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BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
Washington 25, D.C.

December 18, 1944

Honorable James E. Murray, Chairman,  
Special Committee to Study Problems of  
American Small Business,  
United States Senate,  
Washington, D. C.

Dear Senator Murray:

In response to your circular letter addressed to the individual members of the Board of Governors asking for expressions of opinion on reconversion credit legislation for small business, the Board submits this reply. The ten specific points set forth in the letter are having further study.

The Board is already on record as favoring the enactment of the Wagner-Spence bill (S. 1918) which would authorize the Federal Reserve Banks to guarantee business loans. It regards this measure as the simplest and most effective means of aiding reconversion and postwar economic readjustment by stimulating the greatest possible use of private credit. Although the liquid resources of business as a whole, including small business, have increased greatly during the war, there will be enterprises that must resort to credit in order to accomplish their individual reconversion and readjustment. The credit needs of a substantial number of these can be met by the banks in the form of regular bank loans. The Board believes, however, that in many cases the financial needs of worthy enterprises, particularly during the reconversion period, will represent degrees of credit risk that banks ordinarily should not be expected to assume.

The desired extension of the credit area to cover these situations may be brought about either by encouraging the private banking and credit system of the nation to perform the task or by further expansions and innovations in direct lending by the Government. The Board emphatically favors the former course.

The Board recognizes that whenever private credit appears to be restricted or otherwise inadequate, pressure for increased Government lending is inevitable. However, no expansions of Government activity in the field of credit should be permitted unless and until it is clearly demonstrated that the private financial system is either unable, or able but

unwilling, to do the job. The supply of funds today in the hands of the private banking system is abundantly adequate for all demands of reversion and readjustment of business. Bankers are actively seeking outlets for increased commercial and industrial lending. The Board believes that as long as private enterprise in finance can and will do the work, it should be encouraged and aided in doing so.

The Wagner-Spence bill embodies principles which the Board considers sound. It abolishes the direct lending features of Section 13(b) of the Federal Reserve Act and, without additional Congressional appropriation, extends and makes more workable a loan-guarantee mechanism by which the private banking system could meet more fully the credit needs of business and industry.

Arguments in behalf of this bill have already been presented by Chairman Eccles to the Senate and House Committees on Banking and Currency. The arguments in favor of the bill, as changed by three limiting amendments, suggested by the Chairman in the hearings, may be summarized as follows:

The bill would encourage a greater flow of funds from the private banking and credit system into those marginal credit risks which banks would not assume without a guarantee.

All loans would originate with banks or other private financing institutions. Amounts, terms, collateral and other details of proposed loans would be worked out between the borrower and the financing institution to which he applies. Thus the operation of the plan would be decentralized throughout the United States.

Credit extensions in the marginal area of risk would be encouraged by guarantees up to 90 per cent of those loans on which banks may desire guarantees. The lender would share in the risk to the extent of 10 per cent or more, which would be a sufficient exposure to prevent lending institutions from involving the guarantee fund in careless or excessive credit hazards.

No new appropriation would be required. An appropriation made by Congress in 1934, amounting to \$139,000,000, would be adequate to guarantee a total of more than \$500,000,000 of loans outstanding at any one time.

The benefits of the guarantee would go primarily to the smaller units of business and industry. For the small businesses that are regarded by bankers as marginal or debatable credit risks, the guarantee would be the decisive factor in establishing their credit. Term lending, in which the risk factor is generally higher, would be especially encouraged.

The plan would be administered by experienced personnel in the Federal Reserve Banks who are administering the V-loan and T-loan programs, a similar credit mechanism. Financing institutions are already familiar with services of the Federal Reserve Banks in this field. Thus no new personnel, controls over banking, or untried activities or principles, are involved.

Finally, no competition between direct Government lending and the private credit system would be involved. On the contrary, the guarantee plan would encourage the existing private system to extend credit which otherwise might be furnished by the Government or not at all. The trend toward multiplication of Government credit agencies, if continued, may threaten the destruction of the private banking system.

Thus far, legislative emphasis, as is natural, has been on the immediate and temporary problems of war contract termination and disposal of surplus Government property. Beyond this is the general need of devoting the nation's resources to the revival and resumption of civilian operations of every type, including increased lending activities of the smaller commercial banks. This need also involves every form of business and industrial financing. On the one hand will be those businesses that have been deprived of materials, markets and manpower, and must revive. On the other hand are small war plants whose expanded borrowings have been guaranteed by war agencies, but who must approach their banks for financing during a period of uncertain changes with the wartime guarantees discontinued. Only the Wagner-Spence bill, among all the proposals for legislation that have come to the attention of the Board, is directed toward meeting this broad and manifold problem within the framework of the private credit system.

The foregoing are the general views of the Board as it sees the problem at this time and on the basis of information available to it. The discussion has been limited to the credit needs of small business, as specified by your letter. The Board wishes, however, to emphasize its view that the problem of small business cannot be met satisfactorily by pumping out more and more credit. Programs in other fields would have greater

importance. Chief among them would be a modification of the corporation income tax giving substantial and preferential advantages to smaller corporations and to new ventures. This would encourage the flow of equity capital to such enterprises and correspondingly reduce the need for credit not obtainable from banks on the usual basis. Another aid to small business would be a provision for better access to industrial research and the use of patents. In the opinion of the Board, such measures would be much more effective in maintaining the competitive position of small business than any of the current proposals to provide more credit through some form of governmental assistance.

Should your Committee hold hearings on this matter, the Board would welcome an opportunity to be heard.

Very truly yours,

(signed) Chester Morrill

Chester Morrill,  
Secretary.