term credit available to them. We also find that some small businesses have had to cancel or curtail their rather ambitious expansion programs. (They have curtailed not alone for lack of credit, but because of a belief that their current market outlook does not justify plans that looked feasible 2 years ago.) The number of failures is still small compared with what used to be regarded as normal during the 1920's and 1930's, but the number has been rising from month to month. The failure rate was about 200 per month early in 1947; it is currently around 800 per month, or four times what it was in January 1947. As more marginal firms are liquidated we shall again hear about businesses having been pushed to the wall for lack of financing facilities. In any event, the question of whether there is adequate financing for small business equity capital, is likely to come to the front during the months ahead. It is well that Congress should be reexamining the issue before it does become acute.

Before considering new facilities for granting equity capital to small business, may I say a word about the place of savings and earnings in the growth of small business.

From the standpoint of a small business that seeks to maintain complete control of its own management, there is no substitute for the method of expansion that comes through the plowing back of a substantial portion of one's earnings. This subject inevitably leads into the question of whether our fiscal policy is designed to improve the taxpaying ability of the small enterprise. Moreover, when expansion entails the seeking of outside funds, the prospect of being allowed to plow back earnings for a more rapid reduction of debt, or the recapture of debt-free ownership, still remains a prime factor in the willingness to expand. In that connection, you have no doubt been reminded of the difficulties of administration in any attempt to distinguish genuinely new independent small enterprises, or to distinguish genuine plowing back for constructive development of the business from adroit accounting to escape taxes. Nevertheless, it is to be hoped that the efforts will not be relaxed to find a tax formula that will increase the attractiveness of venture in independent enterprise, to overcome the emphasis on Government bonds or the blue chips in securities as an escape from the risks and responsibilities of individual enterprise.

Does small business need new financing sources?—It is not possible, from available information, to build up reliable statistical measures of the extent to which deserving small scale enterprise is being prevented from expanding through lack of adequate financing facilities—and by adequate, I mean suitable to the nature of small business as well as sufficient in aggregate amount. The whole subject is tied up in value judgments of what is or is not promising enterprise, and what is or is not acceptable creditworthiness.

The position can be taken that the market itself is the most practical judge, and that if we don't have more facilities for financing small business, it is because we don't need more facilities; or that there isn't sufficient attractiveness in the given small business to justify further investment therein.

On the other hand, we have no Nation-wide data on case histories that might show how many promising small-business ideas and ventures may be nipped in the bud by the unwillingness of investors to bother with small-enterprise financing. The fact that small-business men appear before congressional committees with legitimate complaints of unwarranted difficulties and hardships—even a few hundred such cases—may tell us little, from the standpoint of the over-all scene covering more than 3,000,000 small businesses, with respect to how productively additional capital could be employed.

We do have some documentation in studies going back to the depressed 1930's, which indicate that apparently deserving enterprises were unable to get the credit that might have carried them financially over the hump. In the majority of cases of financial distress that have been investigated the deficiency in management appears to have been at least as marked as the deficiency in finances. Bankers, in discussing some of these cases, have made the point that the basic weakness of the capital structure of these cases did not warrant them in risking deposit funds that could only make the applicants get more deeply into debt before giving up the struggle. The kind of relief needed in such instances could be regarded as part of the public-relief measures applicable to a national emergency rather than a part of the problem of expanding the capital structure of the weak enterprises at the distress stage. Credit managers, as well as bankers, have pointed out that so far as mere numbers are concerned, the supply of those who are willing to enter business still exceeds the number who have the capacity to succeed through a positive contribution to the total economy.

Nevertheless, out of such meager coverage of the field as one man is able to make, in the study of this issue I have come to the strong conviction that there is a substantial core of small-scale enterprise—mainly in the area representing 5 to 100 employees per firm—for which there is a genuine lack of an orderly channel of financing designed to meet the requirements. The lack is not in short-term financing through current bank loans or current merchandise credit. It is in the creation of equity capital for small enterprise—not only for launching new businesses, but for expansion of enterprises ready for further development and for putting seasoned enterprises on a stronger base of fixed and working capital.

In this conviction one can find moral support from the testimony of others who have made similar studies. Mr. Roy Foulke, of Dun & Bradstreet, from his continuous study of the capital and credit position of small-business men, stated to the Senate Small Business Committee several years ago that "under the existing set-up of our economic structure we find no organized source or sources to provide long-term money or permanent capital to intermediate-sized concerns." The Filene Foundation, which studied the requirements for small-business capital in the New England area in 1940, noted: "there is little or no disagreement that our financial mechanisms are not set up so as to provide equity capital for the smaller business units. * * * The weight of the evidence and opinion presented is that the need is real and definite." The postwar efforts of the Federal Reserve Bank to obtain legislation extending its powers for longer term capital credit is likewise a recognition of deficiencies in existing facilities. The study of British experience by the Macmillan Committee, and particularly the studies of capital flotations made by the Securities and Exchange Commission, confirm similar views.

The difficulties of small enterprises in the floating of securities have been documented in the SEC study of May 1940, which showed that corporations attempting to sell bond issues of $250,000 or less, paid an average of $8.40 for each $100 of bonds sold; that they paid an average of $16.40 for each $100 of preferred stock; and that they paid an average of $22.80 for each $100 of common stock. These costs were nearly double those incurred for issues between a million and $5,000,000.

In the flotation of securities, such items as registration and underwriting expense, legal expenses, accounting, engineering, printing, listing, and so on, apply to large and small issues alike; and they pile up so that in the case of the small issue there is little left for the firm that is trying to obtain funds. It also means that in view of these expenses, the average large investment house takes the position that there is no advantage in accepting underwritings below $5,000,000. Part of the reason for that reluctance is undoubtedly their poor experience with getting the issues of small companies sold. In studies made by the SEC before the war it was shown, even where there was effective registration of the issues for $250,000 or less, that within 1 year after the effective registration date the issuers were able to sell only 23 percent of the securities registered, and that of 584 companies studied by the Commission, about one-third failed to sell any part of their securities. Among those which reported sales, the new ventures sold only 27 percent of their issues. The established concerns sold 44 percent. Of all the reported sales, about 71 percent were made within 3 months after registration. Once the campaign period was over, the sales were reduced to a mere trickle.

Since the war the Federal Reserve Bank of Minneapolis has published a study of attempts by Minnesota corporations to float capital issues, over the past two decades, which confirms the difficulty of obtaining financing for firms that have not already established Nation-wide prestige.

The prewar and wartime efforts of agencies like the Federal Reserve System, under its section 13B, permitting direct industrial advances, the disbursements authorized by the RFC and the special war loans of the Smaller War Plants Corporation, undoubtedly came to the rescue of enterprises that were very much in need of such accommodation; but the aggregate of the advances made to small business by these three agencies is not too impressive. A break-down of the first 150,000 successful applications with the Federal Reserve banks, under section 12-B, shows that 3.1 percent of the aggregate amount advanced was in loans of $10,000 or less. As of December 21, 1941, the aggregate of all direct industrial advances by all Federal Reserve banks was $9,504,000. If the 3.1 percent applied, you can see that the amount involved per small business was extremely small. (There were, however, at the time, something under $15,000,000 of Federal Reserve guaranty commitments to member banks or industrial advances).

In the case of the RFC, loan disbursements of some $460,000,000 were authorized during the 9-year period from 1932 to 1941; but while some 5,100 loans were authorized to small businesses in amounts of $10,000 and under, during that 9-year period, they represented a total of only $21,000,000 out of $460,000,000 loaned by the RFC.

The Smaller War Plants Corporation was of course a special agency to meet the special needs of the war period, though its operations frequently made for a healthy reexamination of traditional banking practices.

The commercial banks have remained by far the leading vendors of credit to the small business apart from its ordinary commercial credit on open accounts; but that type of lending is not an adequate substitute for equity capital which is the chief requirement of small business.

A number of noteworthy efforts have been made to fill the gap in equity financing for small business. I shall mention three, to point up the requirements. One type of agency with which there have been numerous experiments is the so-called community industrial development corporation. The general purpose of these corporations is to bring the enterprise that needs capital into contact with the sources of funds that are seeking investment outlets. They have attempted to supply a community fund from which investments may be made to new small businesses or to aid a business in obtaining additional financing. It is one of their laudable objectives to reproduce the equivalent of a practical neighborly interest in a local venture that used to develop spontaneously in the more simple social structure of an earlier period. At the same time the industrial development corporation recognizes the fact that technical expertness, and judgment that is respected, are under present conditions more vital than good will in attracting funds to new ventures.

All told, I have found records of some 55 community development corporations that range from small pools of capital offered by a few rich men, for propositions that they themselves would like to go into, all the way to civic funds that may be used for any type of development that will enhance the community, including some projects that were mainly of civic and cultural rather than of strictly business or profit-making value. A review of the histories of the leading industrial development corporations indicates that they have been highly selective in their search for ventures of unusual promise, with emphasis on the development of new manufacturing techniques, or of brand-new products. They have been helpful as far as their activities have reached, but when one adds up the total sum of the enterprises into which these development corporations have entered, it amounts to a very negligible fraction of small business and its capital requirements. The effort to supply the capital needs of small business will obviously have to be made on a much broader front than the industrial development corporations have provided, if the total situation is to be met.

Near the end of the war, the Investment Bankers Association, through its Committee on Small Business, offered a proposal to encourage the establishment of local investment houses specializing in small-business financing. Under this proposal chartered investment companies could be started in local communities, with a minimum of $25,000 of paid-in capital, and the Federal Reserve Banks would be called upon to accept debentures of such chartered investment companies up to three times the amount of the paid-in capital. These special chartered companies were then to be permitted to take on any form of financing including ownership of small enterprises until their stock could be disposed of. A certain percentage of the loans or issues for the borrowing firms would be withheld to go into a separate pool, to enable the financing company to cover the losses on those propositions that turned sour. It also suggested that such investment houses should at the same time maintain close managerial guidance provision over the borrowing companies while they were in debt.

That proposal while well conceived, gained scant acceptance among investment bankers; the framers of the plan themselves pointed out that investment bankers as such are not investors primarily, but are merchants of securities. They purchase new securities not to hold them but to sell as promptly as possible to others. Moreover, they are not primarily interested in securities that have a local market. Under the circumstances, nothing happened in the investment banking fraternity to push along the proposal of its small-business committee.

In view of the lack of private enterprises, capable of filling in the gap in equity financing facilities, legislation has been proposed looking to the establishment of a Government agency that would undertake the financing of small business.

The establishment of a governmental financing corporation for small business raises dilemmas with which some members of this committee have already grappled. If the Government is to be significantly more liberal than are the private banking agencies in financing small business and if, in addition, the Government is to charge rates lower than are available to small business by the financing companies, the Government faces the prospect of a deficit enterprise with questionable risks. It will also be confronted with requests backed by political pressure as well as by the judgment of its staff. As it is, small-business mortality is high. It is hard to escape the conviction that we must expect to find in the lap of a Government agency to finance small business an accumulating residue of defaulted debt and ownership paper of the enterprises which it will have assisted. And on foreclosure, the Government becomes the owner or auctioneer of small business. If the number of small-business failures is to be held down we must contemplate, along with the financing, the Government agency undertaking the continuous investigation and guidance of the firms to which funds are granted. If the Government is to offer investigatory services and counseling services of this sort without charge, then of course it becomes a subsidy program. If it doesn't yield to public pressure for liberalization, it will have failed in its avowed purpose.

In exploring the need for a suitable enterprise channel to carry the additional capital requirements of small business, may I now submit for your consideration the possibilities of finding the means of broadening the financial base for small businesses within our banking system. The logic of this suggestion lies first in the fact that the small business normally looks to the local banker for financing. Were there not the overriding concern for liquidity in the interest of demand depositors, the commercial bank would be the most natural agency through which to finance the growth of small enterprise.

The operation of investment affiliates by commercial banks was made illegal after the crash of 1929 because of the abuses that showed up from their unregulated practices. But that experience should not blind us to the potential value of capital banking protected by adequate sanctions and controls. It is essential to create an agency to which the commercial bank may readily refer the client whose needs go beyond current bank loans into the more specialized area of risk-bearing capital financing.

With the precedent set in the capitalization of the Federal Reserve banks, it should be feasible for the commercial banks in each Federal Reserve District to subscribe a percentage (say up to 3 percent) of their capital and surplus in a district capital bank with branches in as many communities as developing need warrants. Such a capital bank would operate under the authority of the Federal Reserve Bank in the given district, under general policies laid down by Congress and administered by the Federal Reserve Board.

Capital bank financing for small business would require a varied base. It could be supported by collateral, securities, accounts receivable or certificates of indebtedness, secured or unsecured as the conditions warrant. Such a bank should be permitted to purchase capital stock as well as the debt paper of an enterprise. But it should have regard for the objective of fostering independent ownership by the small enterpriser. To this end preferred stocks should be made callable by the issuing firm on a prearranged program. In taking the common stock of a borrower the bank as stockholder should be permitted to share in the earnings and in the increase of equity values; but there should also be provision for redemption of capital stock by the issuing firm within agreed time limits and adjustments of the transfer value of the stock, so that the management of the small enterprise may regain its full control of the venture.

Another logical extension of the plan would be for the capital bank, as an operation under the Federal Reserve System, to be permitted to place its debentures or rediscount paper with the Federal Reserve banks at such rates as would permit a fair return on the employment of the additional funds so obtained.

What such a bank may or should do is a matter that should be permitted to evolve through experience. While the capital bank is conceived in the first place as an accommodation to the bank depositor and his bank, there is no reason why its operation should be limited to clients referred by its commercial bank members. It may, with time, be permitted to accept long-term obligations of finance companies, trade associations, and other enterprises coming within the general area of small and intermediate business. It is not a necessary part of the proposal that private investors should be excluded from subscribing to the capital of the bank, for the initial organization has been set up by the commercial banks of the district, if such expansion of the capital base appears desirable.

The proposal for a separate banking agency rests upon the conviction that the financing of capital operations of small enterprise involves a different approach from that which is normally taken in credit banking by a commercial bank of deposit. A capital bank that can serve small business must not be inhibited by orthodox banking traditions. As a specialist in permanent capital, the proposed type of bank should be in a position to develop new techniques for financing of small enterprise, as conditions demand. It need not for example, be hampered by the traditional procedure of regular payments of equal installments at each due date. It may well find that its clients can be better helped and kept more solvent by adjusting the size of payment, the interest rate and service charges for managerial guidance to the position of the enterprise, to the business cycle, or to changes in central banking or monetary policy at any given time. Where it is desirable to grant interest rates lower than the risk of the enterprise would justify, the bank could accept more liberal payments in stock.

A capital bank, to perform its function adequately, should be prepared to furnish the advisory services that must accompany the successful financing of small business. In this respect, the capital bank would have a valuable ally in the commercial bank, whose information and regular banking facilities would be joined with those of the capital bank in helping the given enterprise through its vicissitudes.

A capital bank serving more than one community would have the advantage of diversification. Many a small-town or neighborhood bank is limited to retailers or to a limited line of industry for its credit market. The capital bank could encompass an area large enough to permit diversification of investments and thus have a better chance of offsetting losses with profit.

A successful effort to preserve our system of private enterprise must provide expanding opportunities for the development of small, independent business enterprises. Big-business executives, as well as those directly engaged in small business, recognize the importance of the small independent enterprise as an essential leaven in the total business structure. Indeed, small business is much more than a leaven; in its own right, it accounts for more than one-third of the total output of goods and services that make possible the American standard of living. It is in the public interest that small business should not lack for adequate facilities to maximize its contribution.

TABLE 1.—*Gross private domestic investment in relation to total economic effort, selected years, 1929–48*

[In millions of dollars]

	1929	1932	1939	Average 1931–40	1946	1947	1948
Gross private domestic investment [1]	15, 824	886	9, 917	6, 644	29, 455	31, 090	45, 008
Private national income [2]	82, 396	36, 703	64, 306	53, 676	158, 677	184, 196	207, 067
National income	87, 355	41, 690	72, 532	60, 515	179, 562	201, 709	226, 204
Gross national product	103, 828	58, 340	91, 339	77, 725	212, 613	235, 697	262, 434

[1] Does not include public construction and foreign investment.
[2] National income excluding compensation of Government employees.

Source: National Income and Product Statistics of the United States 1942–48, Survey of Current Business, July 1949, p. 10.

TABLE 2.—*Gross private domestic investment, selected years, 1929–48* [1]

[Expressed as a percentage of total]

Year	Private national income	National income	Gross national product	Year	Private national income	National income	Gross national product
	Percent	*Percent*	*Percent*		*Percent*	*Percent*	*Percent*
1929	19.2	18.1	15.2	1946	18.6	16.4	13.9
1932	2.4	2.1	1.5	1947	16.9	15.4	13.2
1939	15.4	13.7	10.9	1948	21.7	19.9	17.2
1931–40	12.4	11.0	8.5				

[1] Computed from table 1.

Mr. KAPLAN. Mr. Chairman, since the members of this subcommittee have already received my prepared statement, may I briefly note the main lines of the argument?

Small business has during the past few years experienced an extraordinary spurt. The gaps in its ranks left by the war have been more than filled. The aggregate investment in small business since 1945 may be as much as $5,000,000,000. The new enterprises, benefiting from postwar shortages, have had a better than normal experience for small-business venture. Personal savings were available for new ventures; credit was in plentiful supply, and profits were above the long-term average.

Some reaction from this boom in small business is to be expected. A large number of business entries means a correspondingly large number of discontinuances as the submarginal enterprises fall out. Business failures are still low today, but the monthly rate is about four times what it was in January 1947. There is some evidence that banks are becoming more selective and somewhat tighter in granting credit, so that we shall probably come closer to the prewar pattern of distress signals from small business. We shall be hearing more about the shortages of capital for small business.

As my statement indicates, the evidence on the adequacy or inadequacy of capital for small business is not as definite and conclusive as one could wish. What evidence we have shows that the lack which small business feels most is in equity and long-term capital.

The cost of flotation of securities in small amounts is prohibitive. Issues commanding only a local market are seldom fully sold. Investment bankers find small-business financing unattractive. Voluntary private efforts to set up community funds for small business have thus far not scratched the surface of the problem. It needs to be met on a much broader front than they have been able to reach.

The entry of government into the direct financing of small business involves difficulties that would lead one to look upon that means as a last resort. In many respects the assumption of small-business risks by a government agency would be incompatible with the individual private initiative of which small business is regarded as a symbol.

The commercial bank remains the channel through which small business turns most naturally to meet its credit problems. At the same time, the traditions of commercial banking, with the emphasis on prior claims of demand depositors, render the commercial bank unsuitable to bold experimentation with the financing of small-business risks. A specialized capital bank is therefore proposed—one that has the flexibility required to meet the varying risks of small business and which, at the same time, may operate within a framework of suitable controls within the Federal Reserve System. It is believed that, through such an extension of our banking system, new techniques may be developed under which small business may have more appropriate financing, together with the kind of management guidance which must go hand in hand with more adequate financing of small-scale enterprise.

The CHAIRMAN. Dr. Kaplan, it seems to me that you have given us a very clear and logical exposition of your views with respect to this matter. I say that before turning you over to some of the questioning which may take place.

Congressman Patman?

Mr. PATMAN. Yes; I would like to ask a few questions, Mr. Chairman.

I have read with interest your statement, and I have heard your remarks, and I agree with the chairman that you have a very comprehensive statement here that has certainly given some light on this subject.

One thing I have noticed about your statement, Doctor, and in books that you have written, is that you fail to discuss a problem—that is, adequately from my standpoint—that I think is a major one in our economy today, and I refer to the chain stores, the national chain stores. I do not mean the local chain stores that keep their money within the general area. I refer to the national corporate chains that are spread all over the Nation.

It occurs to me that there are enough people in every local community to do the retail business in that community, and able and willing to do it. That is not true as to wholesaling; it is not true as to manufacturing; it is not true in the heavy-goods industries, but it is definitely true, I believe, in the retail stores.

It occurs to me that we should do something to stop the spread of the national chain stores. What do you think about that?

Mr. KAPLAN. If I may, Congressman Patman, I would like to limit my answer on that to the immediate problem of investment and capital formation.

Whether, on balance, the chain-store development has retarded or stimulated small business is hard to pin down factually. I have tried to compare the experience of grocery stores and drug stores, and other lines that have been most directly confronted with the chain-store problem, to see what their growth experience has been since the chain stores have developed, as compared with the 20 or 30 years before the advent of the chain stores.

On the basis of the available data covering the necessary length of time, independent stores in those lines in which the chain stores have been conspicuous have had a somewhat better-than-average-growth experience, and a somewhat better experience in respect to the number of months before they have failed, than in the retail and service lines which have not had the chains to contend with. So, holding myself to the discipline of the record, I have to say that, while I share your sentiment that we do not want any large aggregations to wipe out small businesses, the record would seem to supply the basis for this inference: that the chain stores have apparently stimulated the small independent enterprise about as much as they have hurt many of the weaker independent enterprises. We do not have today in the average retail store the cracker-barrel type of set-up; even the tiny retail food store is apt to be attractive today, with sanitary conditions; it is conceivable that the stimulus of the chain store may have had something to do with that improvement.

Mr. PATMAN. Do you not believe that the individual merchants would have advanced along with the advances that they have had in other lines of business?

Mr. KAPLAN. I do believe, Congressman, that they would have advanced, but I think the chain-store movement has performed a competitive function in the interest of the consumer.

Mr. PATMAN. But you do not think there is a limit to the number of opportunities that one concern should have?

Mr. KAPLAN. That is another question.

Mr. PATMAN. In one concern, there are 1,000 absentee owners, who have the same opportunities as 100. Should there be a limit upon the absentee ownership of stores that can be handled locally?

Mr. KAPLAN. That, too, is another question.

Mr. PATMAN. Let us look at it from the credit standpoint, and the credit standpoint is what we are talking about.

If you were a banker, would you be inclined to extend credit to a concern that wanted to go into the grocery business when there was danger of absentee owners coming into that place and putting in a similar business?

You would not be likely to be encouraged to offer the venturers in that case capital, would you?

Mr. KAPLAN. My answer to that may surprise you, Congressman Patman; but I attempted to go to a large number of grocers who have felt for years that they have been pestered by the chain store, and I have heard a number of them say that they would not locate in any location except near a chain store. I am speaking of some of them in States where there was a progressive tax on chain stores based upon the number. You recall that the larger the number the greater the tax.

Mr. PATMAN. Yes.

Mr. KAPLAN. And, in those cases, you know what the chain stores did. They reduced the number of stores.

Mr. PATMAN. Sure, large supermarkets.

Mr. KAPLAN. And increased the size of their stores and developed supermarkets. Then, one grocer after another bemoaned the fact that, when there were little chain stores, there was one at his corner, and he got the overflow; people came around, and they got some things from him and some things elsewhere. But, when the chain store moved out and the big store was set up with a big parking lot, elsewhere, that particular corner became a regular cemetery. So he would try to find a place closer to the chain store.

Mr. PATMAN. I know you want to be fair about it. That was done in States—you are talking more about the type of store, a little store where they open earlier and stay open after hours and are open Sundays and holidays, when the big chain is not. I know there is a lot of overflow business that way.

But, generally, do you not think something should be done to restrict the spread of these national corporate retail stores? Are you willing to let it go ahead just like it is and make no effort to stop their expanding at all?

Mr. KAPLAN. I can see where the time may come where we may want to stop that expansion; but, frankly, I do not feel I have the basis, Congressman Patman, for saying whether it should stop at 1,200 or 12,000.

Mr. PATMAN. Would you be willing to separate the units, in other words, the manufacturing from the retailing?

Mr. KAPLAN. Well, of course, that is a problem that is in the hands of the courts now, with respect to A & P.

Mr. PATMAN. That is not general; that is just one company.

Mr. KAPLAN. But that may prove to be the key case with respect to integration of manufacturing, wholesaling, and retailing. It is the only important chain-store case in which that subject has come up; the courts have already decided that certain chain-store activities are contrary to the Sherman Act. I would not want to prejudge the liquidation issue, on which the court will hear the evidence.

Mr. PATMAN. I am interested in the small-business man, as you are, and after this war the young veterans returning did not have the opportunity to go into business that the veterans after the other war had, because these national chains had so much of the opportunity, so many of the opportunities themselves. They could not go out and run a grocery store, a drug store, or engage in any other private business in which the big chains, absentee owners, were in, in that locality. They would not have a chance. They could not get credit; just what we are talking about.

Do you not think it would be a wholesome and constructive thing if Congress would pass a law to at least freeze them where they are now, all of them over a certain number of units, say over 500 units, just freeze them where they are now, not tax them, just freeze them? Do you think that a law should be passed where Congress would say, "You cannot expand any more, and if you go out of business in certain localities you are out, and you will be that way; you cannot put in another new store until the number reduces, say to 500," something like that? What would you think about a proposal of that kind?

Mr. KAPLAN. I would want to do considerable thinking about a proposal of that sort, because I feel that all business, big or small, in a private-enterprise system must have a chance to keep alive, and those who are——

Mr. PATMAN. I agree with you. But should one concern have all the opportunities?

Mr. KAPLAN. But I was going to say, you do not keep alive on a freeze; you do not keep alive by saying, "Here, this is the last word. No new ideas, no aggressive salesmanship, no going after the customers, no further opportunities for investment in there; just stop where you are."

That just is not private enterprise, whether it is big or small, and I do not find myself going along without qualification on that.

Mr. PATMAN. When it comes to the point of monopoly—take the A & P. I know that over a period of years they do not have a monopoly over the entire country, but they have a local monopoly, and we know that in 29 percent of their stores they sold at a loss at all times.

Now, the consumers there got the benefit of it, but in other stores they were charging more money in order to make up for that loss.

Mr. KAPLAN. Well, did not the Supreme Court take care of that situation?

Mr. PATMAN. No; it has not been taken care of, except a thousand-dollar fine each, which is just a slap on the wrist, which means nothing at all.

And the ironical part about it, Doctor, is that the taxpayers, the Federal Government, is subsidizing them to destroy the independent merchant because they get a tax deduction on it. They take a tax deduction.

If they put a store in against you and lower the prices to put you out of business, and they put you out of business, they get a tax deduction for that, so, in effect, the Government is subsidizing them to destroy independent merchants.

Do you not think there should be a limit to things like that?

Mr. KAPLAN. I did not quite follow your tax-deduction theory.

Mr. PATMAN. Well, suppose A & P puts a store in across the street from you and A & P cuts the price, like they do, to put you out of business, and over a period of time, say 1 year, they have lost several thousand dollars in doing that. All right, they get a tax deduction on that. So, in effect, the Treasury is subsidizing the putting of you out of business.

Mr. KAPLAN. But, Mr. Congressman, A & P cannot make out a separate return for every store.

Mr. PATMAN. That is what I am talking about. They make it for all of them together, and the Government permits them to get a tax deduction on losses incurred by putting their competitors out of business.

The CHAIRMAN. May I state it this way, Congressman Patman?

Do you think that tax credit should be permissible under our income-tax laws for losses which are voluntarily incurred for the purpose of competing with a local small business?

Mr. KAPLAN. If you put it as a matter of "should," and it is conversation, I say "No." But I do not know who is going to show me how to distinguish between the voluntary losses and the involuntary losses, or who is going to make the admission that here a loss is a voluntary loss.

The CHAIRMAN. Well, the so-called loss leaders have been pretty well identified, have they not, where a retail store offers for sale to the consumer a particular commodity at a price far below the cost of distributing it, merely for the purpose of getting customers into the store?

Now, that is pretty well identified. A voluntary loss for the purpose of overcoming competition could be pretty well identified, too.

Mr. KAPLAN. Senator O'Mahoney, if you are indicating that you would have, as has been done in some of the State laws, every item in a stock of merchandise take at least a certain minimum percentage over and above all expenses, I must say that I do not feel that that represents sound competitive merchandising. I think a merchant has a right to decide on what in his stock he can get a faster turn-over with a smaller margin, and what he is going to keep with slower turn-over and higher profit, and what he needs to dump in order to clear his merchandise; otherwise, I do not see where you are giving the little fellow a chance to compete. Even your druggist, who is supposed to cry for the national-brand, fair-trading, special-resale-price privileges, uses those staples only as a backlog; he goes out hunting for unregulated items, whether it is in drugs, notions or toys, and sets up bargain tables, too.

You have to have flexibility in small business in order to have it live, and I would not be prepared to impose on business any freezing of its prices; that is, not in a private-enterprise system.

The CHAIRMAN. Of course, that is not the suggestion at all. I merely put in loss leaders to illustrate the point that was meant in the question that Congressman Patman raised, about the deliberate and intentional operation of a retail outlet at a loss, and, in principle, you agree with that. Of course, you raise——

Mr. KAPLAN. The Sherman Act, of course, takes care of that.

The CHAIRMAN (continuing). The difficulty of definition and of detail which, naturally, one must recognize.

Mr. KAPLAN. That is why I say the courts have to decide whether given practices are destructive of competition, and not merely uncomfortable to inefficient competitors, and that is why I do not want to indicate an individual opinion as to what the courts may find, as to whether the structure of the A & P makes inevitable the restraint of trade and competition.

The CHAIRMAN. I did not raise that question. The issue here is whether or not a recommendation should be made to Congress in line with what Congressman Patman has suggested, that deliberate and voluntary operation at a loss should not be the basis of an acceptable tax reduction.

Mr. PATMAN. And add to that: where it is done for the purpose of destroying competition.

The CHAIRMAN. That is right.

Mr. KAPLAN. Certainly, I agree with that objective.

Mr. PATMAN. Well, any court that can determine down to a percentage, like 29 percent of the cases—they did that—could certainly determine for tax purposes the question that we have discussed.

Now, one other point: In this A & P case the judge held that they received over a period of years, oh, it was 10 or 20 million dollars—I do not recall the amount—in inventory gains. Now, an inventory gain is just taking it away from the consumer. You will agree with that, will you not? An inventory gain——

Mr. KAPLAN. Unless it is due to inflation.

Mr. PATMAN. No; I am talking about where you are a local store manager, and they deliver a keg of lard, weighing 100 pounds, to you to sell, and 100 pounds of sugar in a sack, and then you measure it out to the small customers, 1 pound at a time.

Mr. KAPLAN. I see what you mean.

Mr. PATMAN. Normally the honest merchant could not get that amount of it, could he? But these A & P managers had to do it. Not only did they get the amount, but they got a 2-percent increase.

And they were given a small fine of $5,000, nobody put in jail, nobody hurt or embarrassed, just like paying over a nickel or 1-cent piece or something like that, and start out again on a regulatory law basis.

Mr. KAPLAN. You are going there into a question on which I certainly would not qualify as an expert, and that is whether the Department of Justice is using the most effective means in prosecuting these as criminal cases rather than asking for specific relief. In the A & P case——

Mr. PATMAN. I think Congress should pass on it. This evil has been discovered, and plenty of evils have been discovered. It has been shown that they have gotten so large and they have so many advantages, these returning veterans cannot possibly go into the business in competition with them. They have not got a chance, not a chance on earth, and the consumers do not profit. The consumers pay for it in the end. It costs the consumers more in the end, and I am personally working on some kind of a bill, Doctor, that will retard these chain stores, plow them back, or at least freeze them where they are, so that everybody will have some security, and I hope that I have the assurance of your help on working on a bill of that type, and I will submit it to you.

Mr. KAPLAN. Certainly, wherever it gets into the area of malpractice, and is not merely a matter of punishing efficiency per se, you and I do not differ.

Mr. PATMAN. I would not want to punish efficiency per se, not at all; but I do want to keep a few fellows from having all the opportunities in the different local communities of this country.

In other words, I want to prevent, insofar as it is possible and feasible and desirable, absentee ownership of a business that can be carried on locally.

The CHAIRMAN. Any other questions?

Mr. PATMAN. I will yield to the others, if you please.

The CHAIRMAN. Congressman Rich?

Mr. RICH. I was very much interested, Doctor, in the statement that you made.

Mr. PATMAN. Will you pardon me, Mr. Rich, I have just one more thing I forgot to cover.

Your statement about the bank, the industrial bank, leads me to ask this question: Did Mr. Hoover in 1931 organize some large bank such as you suggest here under a New Jersey or Delaware charter just preceding the RFC in order that that bank could help out the banks and railroads, insurance companies, rather than have some Government agency do it?

Mr. KAPLAN. Yes. That was a special measure to take care of the terrific loss in capital values, and to the threatened insolvency of the railroads and others.

Mr. PATMAN. It did not work, and it had to have the RFC?

Mr. KAPLAN. Well, of course, I do not think it was directed toward this continuing problem of giving small business a channel to which it can come with its case, and get advice on whether it is a situation that requires financing, on how to refinance, and the financing for getting it launched.

Mr. PATMAN. And with this statement I will yield to Representative Rich. It is a beautiful theory, but I do not think it is practical, and I do not think it would work. I think the RFC is just better. I do not think these bankers would get together and take care of the problem, as you suggest, and I think the outstanding illustration is what Mr. Hoover tried to do in an emergency. That was the time when of all times they should have gotten together and helped these people in distress, and they refused to do it.

Mr. KAPLAN. Well, Congressman, I might add this footnote: That as to your statement that a good many bankers would be suspicious of the capital bank, and that a number would be opposed to it, I know from conversations with bankers that there is a basis for your doubts.

I also know that a good many of them have seen the merit in the plan. There are individual views that need to be ironed out.

But I reiterate that it is necessary to distinguish between the kind of coming to the aid of the country in a period of distress that you associate with the RFC or with Mr. Hoover's effort, and the continuing problem of having a channel for small business equity capital. I think the two have to be distinguished.

Mr. PATMAN. Excuse me.

The CHAIRMAN. Congressman Rich?

Mr. RICH. I yield to my colleague, who is a member of the subcommittee.

The CHAIRMAN. Congressman Herter?

Mr. HERTER. In connection with this very interesting suggestion that you have made, and which you have developed, it seems to me, extremely intelligently in this brief of yours, just how do you visualize this intermediate capital bank handling its portfolio?

I take it that it has to carry a considerable amount of equity paper of one kind or another, which is very unusual, and not traditional in the banking fraternity. Presumably it has got to carry a certain amount of it through thick and thin to make up for the obvious losses that it is going to have to take. Do you visualize that the management of a bank of that kind could operate very long without having political pressure brought on it very rapidly saying, "You are not adopting standard banking practice and being cautious. You are obviously trying to cut your losses by taking a form of mortgage of one kind or another from the businesses rather than equities," and eventually we get right back to the same place where those who are trying to do something for small business will say, "Well, the Government has to go in and just take losses in the operation."

Mr. KAPLAN. Well, my answer to that—perhaps it is only a partial answer—is that I believe that a bank of this sort can expect to operate as a self-sustaining bank and justify its existence by the fact that at first it keeps afloat, and that in time it learns how to make money for its subscribers.

I have in mind a bank that specializes in small business equities—whose clientele is referred to it usually by commercial banks that know something of the client—a bank which weighs the propositions competently can come out with a sufficient mixing of the more risky ones on which it charges more, and the less risky ones on which it takes less, so that on balance it will come out ahead. I do not see why a bank of that sort should have to yield any more to political pressure than does a commercial bank or than does the Federal Reserve System as a whole.

I am all for insulating the capital bank from the political pressure which is a two-edged sword and which eventually can nullify all that we are trying to do in getting a strong, vigorous, self-reliant base for small business.

Mr. HERTER. Do you visualize making it mandatory on the individual banks to subscribe, say, 3 percent of their capital and surplus for the setting up of what is really an investment trust, is it not?

Mr. KAPLAN. Well, it was mandatory for them to join the Federal Reserve banks, too, if they were national banks. Actually they were not taxed for the full amount, yet a good many of them balked at joining. Some of them changed from national to State banks.

I would expect the same sort of balking taking place. I would try to get it done on a voluntary basis, and if that did not work, I might make it part of the conditions under which a commercial bank is privileged to operate as such, that it also subscribe to the capital bank of its district, just as it subscribes to the FDIC. I think this is a case of moving in a desired direction, with the speed that is practicable, and making it work.

I have come across groups who wanted to start this sort of enterprise by themselves if the bank would not do it. There is a group up in the Northwest, and there is a business group in New England that has been interested. I would rather give the proposed instrument the sanction of being a part of the banking system, a known channel, so that the hundreds or thousands of people who would not know how to go to a detached group of individuals with their proposition, would be referred through regular channels to an agency that was set up for that purpose. I would not be squeamish about making subscription compulsory if the felt need could not be met otherwise.

I think that we ought to go out of our way to make sure that if there are legitimate promising enterprises that are not getting started because there is no channel through which they can get their proposition looked at, that we should have some machinery for doing that.

I believe we are all interested in a balanced economic structure in which we have vigorous small business, along with big business; and I say that despite the fact that I do not always regard small-business difficulties as a problem of small versus big business.

I think that we need capital banking in our banking system, in the interest of the whole structure. We need something in the way of a channel that will make it possible for any business or anybody venturing into business or a business requiring expansion or a business requiring a reworking and strengthening of its capital structure to get a hearing.

Mr. HERTER. What about the initial stages? Take the first 5 years of such an institution. It obviously has taken on as part of its capital structure this money from the bank. Then, it sold debentures to the Federal Reserve banks, as you indicated. Presumably it has got to meet fixed obligations of its own with respect to those debentures.

Mr. KAPLAN. Yes; I would assume it would get the debentures on favorable terms.

Mr. HERTER. Would you make them straight earning debentures, because otherwise would you not visualize where clearly a bank of this kind would be taking the risks, such as the normal banking community would not take? That is, it presumably has got to work out problems over a considerable period of time. It cannot make any quick turn-over from the point of view of its earnings in the initial stages.

I should think you would have a very difficult time to do it.

Mr. KAPLAN. Congressman, I think you would have to distinguish between the debentures that the capital bank itself would issue, and on which it pays interest—that is debt paper——

Mr. HERTER. That is right.

Mr. KAPLAN (continuing). And the business that the capital bank does for earning purposes for its subscribers.

We can go back to the British investment trusts of the nineteenth century, which were really capital banks, that started many profitable enterprises, and find two classes of subscribers: They had the debentures for conservative investors seeking a prior lien. These would be issued on 3½, 4 and 4½ percent; very seldom were they issued above 4½ percent. Then, they had their core of common shareholders who were interested in profits left over after the debentures were taken care of. The debenture money provided needed additional capital, but that was not the risk investment in the British investment trust; that was the senior bond investment.

Mr. HERTER. I was merely trying to examine the details here. But is it your suggestion that three-quarters of the capital should come from the debentures issued by the Federal Reserve?

Mr. KAPLAN. The three-quarters was in the IBA scheme. I did not set any fraction that would come from debentures. I merely said that as this bank developed and got set up, you might add to its privileges of rediscounting its paper or even issuing debentures.

I suppose that the best way to answer the question as to how a bank of that sort can handle a portfolio and come out on balance so that the sweets exceed the sours in the portfolio, is to call your attention to the fact that we are getting the going experiment in this sort of banking in two countries at the present time—England and Canada.

You will recall that the MacMillan report came out in the 1930's with a statement that more had to be done to conserve British small and intermediate business and, as a result of that report, the British and Scottish banks, as subscribers to the capital stock, set up the Industrial & Commercial Finance Corp., Ltd., which has now had a history of about 5 years.

For the same purpose, Canada came through with its Industrial Development Bank, which is under the Bank of Canada. It commenced operations November 1, 1944, but did not really get started until 1946; I have been following the semiannual reports of those operations to see how they are coming out; and while they have been rather cautious in getting started, and although Canada has not handled more than 1,400 cases so far, with about 400 outstanding at the end of 1948, and while the British have not had much more than that, nevertheless, they have found that they have been able to take care of some important areas of small business without cramping themselves.

I think it will take too much time to read the figures from these reports, but may I suggest that, if you are interested, and follow this early experience of the two countries that have launched an experiment similar to the one I am suggesting, have done it in principle, and while their methods were slightly different, you will see that it can be done.

The CHAIRMAN. May I interrupt, Dr. Kaplan, to suggest that you select some of those statistics, and put them into the record at the end of this testimony?

Mr. KAPLAN. Very good.

Mr. HERTER. It would be helpful.

The CHAIRMAN. It would be valuable.

Mr. KAPLAN. I will be very glad to do that.

(The information referred to follows:)

EXHIBIT I

INDUSTRIAL DEVELOPMENT BANK (SUBSIDIARY OF THE BANK OF CANADA)

(Excerpts from annual report to the Minister of Finance, fiscal year 1948, Ottawa, Ontario, December 9, 1948)

Method of operation.—Since commencement of its operations late in 1944, the bank has taken a number of steps to acquaint the public with the facilities it can offer, a subject which was dealt with in our first annual report. Descriptive pamphlets have been widely circulated through the Canadian Manufacturers' Association, boards of trade, chartered banks, and other organizations; and traveling representatives of the bank have visited a number of cities, other than those where our branches operate, in order to give prospective applicants the opportunity of discussing their problems at first hand and learning whether we can be of assistance to them.

I think it may be appropriate in the present report to mention again the kinds of enterprises which the bank can assist, the nature of such assistance, and the manner in which it is extended.

The purpose of the bank is to provide financial assistance mainly to small- and medium-sized enterprises which are demonstrably sound but which might not otherwise be able to get credit on reasonable terms and conditions. The bank is intended to supplement rather than compete with the activities of the chartered banks and other lending organizations. It may lend to firms engaged in the manufacture, processing, or refrigeration of goods, the building of ships, or the generating or distributing of electricity. It should be noted, however, that the bank is not empowered to make loans to primary industries such as farming or fishing, nor to trade or service establishments such as stores, garages, repair shops, theatres, etc.

The bank's loans are usually for capital assistance rather than for working funds and extend over a period of several years in contrast to the short-term loans typical in ordinary commercial banking. To enable it to extend this kind of assistance, the bank may accept any form of collateral security including mortgages on real property. The security requirements of the bank are not rigid and these, as well as the terms of repayment, are arranged to suit individual cases. Practically all applications are investigated at the applicant's place of business. In addition to satisfying the bank's requirements, the results of these investigations are often beneficial to the applicants, particularly the smaller and medium-sized enterprises, since they may result in suggestions for improvements in methods of operation, insurance coverage, and in accounting procedure.

Loans, investments, and guarantees.—The combination of high cost of capital development and the state of the market for various types of consumers' goods, in which supply is tending to outstrip demand, has made it desirable for the bank—both in its own interest and in that of its customers—to scrutinize applications for credit with ever-increasing care. The following table reflects this situation.

Number of applications dealt with

	Fiscal year—			
	1945 [1]	1946	1947	1948
Authorized	97	169	177	143
Refused	160	103	97	159
Withdrawn	228	105	113	89
Total	485	377	387	391

[1] 11 months only.

It will be noted that although the bank has received a slightly greater number of applications in this past year, the number authorized was less than the previous year, and the number of applications refused, greater.

Classification of loans, investments, and guarantees

A. BY INDUSTRIAL ENTERPRISES

	Gross amount authorized to date [1]	Gross amount authorized during the fiscal year 1948	Current authorizations at Sept. 30, 1948	Amount outstanding as at Sept. 30, 1948
1. Foods and beverages	$4, 111, 550	$1, 726, 450	$4, 017, 600	$2, 845, 270
2. Tobacco and tobacco products				
3. Rubber products	25, 000	25, 000	25, 000	25, 000
4. Leather products	615, 500	407, 500	597, 500	395, 118
5. Textile products (except clothing)	2, 393, 250	905, 150	2, 111, 600	1, 400, 456
6. Clothing (textile and fur)	1, 064, 825	311, 875	709, 200	437, 029
7. Wood products	3, 869, 873	1, 566, 473	3, 526, 050	2, 281, 319
8. Paper products (including pulp)	4, 101, 700	521, 500	3, 980, 700	3, 416, 625
9. Printing, publishing and allied industries	1, 197, 689	770, 689	1, 136, 000	918, 515
10. Iron and steel products (including machinery and equipment)	4, 360, 493	1, 731, 430	3, 732, 229	2, 698, 250
11. Transportation equipment	1, 111, 646	500, 300	993, 250	734, 619
12. Nonferrous metal products	35, 000	15, 000	35, 000	9, 111
13. Electrical apparatus and supplies	679, 500	519, 000	675, 500	406, 492
14. Nonmetallic mineral products	2, 269, 974	455, 750	1, 832, 000	1, 457, 243
15. Products of petroleum and coal	801, 000	405, 000	766, 000	543, 064
16. Chemical products	3, 112, 326	551, 500	3, 108, 500	1, 486, 538
17. Miscellaneous manufacturing industries	971, 743	423, 743	695, 000	329, 262
18. Refrigeration	2, 525, 205	1, 360, 455	2, 438, 250	1, 147, 532
19. Generating or distributing of electricity	95, 000	95, 000	95, 000	85, 000
Total	33, 341, 274	12, 291, 815	30, 474, 379	20, 616, 443

[1] Less cancellations and reductions in amounts authorized.

Statement of profit and loss for the year ended Sept. 30, 1948

INCOME

On Government of Canada securities:		
Interest	$293, 597. 29	
Less loss on sales	148, 849. 06	
		$144, 748. 23
On loans, investments, and guarantees		747, 152. 40
All other		1, 417. 17
Total		893, 317. 80

EXPENSES

Salaries	$265, 440. 26	
Pension fund and unemployment insurance	33, 467. 78	
Investigation and supervision expenses (including travel)	15, 131. 81	
Traveling expenses—general	10, 126. 87	
Rental and other costs—leased premises	29, 580. 15	
Depreciation of office equipment	4, 783. 05	
Telephones and telegrams	8, 281. 10	
Office supplies, expenses	12, 455. 21	
Directors' fees	3, 600. 00	
Auditors' fees, expenses	6, 000. 00	
All other operating expenses	9, 789. 43	
		398, 655. 66
Profit before deducting appropriations referred to below		494, 662. 14
Deduct: Provision to reduce Government of Canada securities to market value	$325, 950. 94	
Amount appropriated as reserve against loans, investments, and guarantees	134, 340. 12	
		460, 291. 06
Balance transferred to reserve fund		34, 371. 08

Statement of profit and loss for the year ended Sept. 30, 1948—Continued

RESERVE FOR LOSSES

Balance Sept. 30, 1947	$200,000.00
Appropriation from profits for year ended Sept. 30, 1948	134,340.12
Total	334,340.12
Less bad debts written off	34,340.12
Balance Sept. 30, 1948	300,000.00

RESERVE FUND

Balance Sept. 30, 1947	749,241.01
Amount transferred from statement of profit and loss	34,371.08
Balance Sept. 30, 1948	783,612.09

Statement of assets and liabilities, as at Sept. 30, 1948

LIABILITIES

Capital: Authorized, issued, and paid up—250,000 shares par value $100 each	$25,000,000.00
Reserve fund	783,612.09
Contingent liability under guarantees and underwriting agreements	3,080,524.60
All other liabilities	7,151.86
Reserve for losses	300,000.00
Total	29,171,288.55

ASSETS

Cash on hand and deposits with other banks	33,422.10
Government of Canada securities at values not exceeding market	8,224,413.67
Loans and investments	17,535,918.49
Guarantees and underwriting agreements as per contra	3,080,524.60
All other assets	297,009.69
Total	29,171,288.55

EXHIBIT II (a)

INDUSTRIAL & COMMERCIAL FINANCE CORP., LTD., LONDON

This is one of two corporations set up at the instance of Sir John Anderson as Chancellor of the Exchequer and Hugh Dalton, President of the Board of Trade. (1) The Finance Corp. for Industry, Ltd., concerned with large-scale industry; (2) the Industrial & Commercial Finance Corp., Ltd., concerned with the smaller enterprises.

Ownership.—Not a Government agency. Financed by a consortium of the Bank of England and the joint-stock banks of Great Britain. No Government assistance or subsidy. Organization, independent, controlled only by its own board of directors; conducted on a strictly commercial basis.

Capital resources.—Share capital equals £15,000,000. Additional capital of £30,000,000 available under borrowing powers (debenture issues).

Scope.—Finance of small- and medium-sized industrial and commercial businesses, especially where they do not have access to the stock exchange and investment bankers. New as well as established enterprises may be considered.

Test.—Whether the financing provided by corporation will increase the efficiency or production of the business. Not normally intended as an agency for refinancing operations. "The proprietors of any business so aided are expected to hold and retain substantial stake in their enterprise."

Range of financing.—"* * * any amount between £5,000 and £200,000 to any industrial or commercial concern operating in Great Britain which puts forward a sound proposal."

Cost of finance.—No fixed interest rate. In general, secured loans take 4 to 4½ percent. Unsecured notes and preferred shares at slightly higher rates. To avoid excessive interest rates, the company may take additional shares in payment of managerial oversight to protect the transaction. "The provision of finance at a very moderate cost is a feature of the corporation's policy. A small fee is charged, ranging from ½ to 1 percent on finance provided, and the legal costs of both the corporation and the applicant are borne by the latter when business results. If, by arrangement with the applicant, a professional firm were employed to make an investigation of accounts, the fees would be met by the applicant. Otherwise, the corporation is responsible for all its own expenses."

Financial policy.—To encourage increase in the financial strength of the business, "the Corporation is anxious that repayment of advances shall leave the business soundly established. It therefore encourages a policy of ploughing back a proportion of the profits remaining after meeting directors' remuneration, redemption sinking-fund payments, and reasonable dividends. This policy is encouraged even where the corporation holds participating dividend rights."

Source of proposals.—(1) Joint-stock banks, (2) professional firms, (3) direct application by prospective borrowers. No fee paid for introducing business.

Freedom of management.—While the corporation does not seek to interfere in management of a business which it finances, and while it would not finance a business where the corporation did not have confidence in the ability of the management, nevertheless the corporation maintains oversight to the extent of making requirements for certain types of information as to the progress and prospects of the business. The corporation's liaison officers visit clients which have been financed and discuss any new problems that may develop. Managements are encouraged to consult with the corporation on counseling facilities that may be available.

EXHIBIT II (b)

(Excerpts from Financing the Small Business: The ICFC at Work, by J. H. Lawrie, in the Banker, August 1946 (Mr. Lawrie was, until 1948, general manager, Industrial & Commercial Finance Corp., Ltd., London))

ICFC is breaking new ground, and the keynote of its policy is flexibility. Every case that is considered by the corporation's officials is examined, not simply from the angle of what will suit the corporation, but primarily to determine what type of finance the applicant really requires and the best way of providing him with it. Many of the inquiries received by the corporation are based on a misunderstanding of its functions, and in such a case the inquirer is advised that the most suitable place to which to apply is a bank, a building society, an insurance company, a hire-purchase finance company, or any other person or institution to whom the inquiry should more properly be addressed. In this way a good deal of assistance is given to people whose needs do not lie in the corporation's field at all but who are simply unaware of where they can obtain the assistance they need. When it is clear, however, that an application is one which is not only in ICFC's field but also deserving of support, the first point to be considered is what type of finance is most suitable for the applicant's needs.

Broadly speaking, applications can be divided into two classes: money is required either to cover the cost of reequipment or reconversion, or else to finance a permanent expansion. Applicants in the first of these two classes usually expect to be able to repay out of profits any sums that they borrow, and a fixed loan, either secured or unsecured, is the probable answer. If it so happens that part of the finance is to be provided by unsecured bank accommodation, the finance provided by the corporation may take the form of redeemable preference shares, or may be part-mortgage, part-preference shares. If a company which applies for finance is a wartime mushroom growth and the problem is really one of conversion rather than of reconversion, there is likely to be a considerable degree of risk in the new finance, and participating preference shares may be the most desirable way of providing it.

The second of the two classes covers a variety of types, including both new companies and those that expect eventually to become public companies but are not yet ready for this step. If a company is likely to appeal to the public for capital at a later date, the corporation's finance is designed so that it can be repaid when the public issue takes place.

With the other companies in this class, the problem is somewhat different. What they usually require is permanent, or at least long-term, capital. The corporation has found from its experience that many small private companies that are, in fact, family businesses expect both to grow big on borrowed money and, despite high taxation, to repay borrowings out of profits within relatively few years—two things which are more than likely to be incompatible. They also often prefer to borrow against a debenture, even at a higher rate of interest, than to issue shares to someone outside the family. The corporation usually attempts to show such people that this point is less important than having a balanced capital structure, and that it is very unwise for a small business, especially in its early stages, to be highly geared and weighed down with prior charges.

It is on this question that ICFC's relations with the banks are of great importance. The banks are the corporation's shareholders, and this fact places it in a very special relationship to them. Nonetheless, certain customers appear to think that the corporation exists to lend them money at lower rates than they are at present paying their bankers. Such customers are quickly disillusioned. It cannot be too often stressed that the corporation is in no sense in competition with its own shareholders.

Before the corporation was formed, the clearing and Scottish banks made an announcement to the public about its impending formation, and this announcement was accompanied by an aide-memoire for the press which contained the words: "As a matter of principle, a deposit bank should not advance money on long term, but its lending policy should have as its main object the temporary augmentation of a borrower's floating capital rather than the provision of funds to be invested in permanent assets." On this principle—if duly observed both by the banks and by the corporation—there can be no question of competition. The corporation is intended to supplement the activities of the banks and of other institutions, and cooperation with the banks is bound, in the long run, to be in the interests of the customers, as well as of the corporation and of the banks themselves.

It follows that when a company that is really in need of long-term capital suggests to the corporation that, if the balance sheet and the prospects do not justify an unsecured loan, the corporation should take a charge over fixed and floating assets, the normal reply of the corporation's officials is on these lines: "If we lend you money to build a new factory and to buy new machinery, you will certainly require additional working capital to finance the increased turnover that will result from the acquisition of these fixed assets. The natural person to supply you with this working capital is your banker, but it does not seem likely to us that your banker will lend you anything if we have taken a charge on all the assets of the company."

When faced with a problem of this kind, ICFC usually has recourse to one of the two following methods: It can make its contribution partly on mortgage on the factory and partly in preference shares; this leaves the floating assets free as security for the bank and strengthens the company's position from the banker's point of view by injecting more capital. This method has been used sufficiently often in conjunction with several of the banks to become known as the ICFC sandwich. On the other hand, it may seem undesirable to saddle the company with a mortgage to the corporation and a floating charge to the bank; if so, it may be preferable that the whole of the ICFC contribution should be in the form of share capital. In the case that is being discussed, it was a primary assumption that the balance sheet and prospects did not justify an unsecured loan. It is clear, therefore, that an investment would be justified only if there is a prospect of reward commensurate with the risk. This can be assured by an issue to the corporation of participating preference shares or, perhaps, a large parcel of preference shares and a small amount of ordinary shares.

As all ICFC's loans or investments are for medium or long terms, it is important that the corporation—and this applies especially where it has a shareholding which is a substantial proportion of a company's total capital—should keep in close touch with its customer's activities. and for this purpose the corporation has started a liaison department, whose officials will be constantly traveling about the country visiting the various customers, giving them advice when they seek it, and watching on the corporation's behalf for danger signs that may indicate the probability of trading losses or other troubles.

The advisory functions of the liaison department will also, it is thought, be important. Amongst the many applications received the most common is that of the company which, before the war, was quite a small family business operating in something not much more than a garage or back room, and which grew during the war into quite a large unit executing considerable orders for the Ministry of Supply or the Ministry of Aircraft Production. If there is a good reason why a business, having grown big during the war, should remain big, then ICFC may be able to help, but safeguards are necessary. The people may be good at their job, but they may have no idea how to run a big business. Many people who come to ICFC realize that during the war they have been nurtured on progress payments; they have had no sales problems; and for countless other reasons they have had no experience of running a business of the size which, more or less by chance, they have attained. Such people are often eager to receive advice from ICFC's liaison department, and, in the long run, this may well prove one of the most valuable services rendered to industry by the corporation.

Applications to ICFC have been flowing in, not only in a steady stream but at an increasing rate, throughout this year. Even when allowance is made for the fact that many of them are due to reconversion, it still seems certain that there is likely to be a lasting demand for the facilities provided by the corporation. The staff now numbers 40 and the organization is being built up on the assumption (which could not safely be made until some months' experience had been obtained) that ICFC is not merely a "morning glory," but has for many years to come a definite and important part to play in the financial structure of the country.

EXHIBIT II (c)

(Excerpts from report of the chairman, Lord Piercy, at the third annual general meeting of the Industrial & Commercial Finance Corp., Ltd., December 7, 1948)

The comparative analysis which will be found on the back of the accounts (see below) shows that, in the 12 months ended September 30, 1948, confirmed advances and investments rose by about £3,000,000 to £13,500,000, and cash invested in loans and shares by about £5,000,000 to £10,750,000. The figures are net after deducting repayments and redemptions. The latter amounted to £650,000 at September 30, 1948, showing that our funds are beginning to revolve. The net increase in business would have been larger but for heavy withdrawals, during the year, of business approved, and for the most part confirmed. These withdrawals, due to impediments to the fulfillment of investment plans and unforeseen changes of circumstances, exceeded £2,000,000.

[In addition to the provision for income tax] We have provided a further £135,000 for bad and doubtful debts, bringing the total provisions in the balance sheet to £275,000. The new total arises from a careful review and assessment of possible losses, and is the provision which we believe to be necessary at the present time.

After making this provision, and making the appropriate adjustment of tax liability at the 30th of September, the account balances, with a trifle on the right side.

From now onward, the corporation's revenue should continue to cover its operating expenses with a margin sufficient for making any reasonable provision currently required for specific bad and doubtful debts. If this opinion is well founded, and I think it is, the first stage of building up this new financial instrument—the achievement of viability—has been accomplished.

The second stage—building up the general reserves which are needed in this business—will take much longer.

The corporation was formed, of course, for the precise purpose of meeting the difficulty which private companies, and the medium and smaller companies, often experience in obtaining their capital requirements, now that the private investor no longer plays an important part in providing capital and undertaking risks in this field and taxation has so severely limited the possibilities of accretion. Accordingly, as and when opportunity offers, our facilities will be brought to the notice of small- and medium-sized manufacturers and of companies who, for one reason or another, or because of the state of the market, are not easily able to avail themselves of the facilities of the issue market.

On the broader aspects of capital investment in this country, it is satisfactory to observe the Government's estimate that, over the next 4 years, 20 percent of the gross national product will be devoted to the investment program. Apart from a relatively small group of important industries, British manufacturing industry, in the last 3 years, has, on balance, hardly caught up with deferred maintenance and essential replacements arising from the war. There should now be scope for plans for modernization and for increased capital formation in the way of plant and machinery. To achieve these ends in the bulk of the manufacturing industry, which consists so largely of concerns of moderate size, fresh initiatives are needed. Is it too much to hope that in part these may still arise out of the labors of the working parties?

During the year, our relations with other institutions of the capital market have been developed in a friendly way, and have led to fruitful cooperation in a number of instances.

Our relations with the liaison officers of shareholding banks are excellent, and we owe much to their collaboration, which has become an integral part of our operation.

Our thanks are also due to the members of the Scottish Committee, who have assisted us with valuable help and advice.

The staff now numbers 60. It includes, naturally, a large proportion of highly qualified specialists. Its enthusiasm is higher than ever, and a corporate loyalty has developed which is of good import for the future.

Funds outstanding analyzed by types of facilities

	Year to Sept. 30, 1946		Year to Sept. 30, 1947		Year to Sept. 30, 1948		Total at Sept. 30, 1948	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Secured loans	443,000	35.8	1,169,400	26.1	2,260,300	44.7	3,872,700	35.9
Unsecured loans	301,300	24.3	1,545,100	34.5	1,362,800	26.9	3,209,200	29.9
Preferred shares	194,900	15.8	1,144,200	25.6	772,700	15.3	2,111,800	19.6
Participating preferred shares	288,000	23.2	192,600	4.3	295,900	5.9	776,500	7.2
Ordinary shares	11,800	.9	425,700	9.5	363,500	7.2	801,000	7.4
Total	1,239,000	100.0	4,477,000	100.0	5,055,200	100.0	10,771,200	100.0

Classification of total business approved by industries

Industry	Amount (£000)	Percentage of the whole	Industry	Amount (£000)	Percentage of the whole
Mechanical engineering:			Iron founding	165.4	1.1
Agricultural machinery	625.0	4.2	Hand tools and cutlery	384.9	2.6
Machine tools	341.0	2.3	Bolts, nuts, etc	6.0	
Prime movers	567.3	3.8	Hardware, hollow ware and sheet metal	428.1	2.9
Printing machinery	58.0	.4	Watches, plate, jewelry	224.0	1.5
Textile machinery	271.4	1.8	Other metal industries	795.0	5.3
Cranes, hoists, and winches	183.5	1.2	Textiles	1,132.1	7.6
Food machinery	14.0	.1	Leather	58.9	.4
Pumps	410.0	2.8	Clothing	341.4	2.3
All other machinery	555.3	3.7	Food, drink, etc	223.7	1.5
			Woodworking	106.5	.7
Total	3,025.5	20.3	Building, etc	190.7	1.3
			Paper	332.2	2.3
Agriculture	185.0	1.2	Printing and publishing	160.0	1.1
Mining and quarrying	7.0		Rubber	170.1	1.2
Cement, lime, etc	210.0	1.4	Plastics	321.0	2.2
Bricks, tiles, pipes	210.5	1.4	Scientific instruments	110.0	.7
Pottery, earthenware	145.0	1.0	Other non-metal industries	120.2	.8
Glass	15.0	.1	Transport	162.9	1.1
Chemicals	1,271.7	8.6	Distribution	1,726.1	11.6
Paint, color, varnish	9.9	.1	Hotel and catering	6.0	
Iron and steel	235.0	1.6	Laundering, dyeing, etc	27.8	.2
Nonferrous metals	337.5	2.3			
Electrical engineering	1,080.6	7.3	Total	14,867.8	100.0
Vehicles	942.1	6.3			

Mr. Herter. One other thing I would like to ask you: I suppose you feel that these banks could take equities which were unregistered equities, but small business would not have to go through any formalities with the SEC.

On the other hand, what would the position of that bank be if in the shifting of its portfolio holdings it tried to dispose of that to a variegated number of clients, if they were not registered? That registration, as you have pointed out, for the small issuer of equities is a hideous burden. It is so great a burden that they duck it every way they can.

How would you handle that equity situation?

Mr. KAPLAN. Well, it seems to me that it could be put on the basis that an application to a capital bank which the bank authorized, if it was below a certain limit, let us say $500,000, would not require registration. Indeed, it may be argued that the exemption of small issues from registration should be made general, and present exceptions eliminated, regardless of the question of capital banks.

Mr. HERTER. Well, make that universally applicable?

Mr. KAPLAN. Yes, make it universally applicable. The principle need not be restricted to the capital bank. All of the early thinking in connection with the SEC was that $300,000 was a limit below which registration was not needed.

The CHAIRMAN. That is the SEC limit now.

Mr. KAPLAN. Yes, provided that certain other conditions are also met.

Mr. HERTER. I think you have made a real contribution, Dr. Kaplan.

The CHAIRMAN. Congressman Rich?

Mr. RICH. Doctor, where would you define the difference between small business or individual business, and a large business?

Mr. KAPLAN. There are two ways of defining that: The one that I suppose would be the easiest to stick to, if you put limits on size of business that a capital bank would be concerned with, would just be to put a figure. I would be inclined to say that any business with a hundred or fewer employees, or with sales of a million dollars or less per year would be in the small business category.

Now, it is not tiny business, but it is the kind of business we are trying to encourage because it is independent enterprise in which the management is very close to its employees, and in which you have a direct relationship between ownership and management in which you are interested.

Now, you can go beyond that, of course, and get larger businesses that look like small businesses. A million dollars in sales might be very small for a wholesale house in some lines, where two transactions a month might amount to that.

So, I realize it is very hard to draw the line, but you could in terms of that sort.

Beyond that, you might say that even if a business has gone beyond that amount in sales or in number of employees, you might still call it a small business, if it has owner management, if it has that closeness of the owners to the operation, and if it is in an area of business in which that is the smallest business that could possibly exist in the area and, of course, in an industry like the automobile industry, a $50,000,000 industry would probably be too small to operate, so it is very hard to pin it down.

Mr. RICH. Well, is it not a fact—you say we have business enterprise for every 38 people. Therefore, the great number of business enterprises in this country would comprise the employment of less than 10 people, evidently.

Mr. KAPLAN. Oh, yes; one-half of all the enterprises have less than one employee; they have no employees, just the proprietors.

Mr. RICH. I would consider that anyone who employs 100 people, and does a million dollars worth of business, is a pretty good-sized business.

Mr. KAPLAN. I would say it is pretty good sized. It could be pretty good sized, and still represent a dividing line for purposes of definition.

Mr. RICH. Well, what do you consider the greatest necessity for the success of any business?

Mr. KAPLAN. I suppose management would be the——

Mr. RICH. Certainly. It would not be anything else but management.

Mr. KAPLAN (continuing). First, certainly.

Mr. RICH. All right, now, if you have management and you employ—let us get down to—15 people or 10 people and less, and you have the proper management, the individual who is operating that business, how many hours a day, as a rule, would he have to spend on the job to make a success of his business?

Mr. KAPLAN. I really do not see the relationship between the number of hours and success. I know many who have failed in business who worked 16 and 18 hours a day.

Mr. RICH. Sure, I do, too; but I do not know anybody who has made a success—do you know of anybody who has made a success and who has worked 8 hours or less, and operated a business that was supposed to be successful as a business?

Mr. KAPLAN. I would hate to admit it, but I do know some like that; but I think I agree with your point generally, Congressman, that you have to put yourself into a business. Certainly, in 999 cases out of a thousand, you have to put yourself completely into it with, perhaps, no thought of hours, if you are going to make a success of it. I follow your point; yes, sir.

Mr. RICH. The point I am trying to bring out here is that management is the success of any business, and the fellow who wants to make a success of his business has got to work at it. It is not going to run itself.

Mr. KAPLAN. To be sure.

Mr. RICH. You can get the very best business in the country, inherit it, and have it running for a short time, and the momentum of itself will keep up; but, if you do not look at it yourself, you are going to fail.

Mr. KAPLAN. Congressman, I tried to say in my testimony that I do not feel that financing a loan in distress situations is going to save a business.

I pointed out that the management must go with it. I would also like to repeat again what I said in testimony with regard to size of business.

If we have 4,000,000 businesses in this country, and there are nearly 2,000,000 of them that have no employees, the problem of "equity capital" floating through a capital bank is not the problem with those people. Those are people who very often come into a business on their own, we will say, as an odd-job building contractor; if they cannot get a job, they come in that way. As soon as they can get a job, they are out of business, and they become employees. That kind of turn-over is not the sort of thing we are concerned with, and the average very little fellow really worries less about "capital equity" structure than those who have employees and have a substantial business.

The area that requires our attention is the kind of small business that really can compete with larger businesses. It is the area between 8 and 100 employees, we will say, and in some cases, even a little more than a hundred employees; that represents vigorous independent business enterprise that may be stumped for lack of attention with respect to a real capital problem. That is the key area.

It does not add up to millions, but it adds up to a core of 150,000 units that are the very heart of independent enterprise; and, if in that area we need real attention to this problem of improving the capital structure, I think that is very important for us to gêt at.

Mr. RICH. Well, I quite agree with you in that, and yet I happen to sit from time to time on a board of directors of a bank. We have people coming in there and making applications for loans.

Mr. KAPLAN. Yes, sir.

Mr. RICH. And, when they come in there, what do we consider first? We consider the man himself and his ability to put himself to the task in which he is trying to make a success. Is that not it?

Mr. KAPLAN. You certainly do that, but you also look at his current ratio, and you look at his general ratio of assets to liabilities; and, if the whole structure is shoe-stringy and there is nothing to build on, if something should happen to the man, you know that the capital structure is too thin for you to go very deeply into a loan; and, while you might give him 60 or 90 days, you are not going to give him a 1- to 3-year loan on that kind of basis.

Mr. RICH. On the other hand, the bank is just as responsible for its capital, because it is investing somebody else's money. The banker is not investing his own money.

Mr. KAPLAN. I pointed that out.

Mr. RICH. He is looking after somebody else's money.

A lot of banks fail. Why do they fail? They fail because some of the assets they had or the moneys that they loaned, they were not able to get back, and those fellows were condemned and damned by the Government because they let their banks fail, and the Government stepped in and closed them up.

Now, good, honest, conscientious men, the finest men I know of in this country, were in banks that failed, and they have been ruined and wrecked because they were not able to withstand the demands that were made upon them at the time by the people who wanted to take their money out.

So, the bankers have that to consider; do they not?

Mr. KAPLAN. Yes; and I tried to avoid putting it on the basis that the commercial banker has horns. I don't have that point of view.

I do not think that is the issue; I do not think the problem is with short-term credit or with lending in the ordinary turn-over sense. The problem is with getting the necessary equity capital or permanent capital for expansion or development or reorganization so that the small business is soundly financed, so that it can go to the commercial bank and show a statement that, coupled with character, would enable you to give credit.

Mr. RICH. Then, you want to take the Government and put it into the business of loaning money, and assume the responsibility. You want to put it up to the taxpayers, if there is a deficit and it cannot meet its obligations, the taxpayers have got to pay the bill?

Mr. KAPLAN. Congressman, I do not know where you could have gotten that from my testimony.

Mr. RICH. If the Government organization sets up an agency to loan money, and they loan money at 2, 3, 4 percent, cheap money, as you spoke about a while ago. If they loan that money, and if the politicians come in and say, "Here is a friend of mine who wants to borrow money, you ought to loan it to him," the chances are that the taxpayers will have to make up any deficit we might have in the banks that we set up if we have losses.

The CHAIRMAN. Congressman Rich, I think you misunderstand the witness. He did not testify with respect to the recommendation of Government loans at all; did you?

Mr. KAPLAN. I thought that I did quite the contrary.

The CHAIRMAN. That is what I understood.

Mr. RICH. I thought he reached the point of the setting up of a Government bank.

Now, we had a Government bank here in the guaranteeing of crop loans, and we put in $50,000,000. We lost that. We put in $25,000,000 more; we lost that. We operate today, but we cut it down, and we are trying to get it on a firm basis.

The CHAIRMAN. But he did not recommend that.

Mr. RICH. Well, he recommended that we establish a Government loaning agency.

The CHAIRMAN. No.

Mr. RICH. For small business.

The CHAIRMAN. He did not at all.

Mr. RICH. I understood that from his report.

The CHAIRMAN. Well, ask him if he did.

Mr. KAPLAN. I thought I contrasted my suggestion with a Government capital-lending agency, and indicated that I thought that within the area of private banking we could provide this additional channel that would take care of the equity banking that I do not say a commercial bank should undertake.

The CHAIRMAN. He is on your side, Congressman.

Mr. RICH. All right. Who would establish that? How would you establish that?

Mr. KAPLAN. I would establish it as part of the commercial banking system, not of commercial banking, but as part of our private banking system, with the commercial banks subscribing a portion of their capital into district capital banks.

The CHAIRMAN. In order that you may not be misunderstood, you do not want to compel them to do it, you are merely suggesting that the opportunity be created by law to permit such a thing if private banks want to do it.

Mr. KAPLAN. That is correct, Senator, except that when Congressman Herter said, "Would you go so far as to compel them?" I am not precluding that possibility as a last resort, if there were no other way of getting it; but I would not want to start with it on the basis of compulsion.

Mr. RICH. I am glad that I am corrected on that because I inferred you wanted the Government to set up that bank, and I apologize for even thinking that you would want the Government to do that.

Now, the human element that enters into an operation of an institution of that kind is a very difficult one to define, and to regulate by law, and it would be pretty hard to do that, would it not?

The CHAIRMAN. Dr. Kaplan, that bell indicates that it is a quarter of 12 and I think members of the committee may have to go to the floor. Would you be available later on? I have made so many notes on what you have said—you have been so stimulating—that it would be utterly impossible for me to cover some of the things I would like to raise in the short time now available.

(Discussion off the record.)

Mr. PATMAN. May I cover one point which will not take more than 2 minutes?

The CHAIRMAN. Yes, Congressman.

Mr. PATMAN. The number of businesses in our country, a large percentage of these businesses is represented by retail stores, is that right?

Mr. KAPLAN. Yes.

Mr. PATMAN. About 50 percent, something like that?

Mr. KAPLAN. Not quite that, but it is the largest segment of small business.

Mr. PATMAN. Approximately 50 percent. Now, the reason I am disappointed in your recommendation, Dr. Kaplan, is because it is not accompanied by a recommendation that would give these little fellows security. You can make all the credit in the world available to them—and they have it now; the Federal Reserve can make direct loans, the Federal Reserve banks, the RFC, local banks, they have plenty of sources of capital, if they have security, but they have no security.

As long as an absentee owner can come into their local community and destroy their business, why, they have no security that a bank would extend loans on, so I think that, No. 1, is to get something done so that there will be small-business security against these Captain Kidds in business and industry; give them some protection. Until we do that, I do not care how many set-ups we have, it will never work. That is just my view.

The CHAIRMAN. Most of our discussion apparently has resolved around the debt financing instead of the equity financing.

Mr. KAPLAN. That is right.

The CHAIRMAN. I was interested in your testimony that the local development corporations have apparently not been strikingly successful; that the Filene attempt was abandoned in 1943, and that some sort of a recommendation was made by Filene for Government intervention, and that the small business committee of the Investment Bankers Association had suggested the establishment of an institution which would operate through the Federal Reserve or in working with the Federal Reserve to provide capital.

But I am more concerned about what we can do or should do to stimulate the investment of private capital in little and local enterprises, and those are the points that I would like to go into with you a little bit later.

Mr. KAPLAN. I will be very glad to wait.

The CHAIRMAN. Mr. Geier, would you be good enough to take the stand?

STATEMENT OF FREDERICK V. GEIER, PRESIDENT, THE CINCINNATI MILLING MACHINE CO.

Mr. GEIER. Shall I proceed, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. GEIER. My name is Frederick V. Geier. I am president of the Cincinnati Milling Machine Co., builders of machine tools.

Our company has been in the business for 65 years.

The CHAIRMAN. How long have you been connected with the company, Mr. Geier?

Mr. GEIER. I have been working there 33 years.

The CHAIRMAN. You were not president all of that time?

Mr. GEIER. Fifteen years as president; yes, sir. My first association was as a small boy.

The company builds power-driven, metal-cutting machines; including milling machines, grinding machines, broaching machines, cutter-sharpening machines and other machines and related products used on production work, in toolrooms, and for repair and maintenance in a wide range of industries.

These industries produce automobiles, tractors, electrical machinery and electrical appliances, office machines, sewing machines, construction machinery, printing presses, shoe and textile machines, aviation, marine and transportation equipment, Diesel and gas engines, ball and roller bearings, as well as a wide variety of consumer and durable goods.

The machines we build range in weight from 900 pounds to 78 tons, and in power from one-third to 250 horsepower. They mill a tiny piece in a sewing machine, or the main frame of a Diesel locomotive. They broach a part in an electric razor, or an automobile cylinder block. They grind the 65-ton steel mill roll to a precise mirror finish, and they grind the sutures used in eye surgery, to be smooth and round and exactly 0.004 inch in diameter.

Our firm is primarily a group of able engineers and skilled machine-tool men, over 500 of whom have been with the company and who have had more than 20 years' experience with the company.

My own activity in the business has extended over 33 years, the past 15 as president of the company.

To make our living we must develop, design, and build machines that will lower costs, increase output, and improve quality for the industries which invest in productive equipment. Our jobs and our living depend on a healthy and growing industrial economy in America. We plainly see the necessity of stimulating and maintaining healthy levels of investment in equipment of increasing productivity. This is a basic necessity as a means of sustaining and raising the American standard of living, as the foundation for the security and defense of the Nation, and for the general welfare, vitality, and progress of our economic way of life.

Besides access to raw materials, which America has, a vigorous, advancing economy depends on three primary factors. These are:

1. Management skill and resourcefulness in engineering, in production, and in merchandising.
2. Productive tools and equipment, frequently renewed.
3. A spirit of enterprise and risk taking.

If enterprise and risk taking are discouraged, if know-how in engineering, production, or merchandising fails to keep pace, or if machinery and tools become worn and obsolescent, the economy will become static and the standard of living will suffer. If any one of these three factors—risk taking, know-how, or equipment—lag, there can be no vigorous, advancing economy. In Great Britain the transition from the vigorous economy of the nineteenth century to the comparatively static economy of more recent years has been one of the major factors in contributing to the current economic difficulties of that country.

How do we measure up in the United States today? Our management know-how in engineering, production, and merchandising has continued to advance. Our spirit of enterprise and risk taking has, I am sorry to say, been under something of a cloud. We have developed machines of advanced productivity, but America is falling behind in keeping its machine-tool equipment up to date. During the 1930's the industrial equipment of the Nation was not being replaced as fast as it became obsolete or wore out. The deficiency in replacement of capital goods during the period was variously estimated at from $50,000,000,000 to $75,000,000,000, without providing for the needs of a growing population or an improved standard of living.

Actual figures, however, are available showing the number of over-age machine tools in use in the United States by 5-year intervals from 1925 to 1945. In 1925, 44 percent of the machines in use were over 10 years old. The percentage of over-age machines rose to 49 percent by 1930, to 66 percent by 1935, and to 72 percent by 1940. Notwithstanding the huge production of over 700,000 machine tools during the war period, by 1945 the percentage of over-age machines, inclusive of war surplus machines in storage and in reserve, had only been reduced to 38 percent, while of those installed in private industry 54 percent were over 10 years old. A corresponding survey to be concluded late this year could show an interruption of the obsolescent trend at the moment, but unless there is a very large step-up in the building of new machine tools, in about four more years the percentage of machines in use over 10 years old will be at record high. This simply means that a smaller percentage of American industry's machine tools will be up-to-date than ever before.

The facts as just given present the picture in a more favorable light than is justified. This is because the data are based only on the physical age of the machines. When account is taken of the up-to-dateness of design, the results are even more disquieting. The reason for this is that during the war period the great bulk of all the new machine tools built were necessarily of designs current immediately prior to the war. These embodied features of construction and tooling methods largely prevailing during the 1930's. With the gathering of war clouds over Europe and the first stirrings of defense needs in the United States, the insistent demand for machine tools resulted in the virtual freezing of design of the standard machine tools. Not until after the war was over could the normal processes of redesign be resumed. As a consequence, the great wartime output of machine tools was largely of machines of prewar design type. No appreciable numbers of postwar design machine tools were built until after the machine-tool show of September 1947 and, as a result, fully 95 percent of the machine tools in use in the United States today are basically over 10 years old in design.

In March 1943 the United States Department of Commerce published a book, Markets After the War. Under assumed conditions of full employment, in a typical postwar year, the demand for machine tools was estimated at $945,000,000. Although the Nation's economy and employment were running at high levels in 1946, 1947, and 1948, the actual shipments of machine tools, including exports, were only $335,000,000, $306,000,000 and $288,000,000 respectively, or an average less than one-third the Department of Commerce estimate.

In spite of the high operating levels of the economy, the percentage of the gross national product invested in new machine tools has been below the level of the comparable years in the 1920's and the 1930's. The rate at which business management is buying machine tools is the acid test of business appraisal of the prosperity health of the economy. Management's first responsibility is to maintain the business as a going concern, in order to preserve the livelihood of employees and the savings of shareholders. Feeling a sense of trusteeship toward employees and shareholders, management endeavors to follow prudent principles in deciding on capital investments. The principles of prudent investment demand consideration not only of the estimated return, but careful weighing of the economic, social, and political outlook as factors affecting the safety, soundness, and wisdom of the investment. For example, the level of taxation is a vital factor. Similarly, rising levels of government activity and spending are very serious factors because they foreshadow even higher tax burdens. Another major factor is the level of profits and the outlook for profits adequate to support a vigorous advancing economy.

The factors affecting investment in, and replacement of, machine tools are varied, but a major deterrent arises from Federal income-tax depreciation-rate policies. America has led the world because Americans have had more and better tools, and used them more productively. But, to maintain a high standard of living, tools have to be replaced as fast as they wear out and whenever more productive new tools are available. Instead, tax regulations practically condemn America's tools to grow old and rust away. The usual way to provide replacement of tools and equipment is by depreciation, an annual setting aside on the books to build up a replacement fund. If enough depreciation is taken, machinery and equipment can be kept up to date. The trouble is, Federal income-tax policies arbitrarily force business to stretch out depreciation beyond the normal productive life of the machine. This blocks purchase of new equipment and keeps old and obsolescent equipment in operation long beyond its time. Whatever blocks the replacement cycle needed to keep America out in front, unfortunately, also penalizes the earning power of every American as a producer, and his cost of living as a consumer as well.

If only 80 percent of the 1,700,000 machine tools of prewar type in American plants operate only 40 hours per week for only 40 weeks out of the year, at a direct cost of only $1.25 per hour, and if they could be replaced by new postwar-model machines rated an average of only one-fourth more productive, then the cost of production on existing machine tools is over $500,000,000 per year too much.

It is time to take the brakes off of equipment buying needed to keep America up to date.

The CHAIRMAN. Congressman Herter?

Mr. HERTER. I take it that the real essence of this statement of yours with regard to keeping our productivity up to date through the machine-tool industry is in our tax structure, particularly on the depreciation allowances that the Treasury now permits.

Have you thought through, yourself, what you would recommend from the point of view of depreciation allowances, taking account of two factors: One, your actual wear and tear, and the other the obsolescence, which would be a fairly difficult thing to figure in a competitive world?

Mr. GEIER. Well, if we could go back to more flexibility so that depreciation rates could be based upon the conditions in the user's plant rather than have them limited to the degree they are by present policy, that would be the main thing.

Mr. HERTER. Now, in flexibility, you mean allowing the individual manufacturer to use his own discretion?

Mr. GEIER. That is right, according to the conditions in his plant.

Mr. HERTER. With the idea that sooner or later the taxes—assuming they remain reasonably level—will catch up with him, whether he takes his depreciation all in 5 years or whether he takes it over a longer period of time, so that the Treasury will not be the loser?

Mr. GEIER. In the long run it will make no difference to the Treasury, unless there are great changes in tax rates. In fact, I think the Treasury would benefit, because, if you had more productive equipment installed, the costs would be lower; corporate profits would be higher, and more taxes would be collected, unless the savings were all passed on to the consumer, which, I think, we would all like to see, anyway.

Mr. HERTER. You are making machine tools that are better and better all the time. From the point of view of the durability of metallurgy, how can you justify the manufacturer to toss them all overboard because of the obsolescence in design for a more productive one in a very short period of time?

Mr. GEIER. Well, if he has to take a very low rate of depreciation, then, when new and more productive machines come along, he is faced with substantial excess remaining value on the books. But if he could take a more realistic rate, then he would welcome improved and more productive machines because he would put them in and lower his costs. I do not know whether you want me to take time here to give instances of the savings and increased productivity of the newer model machines over the old ones, but I tried to make a conservative statement in the illustration I gave of the half-a-billion-dollar excess production cost of use of existing equipment over what new equipment of postwar design will yield.

You notice I reduced that from one-third more productive to one-fourth more productive. Yesterday I asked a question of an engineer in one of our very prominent American companies—what, in his opinion, was the increase in productivity of postwar machine tools over prewar—and he said, well, fully 40 percent in their experience.

Of course, the same company will not consider a purchase today unless they can get their money back in 24 months. They expect a very high increase in productivity to make any purchase at all at the present time.

Mr. HERTER. Is that because they are balancing the cost of getting the money as against the smaller percentage of productivity? Why do they have to see a 24-month turn-over, so short a turn-over?

Mr. GEIER. Well, that expectancy of customers varies at various times in the business cycle. A recent survey showed that 74 percent of the customers of a certain group of firms expected to get their pay back in 3 years or less, and 90 percent of them expected they would have to get that back within 5 years.

If they feel confident about the long-range outlook, then they do not demand as short a pay-back period. We have a classic example of a recent survey of savings that could be made in the plant of an important American company which would have returned the entire cost of replacing 24 machines by 14 machines in $3\frac{4}{10}$ years. They would not make the purchase. The reason was that, while their financial condition would be considered normal, they thought, in view of the outlook, and some of the basic trends in the country, they would have to put themselves into a stronger financial position before they could invest money, even if it would pay itself off in $3\frac{4}{10}$ years.

Mr. HERTER. Have you any idea how much depreciation they had taken on the equipment they had at the time they made that decision?

Mr. GEIER. It is possible that I might have the data here on it. I can give you the ages of the machines to be replaced: Two were 26 years old, one was 25, one was 23, two were 22, four were 21, two were 20, two were 19, two were 18, one was 14, one was 13, two were 11, two were 9, one was 8, and one was 4 years old. Twenty of the machines were over 10 years old, and all were of prewar design.

I would say that they had been pretty well written off.

Mr. HERTER. If they had pretty well written off the depreciation, then presumably the value of the original machine would not set up any reserve for replacement services.

Mr. GEIER. The failure of these people to go ahead in this case, I think, was based upon their concern over the general business outlook.

The CHAIRMAN. Mr. Geier, what reason have you to believe that if there were modification of the tax law so that accelerated depreciation would be allowed on machine tools, the manufacturing industry would take advantage of that to purchase new tools of modern design?

Mr. GEIER. The reason most frequently given by customers for not going ahead with purchases at the present time all centers around the inadequacy of depreciation allowances, and a survey that was made recently showed that, of the various steps which might be taken, such as reducing Federal taxation or providing easier equity financing, more users said a change in depreciation policy would free them in their purchase of equipment than any other one thing.

The CHAIRMAN. Do manufacturers, then, as a whole, indicate to you that they would buy the new machines?

Mr. GEIER. We think so, because of the fact that we have in many cases shown substantial savings.

The engineers, the production men are all keenly aware of the necessity to reduce costs. The stumbling block seems to be when they get up to the upper executives and the boards of directors who are influenced by the outlook.

I could give you some of the current reasons that they give us for not approving orders that they promise.

The CHAIRMAN. Suppose you do that.

Now, you are telling us why they have withdrawn promises of buying new machines.

Mr. GEIER. Some of them say, for example, that the program has been dropped, and they are not going ahead with the project. Something in the business outlook has led them to change, and there have been a number of important ones like that in the last year or two.

Another reason often given is that top management or the board of directors would not approve the expenditure for reasons such as these: One is sales volume is dropping off; another is the trend in labor; another is Government policies that they see coming up; another, they say the outlook is uncertain and they must reduce their borrowings; another reason they give is insufficient earnings, and insufficient working capital to permit them to put their money in longer-term investments.

The CHAIRMAN. Can you define the nature of the products which would be produced by the improved machines in order to give us an opportunity of judging whether or not there is likely to be a market for the product of these new machines?

One of the reasons that you have just given there, or quoted as having been given by your customers, was that the outlook for business did not seem to be too good; and, therefore, I am thinking of whether machine tools were used primarily during the war for the manufacture of a type of product which is necessary only for war, and which would not be needed for peace and, therefore, whether or not there is any substitute product for which a demand in time of peace would exist to justify the manufacture of these new tools.

Mr. GEIER. At the beginning of my statement, Senator—I think, possibly you were out of the room—I read the list of industries that used machine tools: Automobiles, tractors, electrical machinery, electric appliances, office machines, sewing machines, construction machinery, printing presses, shoe and textile machines, aviation, marines, and transportation equipment of all kinds, Diesels, gas engines, ball and roller bearings, and a great range and variety of consumer and durable goods.

The CHAIRMAN. Now, these products, therefore, are products for which a consumer demand exists?

Mr. GEIER. That is right.

The CHAIRMAN. Is that right?

Mr. GEIER. That is correct.

The CHAIRMAN. And in your judgment the obstacle is that the depreciation period is so long, under the tax law, that it constitutes an impediment to the purchase of machines that would increase the productivity of American industry?

Mr. GEIER. Reduce the costs; yes, sir, without any question.

The CHAIRMAN. Do you make the suggestion as a general one, or just for the machine-tool industry?

Mr. GEIER. I do not see why it applies to machine tools alone, but to me—I am not an economist—I think there is a distinction between the different kinds of capital goods.

You may have noted that I pointed out that the reinvestment in machine tools in the last several years has lagged, although, as Mr. Kaplan pointed out, the gross investment in the country was high.

Well, I think of one case where a company found the buildings they were putting up ran so much higher, so much more expensive than they expected, that they did not put in new machines; they put in old machines.

Another thing is that the replacement of a machine tool, the acquisition of a machine tool, is a highly postponable thing. You can always run the old one another 6 months or another year. Every time they postpone it somebody keeps patching it up.

The CHAIRMAN. Well, from your point of view, of course, that is an economy which is not desirable.

Mr. GEIER. Well, we have to live through it one way or another. We probably can, but it is not so good for the country.

The CHAIRMAN. That is what I was going to ask you next.

Mr. GEIER. Because if the productivity of the productive equipment is low, then you, in effect, depress the remunerative earnings that the worker could have on the machine. Likewise, the unit cost of product made on the old machine is higher that it should be, with the result that the ultimate consumer has to pay a higher price than he would had more productive equipment been used. The use of less productive equipment means higher costs and a lower purchasing power for the consumer's dollar.

The CHAIRMAN. Now, yesterday Mr. Holman, president of the Standard Oil Co. of New Jersey, testified that the oil industry in 5 years, from 1945 through 1949, had invested some $11,000,000,000—that is, at the rate of $2,200,000,000 a year—in plant expansion in order to meet consumer demand.

He also stated that the investment of $11,000,000,000 in 5 years was equal to the total investment of the petroleum industry from its beginning through the year 1948.

Now, if that were at all typical of other industries, it would indicate that a tremendous market exists. Indeed, Mr. Holman testified that the first reason for this development was high consumer demand.

Do you think that that situation is at all comparable in the general machine-tool industry?

Mr. GEIER. No, sir. The number of new machine tools that have been produced and installed in American plants has been on the down grade in the last 3 years, at a time when you had this high investment.

I am no economist; I am not proposing or pretending to enter into the field of economics, but to me there is a distinction between what the country really gets for the capital investment it makes. It would seem to me that the type of equipment which is productive of things that the people need is more desirable and more essential as a form of capital investment than provision for something that gives them, let us say, more chance to ride in their automobiles, such as more roads, more bridges, maybe more of a supply of gasoline. I am trying to distinguish between the capital that goes into producing services that they enjoy, as distinguished from capital that goes into producing goods and articles that they need for consumption.

Perhaps I have not made my point.

The CHAIRMAN. I think everybody would be likely to agree who has studied this problem——

Mr. GEIER. Yes.

The CHAIRMAN. (continuing): That our modern system depends—I mean the economic system and the promotion of business depends—upon the production and distribution and utilization of luxuries rather than of the mere necessities of life. You will agree to that, will you not?

Mr. GEIER. I say that is a very strong trend. The point I was trying to make is that machine tools have been regarded as the master tools of industry. They are the things with which everything else is made. Other machinery is made with them. They are the only machines which can be made to reproduce themselves.

Well, if we do not keep our machine-tool equipment in our plants up to date, we are not paying the attention we should to the fundamental root source of the productivity of our economy.

The CHAIRMAN. All right.

You have said that the depreciation rule of the present law is the obstacle.

Mr. GEIER. Yes.

The CHAIRMAN. Is there any other obstacle?

Mr. GEIER. I think I should bring out, as a contributing factor, that high levels of corporate taxation are a definite factor in the rate at which the productive equipment will be renewed.

The reason for that is the majority of the money which is spent for renewing productive facilities comes from reinvested earnings and depreciation, not from new capital. Therefore, if corporations and businesses have low earnings, the source of cash and other funds to replace equipment is absent; so high taxes are a very important thing.

If business sees trends which imply that it will be facing higher levels of taxation because, let us say, they see rising trends of Government costs or Government going into new ventures or new fields of expense, they will figure, "Our taxes are going up. We are not going to be able to pay for this machinery as readily, and we will just have to get along with the old stuff."

The CHAIRMAN. Well, that suggests to my mind a fact which, I think, is somewhat overlooked by many who make that criticism.

The great reason for the increased cost of Government has been the unfortunate fact that we had to engage in the war, and the equally unfortunate fact that the struggle for peace is expensive, and that there is no way of carrying on that struggle for peace except by and through the Government, and if the Government is able to fight a war, if it is to be able to conduct the battle for peace, it must have revenue, and the only way to get that revenue is through taxation.

Now, the fact of the matter is that 76 percent of all our Federal expenditures are war connected. The amount of Government spending which is allocable to ordinary Government activities is only a drop in the bucket, so that it really has no bearing upon questions of this kind.

Then, of course, it should be pointed out that the Government spending for the war, for national defense now, and for carrying on our international obligations goes directly into the hands of business.

During the war very large profits were earned by business.

Mr. GEIER. I merely thought that if I am to give you all of the factors that enter into this, I should say that the level of taxation, without arguing what it is for—I am not discussing that—the level of taxation and the prospects of whether it is going to go up or go down are a definite factor in decisions that are made with respect to whether you expand a business or make new capital investments, or even replace existing investment in machinery.

I wish it were not so, but it is a definite factor that we have to contend with.

The CHAIRMAN. I noted in your testimony that in the machine-tool industry the trend has been down, the trend of investment is down, but that is not true of other businesses, as, for example, the testimony of Mr. Holman yesterday that during those critical 5 years, 1945 through 1949, when taxes were high, the petroleum industry established a record for investment or spending greater than any in history, so obviously high prices, inflationary costs, and high taxes were not impediments to the investment of that sum.

Mr. GEIER. In the oil industry.

The CHAIRMAN. Now, your industry is different.

Mr. GEIER. Yes; it appears to have been different.

The CHAIRMAN. Dr. Kreps?

Dr. KREPS. I have no questions.

The CHAIRMAN. Mr. Scoll?

Mr. SCOLL. You made some reference to equity financing as one of the deterrents of the problems of your customers affecting their purchase of machine tools.

I believe you mentioned equity financing. You were present here and heard Dr. Kaplan's testimony on the subject with respect to means of providing equity financing. Are you prepared to express an opinion as to whether providing equity financing within the present banking structure, such as he described, might assist some of your customers?

Mr. GEIER. I must say that Dr. Kaplan's ideas are too new for me to give you a considered answer, but——

Mr. SCOLL. To put it another way, would you care to elaborate on your statement that equity financing is a problem from the customer's standpoint in the purchase of machine tools?

Mr. GEIER. I think I answered that question in part by pointing out that the users of machine tools normally depend on reinvested earnings and depreciation sources for from 50 to 100 percent of the purchase cost when replacing or buying additional machine tools. They do not ordinarily go to the capital markets for funds for new machine tools. It is largely a matter of the business itself providing the funds to renew its capital investment, so we do not consider equity financing as the major factor. It would be a secondary factor.

Mr. SCOLL. I would like to ask you one further question: In your statement about the level of taxes, if the corporate Federal income-tax rate remained the same, whether it be 38 percent or 40 percent over a period of years, during which time the machine tool paid back, would that not eliminate the tax question, that is, the rate of tax question as far as your problem is concerned?

My point is, is it not stability rather than level that you are concerned with?

Mr. GEIER. Stability is important, but if there are trends in effect which lead people to feel that taxes will rise, I mean, irrespective of whether we intend to have a higher tax, if the things are present which will in time generate a higher tax level, that will be a definite factor.

If you could assure them for a period of 5 years that there would be a stable tax rate, and if you were not, on the other hand, saying that you have to take 25 years to write the machine off, why, it would have some slight effect.

Mr. SCOLL. One other question: Your current prices of new and up-to-date machines would not have anything to do with the lack of market, would it?

Mr. GEIER. I could make one or two comments on that general subject. First, perhaps, I should say that it was very large-scale liquidation of Government war-surplus machine tools at bargain prices after the war which interfered with the machine-tool industry's normal sale of new machines.

However, that was largely concluded some time ago, and investment in new postwar machines has not grown since that ended, but it has declined.

Second, on the question of cost of machine tools, they generally range in price from $1,000 to $20,000, and some go up as high as $100,000 or more, so that there are very substantial sums of money involved.

Yet machine-tool prices today are very moderate in comparison with current cost levels.

While it takes considerable capital, they are at a relatively favorable cost level. For example, if the customer takes the amount he pays per hour to the workman to run the machine, and he figures how many hours of that man's pay it takes today to buy the machine tool the man works on, on that basis, many machine tools are lower in cost than any time in 20 years, or even longer.

And not only because of that favorable cost factor in relationship to the cost of operation, but because new postwar designed machines are so highly productive, they really are more attractive, and you have a better investment to offer the buyer today than at any time since I have been in the business.

Mr. SCOLL. That is all.

The CHAIRMAN. What is the extent of the exportation of machine tools, modern machine tools?

Mr. GEIER. From the United States within the last year or so, from month to month, it has been in the range of somewhere between 17 and 35 percent.

The CHAIRMAN. Of the total output?

Mr. GEIER. Yes; of total sales.

The CHAIRMAN. What countries are taking those machine tools?

Mr. GEIER. The principal recipient country in the recent past has been France; to some extent, Italy. Some of the South American countries are getting them. England has taken some; not so much.

The CHAIRMAN. Dr. Kaplan, did you care to ask this witness any questions?

Mr. KAPLAN. I do not think I would care to.

The CHAIRMAN. Mr. Geier, we are very much obliged to you for your statement. I thank you on behalf of the committee for having come and given your testimony.

Mr. GEIER. Thank you.

The CHAIRMAN. The next session of the committee will be held tomorrow morning at 10 o'clock in room 224 of this building. Mr. Wimmer, as well as Dr. Kaplan, if the doctor is good enough to come again, will be our witnesses.

The committee stands in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 12:40 p. m., the subcommittee adjourned, to reconvene at 10 a. m., Thursday, September 29, 1949, in room 224, Senate Office Building.)

VOLUME AND STABILITY OF PRIVATE INVESTMENT

THURSDAY, SEPTEMBER 29, 1949

UNITED STATES SENATE,
SUBCOMMITTEE ON INVESTMENT OF THE JOINT
COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10: 15 a. m., in room 224, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney (chairman), and Representative Patman.

Also present: John W. Lehman, clerk to the committee; Dr. Theodore Kreps, staff director; Dr. William H. Moore; and David Scoll, special counsel to the Subcommittee on Investment.

The CHAIRMAN. The committee will come to order.

Dr. Kaplan, would you be good enough to take the stand?

STATEMENT OF A. D. H. KAPLAN, SENIOR STAFF MEMBER, THE BROOKINGS INSTITUTION—Resumed

Mr. KAPLAN. Yes, Mr. Chairman.

The CHAIRMAN. Dr. Kreps, you did not have an opportunity to question Dr. Kaplan yesterday, after the presentation of his most excellent review of this problem, so we will give you your chance now.

Dr. KREPS. I do not have so many questions on the testimony so much as on one or two aspects of the general problem of risk capital for small business and, for that matter, for the economy, in general; and, since Dr. Kaplan is an expert as well on the general investment problem, I would wonder whether I might utilize some of his information and bring it to the attention of this committee.

You heard, Dr. Kaplan, yesterday that one of the measures which would aid the capital investment problem considerably—that could be adopted by the Government—would be to have a more liberal depreciation policy; and, as I remember it in your book, some mention is made of that.

It is my impression that if a firm has a machine which becomes obsolete, and it puts in a new machine, even though that old machine has not been completely written off, it can, in the year in which the new machine is put in, deduct before taxes the unamortized value of the old machine.

Just to take an example: Suppose there is a machine that costs $100; $40 depreciation has been taken; the old machine is sold for $20. There would be $40 unamortized value, and as I understand it, in such abnormal obsolescence, due to casualties of one kind or another, or invention, and so forth, that could be deducted in full; and even normal obsolescence can be deducted in full if you have item accounting or if you are thinking only of this particular item.

Do you happen to know whether that is true?

Mr. KAPLAN. Dr. Kreps, in the first place, I would not expect to qualify as an expert in the tax-accounting field; certainly, I am not fresh on the details.

I can say that within limits such opportunities as you mention do exist, especially if a separate item account is kept for each type of machine. I think the problem, so far as small business is concerned, is that of being able to get the full benefit of keeping up with improvements in equipment, so that the small business will not be behind the procession, efficiencywise; and, in that connection, to be able to get maximum depreciation allowances during the early periods, thereby permitting as large a plowing-back opportunity for the small business as possible.

The CHAIRMAN. Well, there is such an additional credit; in other words, the depreciation on the unused portion is not lost, as I understand it.

Dr. KREPS. That is right.

The CHAIRMAN. When an old machine is displaced for a new machine; but I take it that Dr. Kaplan's position is that it is not sufficient incentive; that there ought to be a positive incentive in the way of a shorter period of amortization for new investment.

Mr. KAPLAN. Especially at the front end—the first year or two.

The CHAIRMAN. Yes.

Dr. KREPS. Oh, yes; the method of computing the depreciation instead of——

Mr. KAPLAN. That is perhaps as important as the number of years over which it can be taken.

Mr. SCOLL. May I interpolate something here, Senator?

The CHAIRMAN. Yes.

Mr. SCOLL. Is not the issue here the question of pay-back on the new machine, rather than the deduction of the unamortized portion of the old machine? Is that not the problem that we are concerned with in this depreciation question?

Mr. KAPLAN. Well, you are concerned with the problem as to whether you can reduce your profit statement to the extent of an accelerated depreciation.

Mr. SCOLL. Accelerated pay-back of your investment.

The CHAIRMAN. I suggest that the question be framed formally for the Treasury, the Bureau of Internal Revenue, and let us get their response in the record, so that there will be no doubt. We will not be guessing about what this depreciation is.

Mr. KAPLAN. Yes; I am not the person to ask about that.

Dr. KREPS. I was wondering whether you felt that the United States Government is willing almost anytime for any person to accelerate his depreciation and take it all in one year, if necessary, or take a good deal of it.

The CHAIRMAN. Well, you submit that question to General Counsel Lynch, and we will get a specific answer.

Dr. KREPS. Now, the other question I had in mind concerns itself with the results of a study which you had in mind, of Mr. Litterer of the Minneapolis Reserve banks. Do you have that study there? I am particularly interested, Dr. Kaplan, in his conclusion. The heading for that conclusion is—I trust you will read it there—the last section that Capital Supply Meets Needs; is that not it?

Mr. KAPLAN. His conclusion is Capital Supply Meets Current Needs.

Dr. KREPS. Meets current needs?

Mr. KAPLAN. As of 1948.

Dr. KREPS. Would you like to discuss that?

Mr. KAPLAN. But he also modifies that by saying, "The uneven distribution of equity capital available to small-business entrepreneurs is traced to an unorganized market. No institutions have been established for this purpose."

Dr. KREPS. Would you read the succeeding paragraph over on the next page?

Mr. KAPLAN. "Should personal savings again fall to the prewar level, the primary sources of equity capital may dry up materially the rate of expansion in small business enterprise or may be reduced significantly."

Dr. KREPS. Just read further.

Mr. KAPLAN. "If the sources of equity capital largely govern the expansion in small business enterprise, they may have been too ample in recent years. It is doubtful that all firms now in business can be maintained on a profitable basis when prices fall or level off."

Dr. KREPS. Now, it is that last paragraph, to which the other paragraphs lead up, upon which I would like to have your judgment. Do you feel that possibly the years 1947, 1948, or 1949 have been years in which, if anything, firms—small business firms—have remained in operation which normally are submarginal and have shown profits, and that, by and large, probably, as he says, there is equity capital which has been too ample?

Mr. KAPLAN. I think that we have to agree with the statement in this sense: That we have never had any period, of the same length as the last war period, in which so much was accumulated in personal savings; and it is not likely that you are soon going to see an available fund of that sort, with all the special situations that stimulated small businesses to open up. Moreover, we have to admit that, in the sellers' market existing immediately after the war, a good many small businesses have looked good that would not look nearly as good in ordinary times.

I think we also have to reckon with the fact, as I said in my testimony, that since the beginning of 1947 the monthly figures for failures have quadrupled. They are about 800 a month now; they were 200 a month in early 1947. Historically, whenever there has been a great influx of new businesses, it has been followed by a corresponding dropping out of new businesses during the succeeding year or 2 or 3; hence we must expect that the number of discontinuances over the next few years will be very large.

Now, possibly some new facilities for counseling, and for straightening out capital structures, can save those businesses that are essentially sound, and need only a little financial help to save them. But thousands of ill-conceived and naively operated will have to go by the wayside. They have had their fling; they do not fit into the need, and in the general course of things you must expect them to drop out, and a good many will drop out voluntarily.

The CHAIRMAN. Will I interrupt you, Dr. Kreps, if I ask a question here, or make a remark?

Dr. KREPS. No.

The CHAIRMAN. During the hearings by the Appropriations Committee on the appropriation for the Federal Trade Commission, Dr. Corwin Edwards presented to the committee a study that had been made by the Commission on the profit status of businesses of all sizes, and that showed quite clearly that the small businesses were becoming quite marginal; in fact, many of them were losing money, whereas the big ones continued to make money, and it struck me that that was more or less emphasized by your testimony yesterday with respect to the increasing number of failures, and the holding down of small business by the banks through inadequate credit facilities.

The picture on the other side with respect to so-called big business is that their fiscal resources are so great, their inherent fiscal strength is so great, that they can withstand the shock, and the little fellows cannot. Is that not right?

Mr. KAPLAN. I follow you on that, Senator. Perhaps this further statement needs to be made: That a good many small businesses with rather makeshift equipment, and even with makeshift managerial facilities, were able to jump in at the war's end, to scout around and supply goods quickly, or to make products that fed into a market eager for available goods, while some of the big companies were building up their plant and equipment during the postwar period.

So, during that waiting period, the small businesses had their golden chance. Now the big fellows have their full capacity working and their new equipment, naturally, many of the little fellows will show up as submarginal in this stabilized situation.

The CHAIRMAN. Yes; and if this discontinuance of which you speak should continue, if steps are not taken by business leadership or by Government leadership to cushion the effects of the discontinuance, to use your very diplomatic words, is not the result going to be that the big businesses will have a larger share of the economic life of the country, and the pressure for Government intervention in business will become even stronger than it has been?

Mr. KAPLAN. That can very well happen. The only reservation that I have arises from the notable stamina that small business seems to show through the years. In spite of the influx of big business, in spite of chain stores, in spite of the many cases in which small businesses have not been able to catch up with advances or have not been able to slide into a niche that is right for them alongside of the mass-production standardized lines, they keep coming along, and little ones keep moving ahead.

I agree with you, Senator, that we might have a better balanced structure if you could get a larger percentage of the total in the small-business area; and to that extent, I would like to see every practical effort made to give small business the opportunity. Yet, I could not go along with Congressman Patman if his remarks of yesterday implied security from competition for small business.

Mr. PATMAN. I did not say that at all.

Mr. KAPLAN. Well, then, I shall not put it that way. We are all after some measure of security.

Mr. PATMAN. I am for competition, but it should be fair competition.

Mr. KAPLAN. Competitive opportunity. Perhaps we can agree on that.

Mr. PATMAN. That is right. Fair competition is what I want.

Mr. KAPLAN. Competitive opportunity is the goal in my conception of business enterprise. No stone should be left unturned to enlarge the range of competitive opportunity. I hope we are together on that.

Dr. KREPS. I have one question allied to this: You would envisage your bank, capital credit bank, as a part of the commercial banking system then, as having a function not only, I trust, in periods of depression, giving capital to small business, but it might have a stabilizing function in periods of prosperity, such as the last 3 years, and in seeing to it that the small businesses that did start then, on the whole, had a fair chance of weathering the subsequent decline, I mean, or do you envisage your banking, small-business banking system, as essentially operative during declines only?

Mr. KAPLAN. Definitely I do not envisage it chiefly as a relief measure for a distressed period. I am thinking of it as part of the long-run machinery to make sure that where there are ideas that have promise; where there is management coupled with an opportunity, in need of guidance and financial backing, where there is reasonable risk with opportunity, that business should not lack for an orderly channel through which the proposition can be examined, and through which financial reinforcement and guidance can be provided. That is an essential part of the long-run effort to retain the balance in our economy between small and large enterprise, and to make sure that the quality of management in small business is good enough to justify financial backing of it.

Dr. KREPS. Thank you.

The CHAIRMAN. You agree with me, Doctor, that it is essential to that, if we are going to maintain a competitive system or a free-enterprise system and stop the trend toward Government power in the economic field?

Mr. KAPLAN. I agree with you on that, Senator.

If I may come back to the suggestion of a new agency for capital banking, we have to convince ourselves—that is, since we do not have the statistical proof, we have to clear up this question as to who is right, as between those in the banking fraternity and elsewhere who say that all the capital we need is available to deserving small business, and those who say that potentially productive small business is languishing for lack of adequate capital facilities.

It is a comparatively small investment that is involved in providing the suggested channel for small business capital. If we want to be cautious about spreading it over the country at once as a total national system, we can start out with some pilot capital banks.

The Federal Reserve banks of the Philadelphia and Boston districts, for example, believe they have shown more concern about helping industries under section 13-B, than other districts have done. We might choose such receptive areas to try it out, and see what progress can be made. They have done that in England, with the Industrial and Commercial Finance Corporation, and they have done it with the Industrial Development Bank under the Bank of Canada; and recent reports of those two banks carry convictions that they are serving a vital area that has needed such facilities.

If it became generally known, and the banks made it known, with the capital bank itself participating in the promotion, that nobody need lack for a chance to place the case for his enterprise before people who are in a position to pass dependable judgment on it, we could get a good deal more clearance and backing for the propositions that deserve help, separating them from those that, after a hearing, are found not to merit outside risk-taking. It seems to me that the means must be found, the instrument set up.

The CHAIRMAN. Most of the discussion to date has been on the debt capital side of the picture. I should like to direct your attention more specifically to the equity capital side or the investment capital side.

I recognize, of course, the great importance of having better facilities for loans to little business. I was particularly impressed with what you had to say about the lack of long-term credit; but I am also impressed by the fact that the solutions which are being suggested for little business seem to take the line of Government loans, where private institutions will not make the loans. That, to me, is only an invitation to the owner of small capital to get into debt, without clearing away the obstacles which cause the impediment to the stability of small business and its growth.

So, I am concerned particularly with what we can do to promote investment.

Do you care to amplify anything you said about it?

Mr. KAPLAN. My focus, too, is on equity investment. However, the distinction between capital financing through credit and strictly ownership investment is not a clear-cut line.

If it is true, as we believe, that the old-time neighbor, friend of the family, or member of the family, who used to back the young fellow and the young enterprise is not so much in the picture today, with our urbanized society; and if the providing of equity funds has to be on a less personal basis because of the changing character of our society, then we must look to other appropriate institutions capable of programing the permanent capital expansion or launching of an enterprise through a variety of media.

In some cases, a long-term loan to be amortized may be the one way to build up the equity structure of a business without sacrificing the original owner control. In other cases it may be necessary to convert the nonincorporated enterprise, which is essentially sound, but in need of capital reorganization, into a corporation and to have a financing agency to buy the stock—preferred or common—which is definitely an equity proposition.

The CHAIRMAN. You will be accused presently of advocating some form of planning for small business by some sort of an institution which will have charge of this programing. That is very dangerous ground to get on these days. You know all the criticism there is of planning today.

Mr. KAPLAN. I never heard of an enterprise that was successful without planning.

The CHAIRMAN. Neither have I.

Mr. KAPLAN. Big business does its long-term planning, and that is one of its great advantages over many a small business; and if we could get away from the peculiar semantics associated with the term, I think we should take it for granted that without planning there can be no successful enterprise.

Mr. PATMAN. Including government, too? You would have the Government plan for the future?

Mr. KAPLAN. Certainly, sir. The Government is an essential partner in shaping our economic destiny. I think that it is unfortunate—well, it is always dangerous to throw out a word like "plan" without defining your term and knowing in what sense you are using it, but if you——

The CHAIRMAN. Well, you avoided it.

Mr. KAPLAN (continuing). Put chaos as against planning, nobody is for chaos any more than he is for sin. But neither individuals nor enterprises can grow strong if most of the planning is done for them.

The CHAIRMAN. Well, as I say, you avoided the word, and you ought to be congratulated on substituting "programing" for "planning."

Dr. Kaplan, the examination of Mr. Holman the day before yesterday, started by Mr. Scoll, on the discoveries and patents made by the Jersey Co. in its research laboratories, suggested to my mind the thought that some steps might be taken by providing a method whereby such idle discoveries and patents would be made available for the investment of private capital and independent enterprise, particularly when the discoveries and patents had no direct bearing upon the primary business of the research laboratory which discovered them.

There is not any question about it that the larger the business becomes and the more intense its research activities, the greater the new opportunities that it uncovers.

Now, it has frequently been said that many of these opportunities are kept idle because of the desire of the owners of the new possibilities to hold them under cover until those discoverers have the chance themselves to develop them.

Mr. KAPLAN. My guess is, Senator, that there are a good many idle patents which, as you say, are being held under cover, and it may be that they are being held under cover too long, from the public's standpoint. I am also concerned with the fact that even where some of these patents have been placed with the Department of Commerce—and I learned from one firm that it had nearly 3,000 such items placed with the Department of Commerce—where they offered their know-how and offered their engineering skill to anybody who would go into that field, that there have been no takers.

The CHAIRMAN. That is because we have not provided the incentive by law to induce the investment of capital in such channels.

Mr. KAPLAN. Plus the fact, possibly, that something is missing in the way of getting it around that those opportunities are available; sifting them, analyzing them, studying them, perhaps making an annual analysis of these availabilities.

After all, even the largest mail-order house has to issue a catalog to let people know what merchandise it has. I have the feeling, as I have been learning about some of the items in the "open lists" that have been left by large businesses with the Department of Commerce, that they deserve to be more widely known.

The CHAIRMAN. Perhaps we ought to provide that the Patent Office should issue an annual catalog of patents; if that can be done by eliminating some of the patents which are ingenious but without any utility, it might afford an opportunity.

Mr. KAPLAN. More analysis along that line appears desirable and, perhaps, some of the private foundations, institutes, and trade associations could do more with that sort of activity. The need to make citizens aware of opportunities is exemplified in the last annnual report of the Canadian Industrial Development Bank. It states very frankly that even though it knew that there was need for its facilities it did not really get adequate response until it sent out district emissaries over the country, got the whole objective stimulated through the banks which were supposed to be part of the scheme, and through speaking directly to various business groups.

Once it was really known that the financing and counseling channels were available and what use can be made of them, then business began to come in. So perhaps, we need some promotion of these very opportunities that are lying dormant.

The CHAIRMAN. All right.

Then, in that connection, would you amplify a little your statement yesterday about the failure of the local development corporations, the failure which led Filene, as you said, in 1943 to recommend some sort of Government action?

Mr. KAPLAN. Yes, that was the New England Development Council. I do think that the difficulty with these local community development agencies has been that the area they reach is restricted. Typically, the private development group is on the lookout for an original product which, with technical aid in financing, can open up a rich new market.

In some cases the small-business man has not wanted to tell the "big shots" of his local chamber of commerce what his troubles were, and to expose himself to them. One manufacturer, in discussing his experience with a local development committee, mentioned the embarrassment that came with telling his story, when some of his own suppliers were in the group sitting around and listening to him. In OPA days I learned that small-business men tend to be sensitive about anything that smacks of being a "civic virtue" type of endeavor, in their behalf. There are similar subtle reasons why people who could use help did not want to expose themselves to the citizens' development groups in these communities.

It seems to me that if you have something as impersonal as a capital bank, which is a part of the total banking system, it is approached strictly as a business proposition. It is a known channel equipped for the specific purpose and there is a better chance of the parties working out the problem which is their mutual business.

I did not mean to suggest abolishing the industry-development corporations. More power to them if they want to keep going; and they do occasionally pick up something that owes its development to them. What I am saying is, that in terms of the total area to be served, they have not begun to scratch the surface.

The CHAIRMAN. I notice that you pointed out yesterday the difficulty of making any attempt to distinguish genuinely new independent small enterprises from the big fellows.

I will not go into it this morning, but I think there is a very simple way of making that distinction if we should adopt a sensible Federal charter system which would define the powers and responsibilities of these various businesses.

Mr. PATMAN. What is the number of that bill, Senator?

The CHAIRMAN. S. 10.

Mr. PATMAN. You set up standards and limitations?

The CHAIRMAN. That is right. The TNEC recommended such standards.

Mr. PATMAN. I know it did.

The CHAIRMAN. It is interesting to note that as long ago as the administration of William Howard Taft, a Federal licensing system was suggested by Senator John Sharp Williams, of Mississippi, and then later, in 1910, President Taft sent a message to Congress, January 7, 1910, was the date, as I remember it, in which he recommended a Federal charter system.

Both of those suggestions fell by the wayside. Then, Senator Borah and I introduced S. 10 for the first time in recent years.

The bill has been before every session of Congress since and, of course, it covers all or is intended to cover all organizations engaged in interstate and foreign commerce, including not only corporations, but labor unions and trade associations.

Mr. PATMAN. Would you restrict them to certain lines of business?

The CHAIRMAN. Well, I have always said that I feel the provisions which ought to be contained in such a law should be first studied by some sort of a national conference on corporation law and economic needs, because it is a very complex and difficult subject, but one cannot forget the fact that in the early days of the corporation, it was public policy to restrict a corporation to a particular line of business.

Then, that field was broadened, and corporations were allowed to engage in businesses that had a relationship to the principal business.

Nowadays the States which have no power to deal with interstate and foreign commerce grant blanket charters, and so we have great national and international corporations which become partners of governments abroad, and of other businesses abroad. They form the cartel, they establish an international economic government, without responsibility to anybody.

Mr. PATMAN. I have not warmed up to that proposition, I will admit, for this reason: I do not want people to have to come to Washington to get their charters. You see, the little-business men, some of their major problems right now are due to the fact that they have to come to Washington. They have no representative here; they have nobody to look after them.

The CHAIRMAN. When the Constitution was drafted, it made a clear distinction between local business and national business.

Mr. PATMAN. Yes.

The CHAIRMAN. Local business was to be handled by the States, by the people in their own localities. National business was to be handled by the Congress.

The suggestions made by Senator John Sharp Williams and by President Taft were put on the shelf for exactly the reason that you have mentioned, and the result has been that the States have not retained their freedom, that little business has not preserved its independence, but that Government in Washington has grown greater all the time, and the power of concentrated economy has grown all the time.

Now, we have an economic system which is managed by private managers who resent any attempt upon the part of Government to regulate their activities in the interest of the masses of the people.

Mr. PATMAN. And who own very little of the company that they control.

The CHAIRMAN. That is right; and they are constantly seeking to convince the little fellows that they occupy exactly the same position.

Mr. PATMAN. That is the reason that I am in favor of stopping the retail chain stores. They are invading every section of the Nation, and if your bill will lend any help in that direction, I certainly will look into it more carefully.

The CHAIRMAN. It will be just the thing to do that.

Mr. PATMAN. Because they are destroying opportunities locally everywhere, which is just not right, the way I look at it.

The CHAIRMAN. It will be quite possible to set up the standard that corporations should be limited in the number of nonrelated businesses into which they enter.

Mr. PATMAN. What would you do if General Motors or General Electric went over there and engaged in the manufacture of a lot of different appliances and different things? Would you say 500? I imagine each one of them can make at least 500 different gadgets or tools or vehicles. Would you break them up?

The CHAIRMAN. I hesitate to say "break them up," because I do not think that any of us is prophetic enough to look into the future——

Mr. PATMAN. That is right.

The CHAIRMAN (continuing). And say what the future needs.

I think the important thing is to deprive corporations and their affiliates of the corporate power to commit the practices which we call monopolistic, which everyone recognizes, and another important thing to do is to realize the difference between a natural person and the artificial person created by the state.

Mr. PATMAN. The court has not done that though; has it, Senator?

The CHAIRMAN. No, but we can do it by law.

Mr. PATMAN. Yes.

Is there any bill pending to that effect?

The CHAIRMAN. Well, this bill of mine would do it.

Mr. PATMAN. You think it would make a distinction between an artificial person and a corporation?

The CHAIRMAN. Certainly.

Mr. PATMAN. You mentioned the corporations a while ago. I do not see how anyone can deal with this subject that Dr. Kaplan is dealing with without considering two major problems in connection with it. One is the retained earnings of corporations—the earnings which are too large—I mean too large earnings that are retained; and the other is the national corporate chains.

Now, last year, your committee, Mr. Chairman, brought out that the corporations, after taxes, had about $21,000,000,000, which was an unprecedented amount.

Instead of paying out two-thirds, as they would pay out normally, they retained two-thirds, and paid out one-third.

That meant that they retained—these people that Senator O'Mahoney is talking about, who own very little of the company, such as the American Telephone & Telegraph Co.—all are the officers and directors connected with that company—own one-thirty-third of 1 percent.

Now, people like that, they retain $14,000,000,000.

It occurs to me that that has had a very bad effect on our economy and especially on credit, and particularly on venture capital for small business. If that $14,000,000,000 had been paid out, as would be paid out normally, the people who received that $14,000,000,000 would be in a position to go into business for themselves or to invest in their neighbor's business, or to invest their money any way they choose.

But the effect of that was that these concerns, through high prices and big profits, have "costless capital." That capital costs them nothing. They got it out of the consumers in high prices.

Mr. Francis one time used the unfortunate phrase "costless capital," but I notice he struck it out of his remarks when the remarks were printed. But you cannot have a better phrase than that, and what chance has small business where the owners put their own money into it in competition with people who have "costless capital" to use in competition with them? How can you deal with this subject, Doctor, and not consider those two problems, one, retained earnings, and the other, permitting absentee owners just to go all over the country without any restriction whatsoever and put local people out of business—unfairly, like the courts have held?

The CHAIRMAN. Well, the result of it is that we have private management gaining control of a larger and a constantly larger segment of the economy, and raising all sorts of criticism against what they call Government management, of which they are the architects, because, when the people cannot find a method to support themselves economically because of the power of the private managers, the inevitable result is that they turn to Government to do it for them.

Mr. PATMAN. Totalitarianism.

The CHAIRMAN. And the suggestions for Government action come indiscriminately from conservatives and radicals.

You can take a list of the bills that were introduced in every Congress and find radical proposals for the expansion of Government power coming from the most conservative-talking Members of Congress.

However, we will get way off the subject if you and I just pass this ball back and forth.

Mr. KAPLAN. Well, Congressman Patman, insofar as you have raised the question of retained earnings for investment——

Mr. PATMAN. Yes.

Mr. KAPLAN (continuing). I suppose that we would all recognize that, so far as the last 3 or 4 years are concerned, the Treasury Department was much more liberal in construing section 102 with respect to ——

Mr. PATMAN. Withholding taxes.

Mr. KAPLAN (continuing). With regard to the percentage of withholding dividends, because of the recognition of the fact that we needed an extremely large retooling, reequipment, catching-up, inventory-building program in order to get started on postwar business.

Mr. PATMAN. To a certain extent, I am in sympathy with that program of the Treasury Department, but I think they went too far. You know, keeping back from the people $14,000,000,000 of retained earnings in 1 year is just about three or four times as much as they ever made all put together in years gone by.

Mr. KAPLAN. And yet personal savings were at an all-time peacetime high.

Mr. PATMAN. Yes; that is very true.

Mr. KAPLAN. So that possibly, Congressman, the last 3 or 4 years would not be the years to pick on as the ones in which it was not useful to retain earnings for rebuilding our capital structure.

There may still be validity in your point in another context; but so far as small business is concerned, I must say I wish it could have retained more of its earnings so as to get its capital structure more solidly built.

The CHAIRMAN. Mr. Scoll, did you have any questions that you would like to ask?

Mr. SCOLL. Well, I just have one question.

Dr. Kaplan, do you not think that the notorious risk that is inherent in all small-business financing, as opposed to the mature securities, would hinder the operation of the capital bank that you propose; that the directors and loan committees would be inclined to act like the normal bankers that they are, and judge the value of the risk in terms of standard criteria and, therefore, just merely be another bank?

Mr. KAPLAN. It would be very unfortunate if this were merely another bank.

The main purpose of setting up a system of capital banks that are specifically capital banks is to develop a new psychology with respect to the financing of small-scale enterprise, one that is not inhibited by the considerations of liquidity and the traditions of limited timing and security that control the activities of the typical commercial bank.

The time certainly is ripe for developing more imaginative techniques in solving this problem of putting an adequate capital base under small business.

I believe that it is possible for us, with personnel that will think promotively, to develop new techniques in the handling of small business; in balancing higher risk financing with lesser risk financing, and coming out with a net that would enable the capital bank not only to keep solvent but do better than keep solvent and, at the same time, encourage a considerable addition to small-business investment.

The capital bank can also serve the function of sifting out some of the poor risks from the better risks—that is, the type of risk that is a poor risk mainly because it is not properly backed financially, from the type of risk that is a poor risk per se. To that extent, it may even reduce the failures. But I do not believe that we have a right to say that small business is notoriously risky, when "notorious" implies that it is a hopeless problem to solve.

I do not believe it is that sort of situation. In that connection, I think we can all find encouragement from the experience that the Canadian and the British capital banks have had during their first few years of operation. I am putting into the record, as you suggested, Senator O'Mahoney, some of the statements that have come out of the first couple of years of experience of those capital banks. It may help to clarify the point that has just been raised as to whether it is an impossible task to make the financing of small business in itself a reasonably profitable venture.

Mr. SCOLL. But my question was addressed to the difficulty of the task of making that banker, the fellow who would administer this, the enlightened risk taker that is going to have to administer the capital bank if it was to work.

Mr. KAPLAN. Well, he cannot be the traditional banker, the traditional commercial banker, obviously. He has to be a type of banker who is venture-minded, and who views small-business cases as ventures to challenge his ingenuity to make them workable. If the powers given to this bank are broad enough so that it is not inhibited, as the commercial banker is inhibited today, I believe that it is possible for the banker to rise to the freedom of action that has to be given to him in what is truly a capital bank.

We used to have what is suggested here during the nineteenth century, where many of the private banks were essentially risk-taking investment houses. British-type investment trusts carried their risks all over the world, and paid off handsomely.

Now, that type of activity has moved out of the picture, and we need to revive some of that risk-taking type of investment banking for small ventures.

Internationally, it has been crushed by political tension, by the fear of getting into a foreign country and not getting the necessary protection. But certainly, in a market as large and as well protected as the total American market, there ought to be ample opportunity for that sort of venture-capital activity to flourish.

The CHAIRMAN. Dr. Kaplan, we are very much obliged to you for a very interesting bit of testimony. I hope that you will follow through with this, and if, on the basis of the record which has been made here, you would care to make a suggestion to the committee as to the special inquiries which should be made later on, I think we would all benefit from it very much.

Mr. KAPLAN. I will be very glad to suggest a number of businessmen who have expressed an interest in getting behind a capital-bank type of venture.

The CHAIRMAN. We will be very happy to talk to them.

Mr. PATMAN. And consider, too, giving these people a little more security against these national chains.

A capital bank would not let a person have money to go into business in competition with these national corporation chains. They just would not do it. If you had charge of the bank, you would not do it, Doctor; you could not afford to because the competition is not fair, and it is ruthless; it is destructive. It is destroying enterprise all over the country, and I think some way ought to be found to stop them, and I hope you help us find that way.

Mr. KAPLAN. Certainly there are many interesting problems outside of this immediate problem of raising investments in this country, but I believe that the problem of finding a new channel of investment for small business needs to be handled by itself.

The question of the chain stores is one of the facets on which we need to obtain more definite information.

Mr. PATMAN. I know, but the security—although the funds are available, the one in charge of the funds would not permit their use in competition with the national chain that can charge prices way below cost to put them out of business. You would not let a concern have money under conditions like that, and that is the No. 1 problem, and your bank business is No. 2. There is no use trying to provide funds unless you have given them some security against ruthless competition, in other words, against the Captain Kidds in business.

The CHAIRMAN. Thank you very much, Doctor. We will be in touch with you. You have not seen the last of this committee, I think.

Mr. KAPLAN. Thank you.

The CHAIRMAN. Mr. Wimmer, you have been very patiently waiting your turn.

Mr. WIMMER. Well, I do not know how patiently.

STATEMENT OF ED. WIMMER, VICE PRESIDENT AND PUBLIC RELATIONS DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, INC.

Mr. WIMMER. Senator O'Mahoney and Congressman Patman, this is a real privilege for me to be here this morning, and I want to express the appreciation of our president, Mr. C. Wilson Harder, and our members and the field men, for this opportunity of being with you today.

The CHAIRMAN. You are speaking of the National Federation?

Mr. WIMMER. Yes, sir. National Federation of Independent Businesses, Inc.

The CHAIRMAN. Yes.

Mr. WIMMER. My name is Ed. Wimmer and I am vice president and public-relations director, and president of the Forward America Publishing Guild, Inc., Cincinnati, Ohio.

I should like very much, if I may be permitted—and I will move quickly, I assure you—to read my statement; that is, follow it as closely as I can, and then I will be open to any kind of questions.

Is that all right with you, Senator O'Mahoney?

The CHAIRMAN. Very good, sir.

Mr. WIMMER. I believe the problems confronting independent business are problems which affect all the people in our society far more vitally than is generally realized. Therefore, in taking up this matter of loans to small business, I should like to state my own position and the position of the federation on what in our mind is the over-all problem to be confronted in these hearings; namely, that three great forces of domination are sweeping over our land, liquidating our free-enterprise system and thus liquidating the American system of self-government. These three forces are big monopolistic business, big monopolistic labor unions, and big bureaucratic unlimited government. If all three are not halted and turned back, it will avail us nothing to solve any other problem.

I would like to go back a long way, and I go back to the third century, to Aristotle, who said:

> The stimulus of gain is necessary to arduous work, and the stimulus of ownership is necessary to proper industry, husbandry, and care. When everybody owns everything, nobody will take care of anything. That which is common to the greatest number has the least attention bestowed upon it. To help the majority of men with state subsidies is like pouring water into an empty sack.

I think that statement might have been made today.

We therefore maintain that the job of providing risk capital and an opportunity for small business to grow and prosper is tied inseparably to the need of developing a sound decentralization program which can be carried out at every level of our society. A free society cannot survive nor can a free society be built on any other foundation than one which guarantees a maximum of individual enterprise and a minimum of power in the hands of the few.

It was about the year 1890 that we began moving swiftly away from this idea of economic democracy toward an economy of power groups in agriculture, industry, finance, labor, and government, until today we are on the very brink of the same kind of disaster which has befallen every other nation that pursued a similar course. In other words, we are developing masses instead of individuals in that increasing millions of Americans are becoming more and more dependent upon giant corporations, giant labor unions, and giant government. At the first sign of a serious crisis in our national affairs these masses can become howling mobs, ready for a master.

Before going into what I believe are the major contributing factors behind this development of the mass man, however, I should like to acquaint you with the results of our balloting of federation members on proposed legislation designed to make risk capital more easily available to small business. In mandate No. 143 we asked for a vote on S. 408, introduced by Senator Tobey, which would liberalize Federal Reserve guaranties on loans to small business, making it possible to obtain longer term loans from chartered banks, with risks assumed up to 90 percent by the Federal Reserve System. The vote of our members showed 91 percent in favor of this proposal. Only 8 percent of those voting recorded themselves as being opposed. I have a good reason for giving those figures.

A few months later, in mandate No. 149, we sought the opinion of our members on H. R. 6250, introduced in the House by Hon. Edith N. Rogers, of Massachusetts, which was a bill to reestablish the Smaller War Plants Corporation as a peacetime agency of the Government, to extend and insure credit to small business. A notable change in the attitude of our members was noticed in the vote on this issue, which was 70 percent for and 23 percent against.

In mandate No. 151, 3 months later, we posed the question, "Are you for or against Government assisting small business to obtain longer term credit (through private, local banking channels) to make possible long-range improvements and compete with monopolies?" The result of the balloting was 79 percent for and 23 percent against. We posed the same question again in mandate No. 160, which was quite recently, and the vote for Government-guaranteed loans dropped to 57 percent and 42 percent opposed. My personal opinion is that the changed attitude of our members is a result of the widespread campaign we have been conducting against too much dependence on government.

I have said for 17 years, that if the individual enterpriser is provided a free market in which he can exercise his initiative, develop his talents, and promote his enterprise without having to compete against others enjoying unfair advantages, that he will seldom need to go outside of his own community for loans or investors. The Federation is the largest organization of independent business and professional men and women in the United States and we have more men in the field than any other independent business organization, yet I have my first time to contact one member or one of our field men who has disagreed with this contention.

The job before us, therefore, must be the development of a healthy economic climate in which individual enterprise and risk capital can be merged. It was risk capital and individual enterprise that built our Nation, and not until we bring the two together again on an ever-expanding scale, can we hope to save free enterprise and free government.

James H. McGraw, a big businessman, made this statement:

> Competition requires independence of action, free access to markets, and no large control by any buyer or seller. The larger the number of sellers the more easily can a buyer shift from one seller to another.

To accomplish this goal, I think we need to explore first of all the economic plight of the smaller communities. The greatest number of businesses which made up the Main Street of the smallest towns were retail businesses. A restaurant or two, a grocery or two, a dry-goods or general store, harness shop, shoe repair, confectionery store, and so on. If a lawyer hung out his shingle, or if a small printing establishment or some other type of business, such as a hotel or local bank, et cetera, was established, it was set up largely because the independent merchants had created a market for such enterprise. Local residents and farmers met together and dealt together on Main Street. Boys and girls grew up in the community, and the father-and-son signs made every business street in America a highway of opportunity. These towns were visited regularly by salesmen representing big and little companies located all over America, and they were unquestionably the incubators of the accountable, responsible citizenship that went into the growth of our country. Profits remained in the community, to a large extent, and were invested in homes, improvements, churches, and other local activity. There were none who looked to the Federal Government for loans or relief grants or other money to meet their financial needs.

In time of distress the banker renewed the notes of farmers and businessmen; the local merchant carried many of his customers over the bad days and the suppliers did likewise with the merchants. There were many problems to overcome in those days but the people found ways and means to combat thir difficulties in their own self-determining, self-reliant way.

Then came the mail-order catalog and the farmers and townspeople were seen buying money orders at the post office to send to Chicago for goods which they had been purchasing from their local merchants. Uncle Sam's post office became the general store. The small towns began to suffer the loss of this business and the profits which would have been accrued to the community for the building of a reservoir for investment, et cetera, were drained away.

This was the beginning of the economic dry rot which overtook our towns and cities, which spread at an ever-increasing pace as the catalog was followed by the invasion of the chains. With the spread of the chain stores we got widespread use of the automobile and business began to concentrate in the county seats and other trading centers, leaving the small community to die.

In a few years, the Main Streets of every sizable town in America became drainage canals of the giant chain-store systems and with their coming we witnessed the disappearance of opportunities for our youth; bank revenues were depressed; distant printers sold the chains their printing needs; lawyers in distant cities handled their legal affairs; salesmen who had spent a night or two at the hotels could call on a half dozen towns in 1 day and as this plague of "chainstoreism" continued to spread, small manufacturers, jobbers, brokers, wholesalers, and other people in every walk of life were affected. Yes, we were fast becoming a Nation of giant chain-store systems, giant oil companies, giant soap companies, giant dairy companies, giant steel companies, giant food processors, and other giants, and we now have giant unions and giant Government as the result.

We paid our first big cost of this destruction of individual enterprise in the crash of '29, and we are well on the way to the final crash that will cost us every dollar and every freedom we possess.

I have said that unrestricted opportunity in the market place for a merging of risk capital and individual enterprise is the key to economic freedom, and that economic freedom is the only foundation upon which political liberty can be established. If this is true, then Government loans or Government-guaranteed loans to small business under present conditions would be nothing less than a subsidy program. What small-business men would actually be doing, should they try to obtain such loans, would be borrowing money with which to buy a little more time. That is what our Government did to fight the depression and that is what the Government is doing today. Borrowing money to buy time on the ability of future generations to pay exorbitant rates of taxation.

A look at the tragic failure of the Roosevelt spending program reveals beyond a shadow of doubt that the billions spent to bring about recovery were gobbled up by the chains, loaded into armored money trucks and carted out of the communities before they had a chance to contribute to recovery. All during those years the independent retailers were giving credit to millions of people, and as I said before, suppliers were giving credit to the retailers. I sometimes wonder what would have happened if those millions who were thus helped by the little fellows had not been so helped. Yet, all during the depression the chains gave no credit and piled up the biggest profits and enjoyed the greatest growth in their history.

I know that it sounds incredible, but the whole future of our Nation is dependent upon what we do to stem the tide of chainism, and what we do to restore independent retailing to the Main Streets of America. The future of the automobile business depends upon this. The future of our great railroad, air and truck transportation systems depend on it. The future of our banking system, and in fact, the future of the lawyers, doctors and everyone else, including the future of the Congress of the United States, is dependent upon what we do to save and expand independent retailing.

Consider a little retail store with a volume of $500 weekly. First of all, we find that literally scores of salesmen driving trucks and cars are stopping at this store every day, selling or delivering goods, or selling some kind of service, printing, insurance, or other tangibles and intangibles. Check this flow of men and cars and trucks with the number who deliver to or attempt to sell anything to the chain store manager doing a business of $20,000 weekly and you could understand quickly that if all the independent retailers were eliminated the mass production of cars and trucks would end right then and there. Even the florist makes more money on the sale of flowers at the death of a small merchant than he can make on the sale of flowers following the demise of a dozen chain-store managers. The customers, wholesalers, salesmen, manufacturers and other suppliers, including the doctor and lawyer and banker, plus friends and relatives, usually bank an undertaker's parlor with their tributes to the little guy who lived among them for years and years. The poor chain-store manager has no business with suppliers or the bank and he doesn't remain in a community as a rule long enough to establish a following.

This is not an exaggerated example. It is easy to show that elimination of the independent retailer in all fields would eliminate all the wholesalers and jobbers. Practically all of the small manufacturers who cannot produce in volume to satisfy the demands of the chains; practically all the banks, printers, sign companies, small meat packers, lawyers, accountants, salesmen by the millions, the hotel business and everything else would go to the dogs if that is where the independent retailer is going. Yet who has the hardest time to get risk capital if it isn't the independent retailer? And if it weren't for the independent retailer, how could any small manufacturer, wholesaler or other business dependent upon the independent for an outlet—obtain risk capital?

If risk capital and individual enterprise is ever to be the spark plug—yes; the motor of a future of peace, prosperity and happiness in this Nation, then every single advantage the chains now hold over the small retailer must be taken away, and every inducement possible must be held out to encourage investment in the retail field, and encourage young people to go into business for themselves.

In last month's Fortune magazine, a most tragic story was written under the title of "The Class of 49." Fortune magazine sent a man across the country to interview the 1949 graduates on what they wanted to do when they got their graduation papers. Here was the gist of the article:

> Small business is no longer the promised land. Above everything else security has become the great goal. The class of 1949 wants to work for somebody else, preferably someone big. From the huge metropolitan universities to the small town campuses the men of 1949 seem to be haunted by fear of recession. The role of the individual enterpriser is not coveted, nor for that matter, does it seem properly understood.
>
> Similarly many shy from any line of work that, because of its demands for enterprising spirit, is associated with coronary thrombosis or high blood pressure.

You might like to know, Mr. Patman, that on the national average 2 percent of the students said they wanted to go into business themselves, but in the State of Texas, 75 percent wanted to go into business for themselves.

I made six speeches in Texas—I have Texas in my blood. Texans want to protect themselves against the big insurance companies and against the big businesses, and it is too bad we do not have more people like that.

Just as the father and son signs were taken down on the Main Streets of the United States of America, they must start going up again and if we delay this process of transforming our economy from one of centralization to one of decentralization, we will pay the same penalty that has been paid by every other nation that violated those principles which we have violated.

Once we get a real decentralization program under way; once we take away the special privileges enjoyed by the giant chains; once we adjust our methods of taxation to encouraging individual initiative instead of destroying it as we are today, the risk capital which is now hiding will come out of hiding and banks will be able to lend money to enterprising people for the purpose of promoting enterprise.

I know that Studebaker, Packard, Kaiser or any of the independent automobile companies would run rings around their giant competitors if they could buy their raw materials at the same price that is charged their bigger competitors. I know that the average competent independent grocer will run rings around the giant chain if he is not handicapped by the shackles of special privileges enjoyed by the chains, and the same thing can be said about small and medium-size business in every line of endeavor.

Big business is here to stay. We need big business and we will have big unions and big government, but all three have grown too big, just as the farm co-ops have grown too big by receiving special tax advantages, and by gobbling up enterprise after enterprise, forming combines to fight the combines of big business. If we can decentralize the chains and the other giants, such as General Foods, General Motors, General Mills, Standard Brands, National Dairy, Borden, United States Steel, American Products, Aviation Corp. of America, Goodyear, the big life insurance companies, Giannini Corp. and all the rest; and if we will take the giant farm co-ops apart—we will be able to take giant labor apart, and we will be able to restore control over local affairs—we can, through this unwinding process, usher in the longest and greatest period of progress and prosperity the world has ever witnessed. And better yet, we can save the next generation from frustration, and defeat communism and socialism in the only way that either will ever be defeated—that of making the American idea a living, breathing, working force for the good of all mankind.

Sears and Roebuck and Montgomery Ward ads are simple examples of what the independent is up against. Here is an advertisement of Montgomery Ward. Ask yourselves what was back of this.

Wards advertised a fishing reel at $2.98 in 1939, which they said was made by the same manufacturer of one selling in an independent store for $6. The heading on the ad said:

> Don't pay double for a famous name. Both are built in the same factory and to the same specifications.

Advertising washing machines Montgomery Ward said:

> Why waste money paying $89 for a washer when you actually buy a finer washer at Montgomery Ward and save at least $32.

Then we move over to Sears and Roebuck, and they say:

> Made by a famous national manufacturer—we would lose our shirts if we mentioned his name—but he is father to the most advertised mattress in America. We give our solemn word that the sister under the skin of our mattress is spread over the pages of most magazines and impressively priced at $39. While we cannot actually mention the maker's name and how we get his mattress with the box spring to sell at $29.95, you can look at the label and see the bargain you are getting.

This ad was run in 1939, and unquestionably referred to Beauty Rest mattresses. When they can advertise a nationally known mattress at $10 below what the other person is selling it for, and usually below cost, his own cost, what are we coming to so far as independent retailing is concerned?

Who would loan money to an enterpriser today who would want to sell soap in competition to Procter & Gamble and Lever Bros.? Who would loan money to anyone who wanted to make light bulbs in competition to General Electric? Who would invest money in a tire factory to make tires in competition to Goodyear or Sears and Roebuck? Who wants to put up money for a young man starting a tire store, grocery store, or other small business in competition to the giants who have taken over in the retail field?

Even the boy who has become an expert in photography and who needs a few hundred dollars more to buy lamps and furniture, is asked how he expects to compete with the chain department store or chain studio, offering to take and color a picture for a dollar, which offer is a come-on for the purchase of other goods or more pictures.

When we solve this problem; when we begin a much-needed war upon cutthroat competition and when we apply the right kind of antitrust laws to those who are violating the spirit of the antitrust laws, then and only then will we be able to take the monsterism and monopoly out of labor and the monsterism and bureaucracy out of government. Only then will we logically, systematically, and successfully approach the problem of getting risk capital into the hands of people who begin things.

Did the woman who ground up tapioca for the first time and whose tapioca pudding led to the establishment and success of Minute Tapioca Co., have to borrow money guaranteed by the Government to become a success? Did the young man who sold a blend of coffee to the old Maxwell House in Nashville, need Government help to launch the business that became the Maxwell House Coffee Co.? No, gentlemen, they did not; but after these companies were built up, the General Foods Corp. came along and bought them up at exorbitant prices, just as they bought Jello, Baker's Chocolate, and some score or more of other corporations.

We ask and recommend that this committee recommend that General Foods and all the rest of their ilk be taken apart, and I include the big chains, the chain banks, the giant holding companies in all fields, in this request. Otherwise we will get what the feudal lords of Japan imposed upon the Japanese; what Hitler imposed upon the German people; what the Socialists have imposed upon Englishmen, and maybe we will get what Stalin is giving the Russians.

Gentlemen, I do not need to tell you that the RFC asks for the shirt off the back of the small-business man who needs a loan. I do not need to tell you, as another example, that Metropolitan Life has assets greater than the combined assets of General Motors and United States Steel; that the five largest insurance companies are interlocked with some seven or eight hundred corporations and approximately two hundred banks, yet the giant insurance companies have no risk capital for small business—only risk capital for big business.

This is a terrible situation, especially when one stops to consider that millions of small businesses are paying huge sums to these insurance companies and banks for various kinds of protection, yet they cannot borrow on any of these funds. The situation becomes even more ridiculous when one considers that the money paid into these big insurance companies and banks by the small businessmen is invested in big businesses which are putting the same small businesses out of business.

General Eisenhower says that we cannot tolerate all this abuse of power which is dominant in our economic and political affairs. Eric Johnston says that if we don't stop monopoly we are sure to get what Britain is getting. Herbert Hoover said, in 1934, that we are building up a form of economic autocracy. Franklin Roosevelt condemned monopoly in all forms and deplored the fact that the owner of the store had been replaced by a managing clerk, and the owner of the factory was now a superintendent with less powers than a bill collector.

In the controversy between Big CIO and Big Steel, and in the case of Big John and Big Ben, we see on full parade the results of all these trends to centralization of power in the hands of the few. I don't know how anyone can ignore the danger when such papers as the Washington Star and the Scripps-Howard Post hint at nationalization of the steel and coal industry. When such free-enterprise stalwarts as Senator Kilgore and Senator Ralph Flanders speak of price-fixing powers by the President and the possibility of making the steel industry a public utility.

These are frightening suggestions, as frightening as the statement of Henry Luce, in 1935, when he said that if we do not "unwind" our economy, the day will come when "the biggest show on earth will be mysteriously controlled from above."

This feeling has been expressed many, many times by Senator O'Mahoney and scores of other prominent men and women in the House and Senate. Not long ago Senator Taft said that if we are to become a nation of big business, "we might as well turn the country over to the Communists."

Just where bigness begins to become too big, I do not know, and I do not think we should try to determine the exact point, but we can say that the du Pont Empire is too big to control General Motors, which in turn is too big in the automobile business to be allowed to go into the refrigerator business, control the Ethyl Gasoline Corp., and other such subsidiaries. All that bunk the du Ponts are putting out about the benefits which have been derived from the monsterism in the du Pont structure is on a par with the tripe which the A & P Co. is now spreading to confuse the public and debase the Department of Justice.

With regards to A & P, who will say that A & P has not destroyed the jobs and investments of millions of Americans, when the record shows that said company has blackjacked growers, manufacturers, processors, newspapers, and others with whom they deal, into complete submission to their demands, using such favors gained as weapons against smaller competitors who had invested their savings in various kinds of enterprises, with no thought of being attacked by forces that no individual could fight.

Take the Albany report of A & P in 1941, as revealed by the Department of Justice, as a flaming example of A & P infamy:

Net profit of the Albany, N. Y., unit	$425,000
Subsidiary profit, Albany, N. Y., unit	244,741
Quarterly advertising allowance (same unit)	140,000
Local advertising allowance (same unit)	21,555
Stock gains (same unit)	47,425

The retail stores of this unit, however, reported a loss of $28,999.

Twenty-four percent of all retail stores operated in the red for 3 years, 16 percent for 4 years.

I just wonder if this article in the Chicago Daily Tribune has escaped your attention? I think it is the beginning of a battle between monopoly and government of the people. I think if A & P win their case in the court of public opinion that we might as well toss all our antitrust laws into the wastebasket.

Here is what they had to say:

> The Government's suit to dissolve the A & P chain of 6,000 stores into 7 unrelated chains isn't going to do the Truman administration any good politically. For every corner grocery whose vote may be gained, Mr. Truman will lose a hundred votes of housewives.
>
> The A & P is justly popular with them. They know that it isn't a monopoly. They know that the competition among grocers is intense, that it never relaxes, and that it has resulted in a steady lowering of distribution costs. There isn't a shopping center of any consequence in the country which hasn't its quota of stores belonging to competing chains, and a good many independents beside.
>
> Every housewife knows there is no collusion among them and that an attempt by any of them to gouge the public with extortionate prices would simply result in the loss of business. Manifestly, the existence and growth of successful rivals to A & P is proof that A & P is not ruining them by unfair competition, restraint of trade, or anything else.
>
> If A & P is to be dissolved merely because it is big and successful, then most of the other chains must be dissolved for the same reason. This is a result which no housewife will welcome because it will threaten the loss of all the economies which the chain stores have introduced in the distribution of food.

The A & P Co. ran a full-page ad, which was paid for out of the consumers' pocketbooks, in most of the important newspapers in the United States. A study of that ad will prove there is not one single statement of truth in it, and it will also prove that the A & P Co. has declared war on government of the people.

Who paid for whatever gains the consumer received from A & P? What was the over-all economic loss to the country? Who could successfully compete with such an operation as this?

When one looks at the whole record of this octopus of the retail field, there is only one logical conclusion that one can reach, and that is—remove the tentacles. And speaking of risk capital, what banker would lend what small businessman what money to go into what business against such odds?

As C. T. Habegger, of Berne, Ind., has said so many times, "We have worshiped size, price, and speed for so long that we are losing all sense of direction." Or as Roger Babson put it, quite recently, "Today the big corporations are frozen big while the little businessmen are frozen little."

Is it any wonder that we are hearing such men as Charles Egley, of the Live Stock Commission, saying, "We must get rid of the profit system and replace it with the cooperative system"; that prominent church groups are passing resolutions favoring consumer-cooperatives over private enterprise, expressing their belief that no other force can lick private monopolies except a great organization of consumer co-ops?

Senator O'Mahoney has long asked for a break-up of the vast network of interlocking directorships as evidenced in the structure of Westinghouse, A. T. & T., United States Steel, Sears and Roebuck, Lehman Bros., and other such combines. Certainly the TNEC hearings revealed beyond a shadow of doubt the need of unscrambling these directorships. But what has been done since toward carrying out TNEC recommendations?

We developed a pattern in the death sentence of the Public Utility Holding Company Act which we should have applied to every kind of business where such action could be taken safely. You will recall the hull-a-balloo that was raised when the death sentence was proposed. We were informed that the whole utility industry would collapse on our heads. We know that it didn't collapse, and although the spirit of the act has been violated in cases and not fully adhered to, the unwinding of those giant public utility holding companies which have been unwound has resulted in great economic gain.

I will never forget Owen D. Young's statement when he said:

> Great numbers of operating utilities with holding companies superimposed on the utilities, and holding companies superimposed again on these holding companies, investment companies and affiliates, which made it, as I thought then and think now, impossible for any man, however able, to grasp the situation.

Louis Johnson, Secretary of Defense, referred to this superimposition upon our economical life as unbridled ambition of "merger-mad groups who are destroying free enterprise."

We, of the National Federation of Independent Business, would go a step further and say that—

> mergerism and chain stor-ism are not only destroying free enterprise, but setting the stage for the downfall of modern civilization.

Under such conditions as these, might we not turn to Lenin for advice——

The CHAIRMAN. Before you go to this new subject, I think it appropriate to interject here that the bill which was recommended by the TNEC to give the Federal Trade Commission power to prevent monopolistic mergers by the acquisition of assets, as well as by the acquisition of stock, it being the intention when the Clayton Act was passed, to prevent monopolistic mergers, including the acquisition of assets as well as stock, has now not only passed the House, but is at this moment under active consideration by the Judiciary Committee of the Senate.

Mr. WIMMER. I will testify on that tomorrow at 2 o'clock, Senator, before the Judiciary Committee.

The CHAIRMAN. I thought you would, and hoped you would.

The President has recommended that; he recommended it in his first economic report under the Employment Act.

It has been recommended for years by the Federal Trade Commission.

Mr. WIMMER. I think it is going to pass this time.

The CHAIRMAN. It looks as though it will pass this time.

The curious and anomalous fact is that businessmen who would be the principal beneficiaries of the enactment of such a law are among those who are opposing it. Of course, it is not surprising to find some lawyers opposing it, who are the representatives of the promoters of mergers. I hope that you will make an equally strong statement.

Mr. WIMMER. I am going to make that point.

The CHAIRMAN. I hope you will make an equally strong statement before the Judiciary Committee.

Mr. WIMMER. Am I talking too loud or too fast?

The CHAIRMAN. Not at all; you are doing fine.

Mr. WIMMER. Under such circumstances and conditions as these, might we not turn to Lenin for advice, who said, and I quote very slowly:

The strength of capitalism lies in the strength of small production, for, unfortunately, small production still survives in a large degree and gives birth to the bourgeoisie constantly, daily, hourly, spontaneously, and on a mass scale.

Unless we take heed from Lenin's words, and give strength to capitalism by giving strength to established small enterprise, and opportunity to new enterprise, how are we going to develop a strong enough middle-class population of individual enterprisers who will have the financial strength and the courage to meet the increasing burdens of debt interest; increased local, county, and State and Federal taxes? Plus all the bills we will be paying for our bought-up friends across the sea? Our young people will repudiate the mortgage we have hung around their necks and turn their backs on free enterprise if we fail them now.

I honestly believe that we can safeguard their future if we will open the vast frontiers of individual initiative, of inventive genius, of new discovery, by facing the truth that America became great because we fostered individual enterprise; because we nurtured freedom of opportunity and cherished our political liberties. All of this can be wrapped up in one package and be labeled with one word "decentralization."

If we do not decentralize, if we do not, as Jefferson urged, "restrain men from injuring one another," and establish a set of rules to govern the market place, similar to the rules which govern a prize fight, a horse track or baseball diamond, then we can write "finis" across our free enterprise system now, and get ready to turn over to our boys and girls the corpse of capitalism.

The Wall Street Journal summed it all up in these words:

When we have monopoly, the free market dies. Some other force must fill the vacuum. The force will be first, "the men * * *" then "the man," who will monopolize the monopolies.

The little shoe repairman who is paying more for his supplies than his larger competitor is in the path of monopoly. The little tire dealer who pays as much for tires as his chain competitor sells them for, is in the path of monopoly. The little steel mill who is fitted into the squeeze between the giant union and the giant United States Steel is being squeezed to death by monopoly. The small meat packer, dairyman, feed mill, department store, and all the rest are in the same boat. Add to this monopolistic condition the effect of inheritance taxes on small business; the enormous amount of book work as a result of increasing taxes; the unfairness of present income taxes as they affect small business, plus narrowing margins due to high prices, increased labor costs and the large amount of money needed to start or conduct the average small business, and it is no wonder that so far as small business is concerned, risk capital has gone into hiding.

To aid in improving the position of established small business, and to aid in opening the avenues of opportunities to millions of Americans who wish to go into business or otherwise become important in their communities, which was a promise we made to our war veterans while they were on the battle line, the National Federation of Independent Business recommends:

(1) A swift overhauling of the tax structure as it affects competitive, independent business, with the idea of removing obstacles to obtaining short- and long-term loans, and of encouraging the investment of risk capital at the local level. Exemption of the first $25,000 earnings from income tax as proposed would be one incentive. Another might be an exemption of $1,000 of business income tax on each employee up to 50 persons. A third approach worthy of consideration would be income-tax exemption on any earned money of individuals that is invested in any new, independent business, or loaned to an independent business.

The Congress should investigate the difficulties encountered by small business in dealing with the Reconstruction Finance Corporation, extending that agency's powers to guarantee long-term loans under a "reasonable risk" clause.

Repeal of the excise taxes is a must if thousands of small businesses in those lines affected are to be launched. There is no excuse whatsoever to continue wartime excise taxes adopted to discourage the purchase of certain goods, at a time when everything must be done to encourage investment, encourage new business and to maintain high levels of employment.

The Federation is convinced that removal of wartime excise taxes would result in a spurt of buying power that would more than make up for any revenue loss resulting from repeal of this obnoxious form of taxation.

I wanted to buy a new traveling bag for the last year. I look at the bag and it says "$30" in the window, and it says "$6 tax," and I am still carrying my scratched-up traveling bag.

We also recommend a study of inheritance-tax rates as they affect independent, competitive business. Not long ago I talked to a member of an organization known as Associated Equipment Distributors whose partner had died. The inheritance tax made it necessary to liquidate the company.

There are times when firms formed on a partnership basis between father and son, or unrelated people, that such firms are judged closely held partnerships or corporation.

I believe an investigation will show that where steps are not taken to evade payment of State and Federal inheritance taxes, that many businesses have either sold out, merged, or been greatly weakened by said inheritance-tax rates. Suggestions have been made that members of small firms be insured to take care of this emergency, but this is not always possible.

We urge the committee to give special consideration to the tax problems of small business with a view to liberalizing loans, and with a view to encouraging investment of risk capital.

As retailers now handle some 68 cents of spendable income, retailer problems should be of vital interest to the committee. Retailer tax problems and loan problems are probably greater than are faced by any other kind of business, yet this is the field where individual enterprise could be more successfully nurtured than in any other.

The difficulty of obtaining funds for research and funds for the development of new inventions in the small-business field needs attention. Too long have we heard that an inventor is at the mercy of big business.

(2) Risk capital will not be available in volume, nor will long-term loans be justified to any great extent so long as the small-business man has to pay more for his merchandise, equipment, et cetera, than is paid by his bigger competitors. Manufacturers selling advertised brands should not be permitted to sell merchandise of equal quality or quantity under a private brand at a price under the amount expended to advertise his national brand.

I would like to insert this thought, which I did not incorporate before, and that is that we should study the possibility of stopping all manufacturers from giving any money whatsoever to any types of business for the advertising of their merchandise.

There was a time in this country when if Lucky Strike or Maxwell House coffee or any of the others put an ad in the paper, every seller of the product received the same benefits.

Today they are spending hundreds of millions, running into billions over the years, which they are giving to the chains, and in many cases the chains have bought newspaper advertising at local rates when they received the national rates from the manufacturers. The records will show that this is true, and I think we should find some way of prohibiting advertising money from going to the chains to advertise any national-brand product.

The violation of this principle is one of the major contributions to the development and growth of the giant chain-store systems, and should be outlawed. There have been a large number of cooperatives formed by independent retailers who have made mass purchases of goods, using their own private brand, to combat the unfair competition of national-brands manufacturers and chain-store systems. These cooperatives would not need any special concessions in a free market, and I am sure that all would gladly give up any concessions now enjoyed if all advantages were taken away from the chains.

In considering the problems of loans and risk capital, it might be well to explore the effects of the Robinson-Patman Act to determine any weaknesses that might exist in said act.

Now, gentlemen, I am coming close to the end.

Early Senate adoption of the bill passed by the House to plug the loop-holes in the Clayton Act, and thus outlaw the merging of competing corporations, is essential to opening the avenues of risk capital and long-term credit to independent business. Thousands of manufacturers are now sitting tight, waiting for or planning a merger with a bigger corporation. These manufacturers should have this avenue of escape closed so that they will get down to the business of making a "go" of their enterprise, but the fact cannot be overlooked that risk capital and loan problems, plus the growing encroachments of big labor and big government, plus the unfair advantages enjoyed by big business, big farm co-ops, et cetera, are obstacles in sufficient number to discourage any small manufacturer, processor or other small operation.

If the antimerger bill passes the Senate, which ought to be soon, and if legislation can be adopted similar to the Public Utility Holding Company Act, which would follow through with an unscrambling of those combines put together in violation of the spirit of the Clayton Act, the investment market would skyrocket, and loans to small business would be made at the local level on a scale unparalleled in our history. Years ago we prohibited meat packers from going into the retail business to prevent monopoly.

I say under these conditions, the way we are permitting Goodyear to open up their stores that we are performing an injustice against those meat packers. Why should Goodyear be allowed to go out and destroy small tire stores, and yet not allow the meat packers to go into the retail business?

I ask you to look at the Main Streets of America today, and you will find a parallel to the biblical statement——

The CHAIRMAN. The degree, Mr. Wimmer, to which the minds of men in business and men in journalism have been closed to the dangers that you have pointed out, was forcibly illustrated in yesterday morning's Washington Post. There was a full-page ad sponsored by Standard Steel Spring Co., under the title, "Who's Shooting at Who, and Who's Going to Get Hit?"

This advertisement was directed against criticism of monopolistic business. It appears, however, to be an argument against what is alleged to be an attack upon the United States business system.

How far the business system has departed from the standards of American principles is indicated by this paragraph in the advertisement:

> As usual, the truth is in the records, so let's take a look at some facts and figures, and call a spade a spade. First, just what is big business? It is not big at all in the sense that the critics would have you believe. It is actually big management of the affairs and interests of a whale of a lot of good average Americans.

Now, there is a bland recognition of the fact that there is a distinction between management and ownership, and that the economic system now is privately managed, that we have big private management, and that it leads directly to big public management, as you have so forcefully stated in this paper.

Curiously enough, in the first editorial published by the Washington Post in yesterday morning's paper, containing this advertisement, there was an editorial on the pay bill which is now pending before Congress. The purpose of the pay bill, of course, is to increase the salary of those who have charge of executive agencies on the ground that unless we do that——

Mr. WIMMER. You cannot get them.

The CHAIRMAN (continuing): We cannot get the men who are capable of handling these big affairs; and the Post says, in the course of this editorial:

> We had hoped that with big government an actuality demanding the best brains that can be hired, legislators would rise above such petty considerations.

The petty considerations were the suggestions by some Members that perhaps the salary increases were too high. But here is recognition, first by a business outfit that we have big management, and then by the editorial writing that we do have big government.

Mr. WIMMER. What greater contribution to the development of big labor and big government could a thing like this be, and where could you hire a brain for even $300,000 a year, that could even begin to understand the workings of these giant corporations, no matter how many charts they could have. Here is Lever Bros., in 37 countries, 400 subsidiaries, 800 factories; Uni-Lever, the twin, dominates the world's soap and margarine business, sells ice cream, rubber, cocoa, lye, paper, salad oils, candles, baked goods, perfume, tooth paste, vitamins.

It operates 2,000,000 acres of palm-oil plantations in the Belgian Congo in Africa. It owns 300,000 acres of cocoa plantations in the Solomons.

They control the Lipton Tea Co. They have the exclusive rights to all Birds Eye foods and frozen foods processed in the United States. They run a General Motors agency in the Union of South Africa; the world's greatest private printing plant, and the largest private bank. Lever Bros. is the prize of the empire, which Mr. Luckman operates for a salary of $300,000 a year.

Soldiers who took Guadalcanal told that they were advised that for every tree that was damaged, it would cost the United States Government $50 each, payable to the Dutch holding company of Lever Bros.

Tom Linder, director of the Agriculture Department of Georgia, told this and more to an audience in which there were 260 Congressmen. How in the world, Senator, and Congressman Patman, can you find a Brain Trust—where would you find a Brain Trust—who could even begin to analyze what they ought to do about a thing like that?

Mr. PATMAN. I have to leave in a moment. May I ask him a question or two?

The CHAIRMAN. Certainly.

Mr. PATMAN. Concerning the chain-store question, Mr. Wimmer, I have known for many, many years your interest in the problem. Has your organization interviewed—I mean, what do you call it, interrogated——

Mr. WIMMER. The man-on-the-street, or something?

Mr. PATMAN. Interrogated your membership?

Mr. WIMMER. Taken a poll?

Mr. PATMAN. On some kind of a chain-store bill on what they would like to have and what they would stand for?

Mr. WIMMER. Yes; I have not the exact figures, but it was overwhelmingly for the revamping of the Robinson-Patman Act, if necessary, and the licensing of chains in order to control their further expansion. Such was our proposal.

Mr. PATMAN. You heard what I said yesterday about restricting them to 500—that was just an arbitrary number taken out of the air.

Mr. WIMMER. I think that is too many.

Mr. PATMAN. What about 100?

Mr. WIMMER. I would say that 100 might be a very good figure to establish as a limit.

Mr. PATMAN. And the farmers, as well.

Mr. WIMMER. And the farmers. We have a case up in Maine where the Maine potato growers organized and went to their governor with petitions and everything to try to stop the slaughter of potato prices in Maine, claiming they were all going bankrupt. We have evidence in the Judge Lindsay trial, at Danville, where they actually had the man who was in charge of the purchases for the farm co-ops on the A & P pay roll.

Mr. PATMAN. Yes; it was brought out in the testimony.

Mr. WIMMER. Here, I think is something which proves a point. I picked this up in 1945, a statement of Gilbert H. Montague, member of the New York bar, author of The Control of Retail Prices. I think you have all heard of him. He said:

Chain-store organizations found the national brands a made-to-order tool for expansion on a grand scale. The Federal Trade Commission's investigations showed that the grocery and drug chains did more than 20 percent of their total volume at a loss on loss leaders. It also shows that these losses were almost wholly on nationally known brands. Trade-marked articles are manipulated for the three-fold purpose of making dupes of the unsophisticated consumers, undermining the independents, and concentrating business in stores strong enough to work this racket. In essence, it is dishonest, despotic, and monopolistic.

Now, listen to this from their own man. This is a statement of William J. Baxter, who was director of Chain Store Research Bureau, of New York. He said:

To me there is not any question as to the advisability of any retail store, if it can, to sell some nationally known products at cost to get the crowd. A consumer will go to a grocery store and she is willing to pay 50 cents for steak, whereas it might be sold for 50 cents elsewhere, if she, at the same time, can purchase Campbell's soup or some other package goods at cost. Scientific retailing means studying the blind articles in the store, and selling them at full prices. But what we call open articles, the ones that every consumer can go from store to store and compare, sell them at low prices.

That is from one of their own boys.

Mr. PATMAN. Your statement is very interesting, and thought provoking. I enjoyed it very much, Mr. Wimmer.

The CHAIRMAN. It was.

Mr. WIMMER. Following the Insull scandal we decided that it was wrong for a few men to control the power and light industry. Recently we held that the motion picture producers should get out of the theater business. Therefore, what is wrong with getting the tire makers out of the retail tire business; and shoe manufacturers out of the retail shoe business and what is wrong with taking General Motors apart, and all other combines, such as National Dairy, Sears and Roebuck, A & P, General Foods, and others?

Here is a chance to open wide the floodgates of individual enterprise and risk capital, and a chance to put a muzzle on the socialistic-minded groups who say the only way to lick a monopoly is for the Government to take it over. Naturally, any such decentralization program as proposed should take in the giant farm or other consumer cooperatives.

The antitrust laws were passed in the first instance to insure every enterpriser an opportunity to compete in a market place where the same rules applied to all. The underlying principle of the antitrust laws is the public good. Of what good is it to turn out hundreds of thousands of young men and women—many of them veterans—from our business schools and Government training institutions, and then have them find that the channels of individual enterprise are closed to them.

On July 14, 1947, our president, Mr. C. Wilson Harder, made the following statement presented before the Joint Committee on the Economic Report:

Antitrust laws must be enforced, not merely by lip service but by a directive of this joint committee to the respective agencies.

Both Democratic and Republican platform committees of last year's conventions contained antimonopoly planks recommended by our organization in the statement presented by George J. Burger, our Washington representative, before the platform committees in the conventions in Philadelphia.

We of the National Federation of Independent Business believe that the whole structure of antitrust legislation needs to be reexamined and redesigned to meet these changes in our modern life. Justice Douglas recently declared:

> The Sherman Act is founded on a theory of hostility to the concentration of economic power so great that only a government of the people should have it.

I would say that the antitrust laws are the only real insurance we have against socialism and communism, and if they are not streamlined and used effectively against monopolistic big business and monopolistic big unions, we will have a Socialist government within a few months after we get the next depression.

If we permit a depression to come upon us with world conditions what they are, neither antitrust laws nor any other law will save us.

Our position regarding the reconstitution of the Senate Small Business Committee is well known, and our position on increased appropriations for the Department of Justice and Federal Trade Commission is established in the mind of all lawmakers.

In the book of Isaiah, chapter 5, verse 8, it says:

> Woe to them that join house to house, that lay field to field, till there be no place that ye may be placed alone in the midst of the earth.

The CHAIRMAN. This is the end of the testimony of this preliminary hearing.

Mr. PATMAN. Excuse me, please, sir.

The CHAIRMAN. I am glad that you were here, Congressman.

Mr. PATMAN. Thank you, sir.

Mr. WIMMER. The Congressman probably feels that I will take care of his end of the argument.

The CHAIRMAN. Do you have any questions, Mr. Scoll?

Mr. SCOLL. No.

The CHAIRMAN. Well, Mr. Wimmer, the Senate bells are calling.

Mr. WIMMER. I do not want that buzzer to sound on me.

The CHAIRMAN. We will have to terminate this hearing.

I am very much obliged to you, sir, for your very provocative statement.

Mr. WIMMER. I feel it a great privilege to be here with you, Senator. I have wanted to do something like this with you for a long time, and I consider that it is really a privilege to come to Washington to be able to sit down with men under conditions of freedom and to enjoy such freedom of speech as I have enjoyed today.

The CHAIRMAN. The hearings will be adjourned.

(Whereupon, at 12 noon, the committee adjourned, subject to the call of the chairman.)

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