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"LOANS TO INDUSTRY AND BUSINESS BY THE FEDERAL RESERVE BANKS"

Radio Address

by

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Let me thank the National Broadcasting Company for extending me the privilege of addressing the country upon the subject of "Loans to Industry and Business by the Federal Reserve Banks".

The occasion reminds me of a time more than twelve years ago when radio speeches were in their infancy, and when regularly each week I traveled to a North Side radio station in Chicago to deliver talks on educational topics. This evening the topic I shall speak on over this national hookup is a quite different one, and yet in a sense what I said then on economic-philosophic subjects involves the same fundamentals as what I have to say tonight on the subject of credit.

By way of preamble, let me say that it is difficult, to say the least, for anyone to state the principles upon which solution of our economic problems is possible. No economist and no expert has been able to state the remedy clearly and persuasively. That is because each economist and expert sees the situation from his own point of view, and his point of view is based on opinions he has already expressed, especially if he has written a book or two. I am not speaking disparagingly of economists and experts. I think very highly of them and know they have contributed much. But I too have studied and taught economics, and therefore know its limitations as well as its possibilities.

Personally, however, I believe that the beginning of a solution of our troubles lies in a full realization that selfishness is at the bottom of them. If we could, without appearing to preach, or lecture, speak so as to move the heart as well as the mind of man for and in

behalf of his fellow man, we would be making a real step in the direction of a permanent solution of our economic perplexities.

It is humanly difficult, however, for us to see anybody else's needs and sufferings but our own. What is worse, perhaps, it is hard for us to realize that our own welfare rests on what we are willing to do for others. In human relations, repayment in kind is inevitable. We get back, with interest, exactly what we give out to others - good or bad.

You have heard this often and much more ably said than I can say it. Yet you may be inclined to feel that it is too easy and can not be true. You may feel that problems so intricate as ours can not be solved by so simple a method - that there must be some formula much more complex than just this simple formula of charity - real charity.

We are inclined in our own human way to be much impressed by things we do not understand - like the boy who came home from school one afternoon, and all out of breath said to his mother: "We had a very brilliant professor teaching us physics this afternoon. He took the place of the regular professor who is sick, and he talked to us all afternoon and nobody in class could understand a thing he said. It was wonderful." How many of us are just like that boy. We look for complex and mysterious remedies for our ills, and we place on a pedestal the individual whose words are big and whose theories are beyond our mental grasp.

Yet in fact truth is simple. It is here - there - everywhere. We could see it if it were not for the fog of prejudice and ignorance in which we live. Occasionally the fog lifts and then we see the truth that was there all the time. It may be astounding, - it may even be shocking, but seeing it we accept it, for the light of truth is its own evidence, and the mind can not resist it, nor remain dark when penetrated by its beams. So it is with our economic difficulties. The solution of these problems rests in simple truths that are all around us - truths in whose midst we have our dwelling - truths which are near at hand and everlasting - truths which distinguish right from wrong in the relation of man to man.

These are the principles upon which to base the solution of our economic problems; and yet, because the statement of them is so simple, I dare say you are smiling at this moment and saying, "Physician - heal thyself." But no one can do it alone. The problem is collective as well as individual, and the solution must be collective as well as individual.

The correction of evils, economic or social, must begin with a sincere and frank admission of our own limitations - our failures to see the truth. From that point on we can begin to live a new life for the good of society. Once we have begun our new economic and social life based upon these fundamental principles, we can proceed courageously without even the smallest fraction of a fraction of fear, and going forward we become leaders - others follow. The

world never follows one who is afraid or uncertain.

I have mentioned these general and fundamental considerations because they are the essential background to my subject. What I am to speak of is only one of the simple measures that we have adopted in order to meet our difficulties. It is a measure for the lending of money to established industrial and commercial enterprises whose working capital has become depleted. It is not a measure intended to dispel all our economic difficulties. But it is helpful, and for that reason I want to explain it so that every business man to whom it may be of benefit may know of its provisions and how he may avail himself of them.

An outstanding fact about the present business situation is that the banks of the country have an abundance of money to lend. There are two main reasons why this money is not being used by borrowers. The first and most important probably is that responsible business men do not want to borrow unless they are confident that they can make a profitable use of the funds. The second is that bankers do not want to lend unless they too are confident that the borrowers can make a profitable use of the funds. But credit is necessary for business, and no effort is to be spared in removing obstacles to the availability of credit whenever and wherever credit can profitably be used. Accordingly, the Federal reserve banks have been authorized to make a distinct departure from their established practice.

They have been authorized under certain circumstances to guarantee loans which local banks may not be willing otherwise to make, and in exceptional circumstances, to make such loans themselves.

Briefly, the conditions are as follows: A Federal reserve bank will either cooperate with a local bank in making a loan to a commercial or industrial borrower, or it will make the loan direct. This provision applies, however, first, only to loans to established industrial and commercial businesses; second, only to loans which are for working capital purposes; third, only to loans which have maturities of not more than five years; fourth, only to loans which can be made on a reasonable and sound basis.

In administering the law the effort has been to avoid narrow interpretations. The question whether or not a business is an established one is interpreted as liberally as possible, though the law can not by any stretch of interpretation be held to authorize the making of loans to people who wish to start up a new business. Similarly, the term "working capital" can not be stretched to cover loans made for the purpose of the erection of buildings, the purchase and installation of permanent equipment, or the refinancing of existing indebtedness. Such uses of credit are desirable and may be taken into consideration incidentally in passing upon applications for loans to provide working capital, but they do not come within the primary purpose of this law, which applies instead to funds required for current operations.

The requirement that loans have maturities of not to exceed five years is a very generous one. It gives the ordinary business man ample time in which to restore his working capital. He can meet his successive payrolls, purchase his materials, renew his inventories, and turn over his stock again and again before his loan has finally to be liquidated. Generally the loan is made payable in easy installments.

In imposing the requirement that the loans be made on a reasonable and sound basis, Congress has left it to the judgment of the Federal reserve banks as to what security should be required in individual cases. The types of business covered by these loans are of the utmost variety, and for that reason standard requirements as to security can not be made in detail. It can only be required that the security offered, whatever its nature, be adequate. The Federal reserve banks have on occasion accepted real estate mortgages, chattel mortgages, stock and bond collateral, pledge of accounts receivable, endorsement, assignment of life insurance policies, etc. No business man who has assets of value to offer as security need hesitate merely because they do not conform to the types of collateral which banks usually require.

The Federal reserve banks are not in competition with local banks in making loans. On the contrary, the idea is that the Reserve banks should cooperate with local banks, which are the proper agencies to supply credit to their communities. Accordingly, the

first step for any prospective borrower is to go to his local bank and state his needs. He should say to his banker that he is not seeking an ordinary short-term extension of credit, but a loan under the terms of Section 13b of the Federal Reserve Act. His banker should know at once what he is talking about. If he does not, the borrower should tell him what he has heard me say; he should tell the banker that under the provisions of Section 13b of the Federal Reserve Act the Federal reserve banks are authorized to cooperate with local banks in making loans for working capital purposes. In case the banker is not familiar with this fact he should ask him to communicate with the Federal reserve bank of his district and find out the particulars. And the local banker should be glad to do it. Ordinarily, of course, he does not want to make long-term loans; he thinks of the depositors who may at any time demand their money, and he wants his funds where he can call them in quickly if he is subjected to such a demand. But the banker need not worry about the long maturity, for under Section 13b the Federal reserve bank will grant him a commitment to take the loan off his hands during the period of the commitment. That commitment makes the loan as liquid as anything the banker can have in his bank. Furthermore, in taking over the loan, the Reserve bank will assume as much as four-fifths of any loss. It makes no difference whether the local bank is a member of the Federal Reserve System or not.

The borrower will probably find, however, that his banker already knows all this; and if the applicant's credit is good and the loan is one that the banker is justified in making he will be very glad to place his funds in use under an arrangement which assures him perfect liquidity and guarantees him that his loss will not exceed 20 percent of the

If, however, the banker does not respond, the borrower should communicate directly with the Federal reserve bank of his district. The Federal reserve banks are authorized to make the loans direct only in exceptional circumstances and when credit is not available from the usual sources. The loan should be adequately secured and there should be a reasonable prospect that it can be repaid from the operations of the business. The loan is not a gift. Applications are acted on as promptly as possible. They are not referred to Washington. They are passed on in the districts where they originate, and each Federal reserve bank has final authority to reject or approve the loans for which it receives applications.

Let me describe a typical loan. A varnish manufacturer with a plant in a medium sized industrial city needed \$25,000 working capital. He needed it for a longer time than his local bank cared to lend without provision for liquidity. Accordingly, an application was made by the local bank, to the Federal reserve bank for a commitment. After investigation of the business and the security offered the application for the commitment was approved. A loan of \$25,000 was made by the local bank repayable in equal semi-annual installments, the last installment becoming due in four years. The security comprised a lien on plant and equipment, assignment of stock in another corporation and assignment of two life insurance policies. Covering this loan the Federal reserve bank gave the local bank a commitment to take over the loan at the local bank's request any time within twelve months. Before the end of the twelve months it can either procure a commitment for a further period, or ask the Federal reserve bank to take the loan off its hands. The local bank is thus enabled to hold a loan of which the liquidity is assured, and on which its

proportion of loss, if any, will not exceed 20 percent

The provisions of Section 13b of the Federal Reserve Act have been in actual operation for more than a year. In that time the Federal reserve banks have approved nearly 1800 applications, aggregating about \$107,000,000.

As of June 30, the automobile industry was using over \$7,000,000 of this credit. Manufacturers of metals were using over \$5,000,000. The machinery and machine tool industry was using over \$3,000,000. Textiles were using \$2,500,000. Food products, furniture, hardware, grain, feed, and seeds, paper, rubber, stone, clay and glass products, hides and leather, chemicals, jewelry, clothing, among many others, are also represented.

Loans have been made in all amounts. The smallest so far is a loan of \$250.00, the largest a loan of \$6,000,000. It should be clear, therefore, that the program is one which is open to all business men, large or small, whose businesses are established and whose prospects are such that loans can be justified.

The measure I have described, Section 13b of the Federal Reserve Act, is a simple one - like those truths I mentioned in the beginning. Its purpose is to aid business and industry and to maintain and increase employment.

For further information and for application forms, ask your banker, or write to the Federal reserve bank of your district.

Thank you, and good night.