## REPORT ON THE AVAILABILITY OF BANK CREDIT IN THE SEVENTH FEDERAL RESERVE DISTRICT

Recently there was prepared and submitted to the Secretary of the Treasury a comprehensive report on the availability of bank credit in the seventh Federal Reserve district. This report was prepared by Charles O. Hardy and Jacob Viner and is being published by the Treasury Department.

The foreword of the report and sections summarizing the findings as to facts and the recommendations are reproduced below:

### FOREWORD

This report deals with the availability of bank credit in the seventh Federal Reserve district; that is, with the question whether adequate supply of bank credit is available if, when, and as it may be demanded by business men who can offer a bank a reasonable assurance of repayment. It does not concern itself with the actual changes in the volume of outstanding credit—the facts in that regard are well known. The volume of bank loans declined very drastically from the end of 1929 to the time of the bank holiday; held about even in the rest of 1933, and has since made a further moderate decline. The decline during 1934 has been more marked in the case of loans classed as "all other", which includes unsecured loans to industry and commerce, than it has in the case of loans on security collateral.

The decrease in the volume of bank loans since 1929 and its failure to recover since the end of 1932 is typical of the trend of such loans in post-war depressions both in this country and abroad. In 1921–22 "all other loans" in reporting banks in the United States continued to decline for more than a year after productive activity, as measured by the Federal Reserve Board's index of production, had turned upward. In nearly every other country which reports the volume of its commercial bank assets, a similar thing happened in these years. Loans and discounts declined drastically and did not turn upward until a considerable time after business began to revive.[1]

The phenomenon was repeated in the years from 1929 to 1933; in almost all countries loans and discounts continued to decline after the bottom of the depression was reached, early in 1933, and have not yet reversed their trend. On the other hand, bank holdings of Government obligations and other securities have increased, both in this country and abroad, throughout the depression.

The tendency of the volume of loans and discounts to lag behind the upturn of business is not surprising. During a depression those businesses which survive tend to accumulate unused balances of liquid funds on which they can draw to finance the earlier stages of the succeeding expansion. It is only after a considerable interval that the expansion of pay rolls and of inventories and the replacement of obsolete or worn-out equipment necessitates a general resort to the banks. The situation in this respect with regard to bank credit during a depression is similar to what it is with regard to other essentials of production; inventories, tools and equipment, buildings, and the time and energy of managers, are all available in excess of immediate needs.

No alarm need be felt, therefore, merely because of the failure of the bank loan figures to expand. What is important is the question whether credit is available for those business men who do need added funds if they are to be able to make their appropriate contributions to the rising volume of business. Failure of credit to expand on account of a decreased willingness to borrow is a situation which can be expected to correct itself as the need develops if credit is available on reasonable terms.

There is a wide-spread belief, however, that at present the banks are over-cautious in lending, and are particularly reluctant to make the type of loans that is most important in the earlier stages of the expansion of business, that is, loans to finance expansion of manufacturing production. The issue is of major importance, because, obviously, the country cannot get back to a normal volume of productive activity without utilizing a larger volume of bank credit than is needed in a period of subnormal activity like 1932, or even 1934. The Treasury credit survey undertook to investigate this question, for the seventh Federal Reserve district; and also to study the success of the efforts which have been made to relieve the credit stringency through direct loans to industry by Federal Reserve banks and the Reconstruction Finance Corporation.

### SUMMARY OF FINDINGS AS TO FACTS

Our findings consist largely of details scattered through the body of the report. We shall not attempt to summarize them all. Our more

[1] Apparently bank loans, as distinguished from investments, have had a downward trend in this country since the war, independent of fluctuations connected with the alternation of prosperity and depression.

important findings are the following (all statements refer specifically to the seventh Federal Reserve district):

(1) That there exists a genuine unsatisfied demand for credit on the part of solvent borrowers, many of whom could make economically sound use of working capital.

(2) That the total amount of this unsatisfied demand for credit is considerably smaller than is popularly believed, but is large enough to be a significant factor, among many others, in retarding business recovery.

(3) That a very large proportion of would-be borrowers are persons whose equity in the business they control is so small that any bank or individual who lends them substantial amounts is assuming a major part of the risk of the business, rather than the normal risk of a creditor.

(4) That there is a larger unsatisfied demand for long-term working capital credit than for one-turnover loans.

(5) That one of the most serious aspects of this unsatisfied demand is the pressure for liquidation of old working capital loans, even sound ones.

(6) That this pressure is partly due to a determination on the part of bankers to avoid a recurrence of the errors which are thought to have brought on the recent wave of bank failures.

(7) That it is also due in large part to the attitude of bank examiners, both State and National.

(8) That so far as small business is concerned, trade credit is much more easily obtained than is bank credit.

(9) That efforts to relieve this stringency through direct lending on the part of the Federal Reserve Bank of Chicago and the Chicago agency of the Reconstruction Finance Corporation have so far had little effect on the general state of credit.

(10) That both agencies have incurred widespread unpopularity, largely because at the outset of their lending operations publicity was such as to arouse hopes that their policy would be more liberal than the law permits.

(11) That in terms of the existing law and its present official interpretation, the staffs of the two lending agencies just referred to are both doing efficient work.

(12) That existing restrictions on the use of funds to clear up existing debt interfere to a marked extent with the attainment of the purposes of the legislation by which the direct lending system was set up.

### SUMMARY OF RECOMMENDATIONS

Detailed recommendations are scattered throughout the main body of the report, of which the following are the more important:

(1) That banks should be encouraged to make sound working capital loans of 6 months' maturity and renew them indefinitely so long as (*a*) the borrower is able to pay interest out of current earnings, or has the prospect of adequate earnings over a reasonable period of time, and (*b*) his statement continues to reflect a sound position as to net working capital and net worth.

(2) That the rules of eligibility for rediscount at the Federal Reserve banks be modified so that paper shall not be ineligible merely because it has a maturity as great as 6 months, nor because of the number of times it has been renewed.

(3) That bank examiners be instructed to abandon the classification of loans as "slow", so that loans will be criticized only on the basis of doubt as to their repayment or the certainty of loss, and that examiners be more closely supervised and given more specific instructions by the examining authorities, to assure greater uniformity of policy.

(4) That the Reserve banks be relieved of the responsibility of making direct loans to industry. We make this recommendation because we believe that the extension of this type of credit conflicts with more important responsibilities of the Reserve banks as supervisors of the lending and investment policies of the member banks.

(5) That in case the Reserve banks are not relieved of the responsibility of making direct loans to industry, the industrial advisory committees be abolished. This recommendation is based on the belief that the work of the committees is essentially a duplication of the work of the lending officials of the banks and results in an undesirable division of responsibility.

(6) That if the Reserve banks continue to make direct loans to industry, lending officials be given considerably greater latitude, by legislation if necessary, in making loans to clear up existing debt. Specifically, we suggest that the Reserve banks entertain applications for the purchase, on a 20-percent-participation basis, of adequately secured notes now or hereafter held by banks representing working-capital advances already made. In passing upon applications for such advances, attention should not be given to the date when the advance was originally made, except as it bears on the adequacy of the security.

(7) That in case direct lending by theReserve banks is continued, the question whether a given concern is a "commercial or industrial" enterprise within the meaning of the law should be regarded as a legal question and that no applications should be rejected for this reason except on the basis of legal advice.

(8) That until the practice of the commercial banks has been liberalized along the lines indicated in recommendations numbers 1 to 3 above, the Federal Government continue to make direct loans to industry. This might be done either through the agency of the Reconstruction Finance Corporation, or through a new intermediate credit system which might succeed to the responsibilities of the Reconstruction Finance Corporation at the expiration of its present authority to make these loans. We make no recommendation as to which alternative should be followed.[2]

(9) That the policy of the Reconstruction Finance Corporation with regard to the making of loans to clear up existing debt be liberalized.

(10) That the Reconstruction Finance Corporation relax the stringency of the regulation which restricts the field of eligibility to applications for "loans made primarily to supply needed working capital * * * as contrasted with fixed capital." While we do not recommend unrestricted lending to finance expansion of plant and equipment, we believe that in some cases loans to rehabilitate or complete fixed capital equipment will not only give employment to labor in the creation of the capital itself, but facilitate future increased employment of labor and enlargement of the national income.

(11) That the policy of the Reconstruction Finance Corporation with regard to the acceptance of a pro rata share in the protection afforded by collateral, along with existing creditors, be liberalized.

[2] In case the direct-lending functions of the Federal Reserve banks and the R. F. C. are consolidated in a new agency, recommendations 5 to 7 and 9 to 17, inclusive, will apply in principle to the work of this new agency.

(12) That the Reconstruction Finance Corporation abandon its policy of requiring applicants to show a probability that a loan can be repaid out of profits, in cases where the security offered is such that the Corporation need not rely on prospective profits to protect itself against loss.

(13) That the Reconstruction Finance Corporation abandon its stated policy of refusing applications for loans from the brewing industry.

(14) That there be instituted a more liberal policy than is now followed by the Reconstruction Finance Corporation with regard to the pledge of inventories and the assignment of accounts, particularly in cases where local banks are willing to participate in the loan and to take responsibility for the "policing" of the loan.

(15) That the Reconstruction Finance Corporation introduce into its procedure the use of a brief preliminary application to the end that loans which are clearly ineligible may be rejected without subjecting the applicant to the delay and expense involved in the preparation of the present form of application.

(16) That the Reconstruction Finance Corporation cease to require audit and appraisal except in cases where such procedure is necessary in order to establish the adequacy of security for loans otherwise acceptable.

(17) That the local agencies of the Reconstruction Finance Corporation be given authority to grant loans of $10,000 and under, without the necessity of such grants being confirmed in Washington.

(18) That in case the direct lending operations now performed by the Federal Reserve banks and the Reconstruction Finance Corporation are united in a single agency, whether the Reconstruction Finance Corporation or a new agency, and in case lending standards are liberalized as recommended above, local offices be maintained in or near all cities of, say, 50,000 population or more, to assist would-be borrowers in preparing applications.