

MONTHLY



Review

**FEDERAL RESERVE BANK
OF ST. LOUIS • P. O. BOX 442 • ST. LOUIS 66, MO.**

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Business Activity Continues its Rise

IN THE FINAL QUARTER OF 1958 the total national output of goods and services, adjusted for price changes, was 5 per cent above its recession low and was less than 1 per cent below the level reached in the third quarter of 1957 before the recession began. Now, with the first quarter of 1959 almost over, it is evident that gross national product has increased further. Industrial production rose in January and February and construction activity held near the advanced levels reached in December, after adjustment for seasonal influences.

Steel output grew from an average weekly rate of 74 per cent of rated capacity in January to a rate of 84 per cent in February. In the first week of March, steel mills produced 2.56 million ingot tons, or 90.3 per cent of rated capacity, the largest volume for any week in history. Automobile assemblies were limited somewhat during much of February by strike-caused shortages of glass which restricted operations of one of the major producers. Later in the month auto production picked up and assemblies were scheduled for March at a higher rate than was reached in February. Production of aluminum and other nonferrous metals also increased after the turn of the year.

Output of construction materials, which was at pre-recession levels in January, probably increased further in February, reflecting settlement of the glass strike and the continuing high rate of construction activity. Demand for Southern pine and hardwood was reported to be growing during February, and output of Southern pine in the first three weeks of the month was above the average weekly rate in January.

Growth of consumer spending has been one of the main supports for the gains in output, with an increase of 3 per cent in real terms between the first and fourth quarters of last year and possible further gains in the first quarter of this year. Total retail sales held within one per cent of their December rate through January and February after adjustment for seasonal influences and trading day differences, and were about 7 per cent greater than in the same months a year earlier. Sales of durable goods stores were nearly 16 per cent larger in February than in February 1958, and sales of nondurable goods stores were up about 6 per cent.

Government purchases of goods and services have also increased substantially over the past year, growing by nearly 7 per cent in real terms between the

first and fourth quarters of 1958. Although outlays for defense purposes increased, the bulk of the growth in government purchases in 1958 was for nondefense activities of the Federal government and continuing expansion of state and local government activities.

In the first quarter of this year government purchases have continued to increase, as evidenced by growth in outlays and contracts for public construction and an increase in cash expenditures of the Federal Government. During January and February cash expenditures of the Treasury amounted to \$15.2 billion, about \$2.4 billion greater than expenditures in the same period of 1958.

Private investment, particularly in residential construction, has contributed increasingly to recovery in the output of the economy since the trough of the recession last spring. Inventory liquidation, which had accounted for a large part of the recession decline in investment, ceased in the fourth quarter of last year. In the first quarter of this year, business inventories have been increasing. In January, manufacturing and trade inventories, seasonally adjusted, rose \$300 million. A part of the high current production of steel is evidently going into stocks being built up in expectation of a possible steel strike, as well as to meet expected larger requirements for steel as production of steel-using products grows.

Although growth in gross national product can be seen clearly, some of its implications for employment and personal income and prices are not so clear. Despite the recovery in rate of output, unemployment in January remained at 6 per cent of the labor force. Personal income, on the other hand, reached a new high in January, both in dollar terms and in real terms. Prices on the average have been quite stable for several months, with declines in prices of farm products and foods tending to offset increases in prices of industrial commodities.

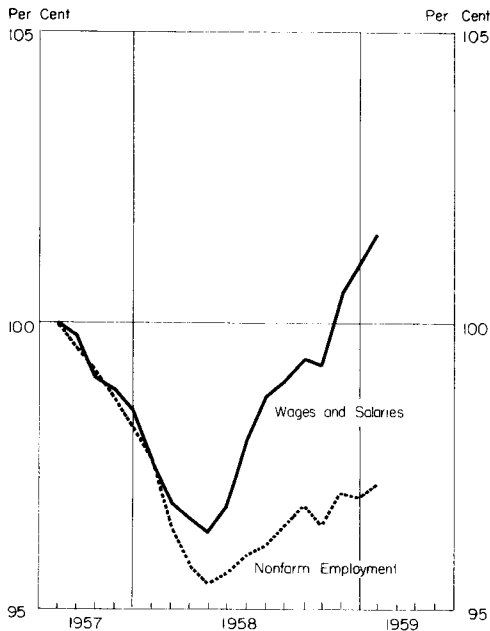
Improvements in employment conditions in January and February were moderate. Between December and February there were slight employment gains, after seasonal adjustment, in construction, trade, transportation, and state and local government, while manufacturing employment remained unchanged. Total nonfarm employment in February, seasonally adjusted, was up 982,000 from the recession low but was still 1.4 million below its 1957 peak.

Unemployment changes have been mainly seasonal since November. February unemployment of 4.75 million was at a seasonally adjusted rate of 6.1 per cent of the labor force, as compared with a 1958 peak of 7.6 per cent. Total unemployment rates and the rates in most major industry groups in February were about the same as in February 1958, or slightly higher. In durable goods manufacturing, however, 8 per cent of the industry work force was unemployed this February as compared to about 10 per cent a year earlier when durables production was sharply curtailed. Improvement over a year earlier was especially marked in the automobile and primary metals industries.

Although employment growth has lagged behind the growth in output, personal income has grown substantially. At a seasonally adjusted annual rate of \$362.3 billion in January, total personal income was almost \$15 billion, or 4.3 per cent, above its recession

low of last February, and was \$10 billion, or almost 3 per cent, higher than at the August 1957 pre-recession peak. Between April 1958 and January of this year total wage and salary income rose 5.4 per cent, while nonfarm employment rose but 2 per cent (seasonally adjusted), reflecting increases in wage and salary rates and lengthening of the average work-week. Income other than labor income was about the same in January as in April of last year. Because the cost of living, as measured by the consumer price index, remained practically constant between April and January, the increase in wage and salary income has been as large in real terms as in dollar terms.

Changes in Nonfarm Employment and Wage and Salary Income August 1957 — January 1959

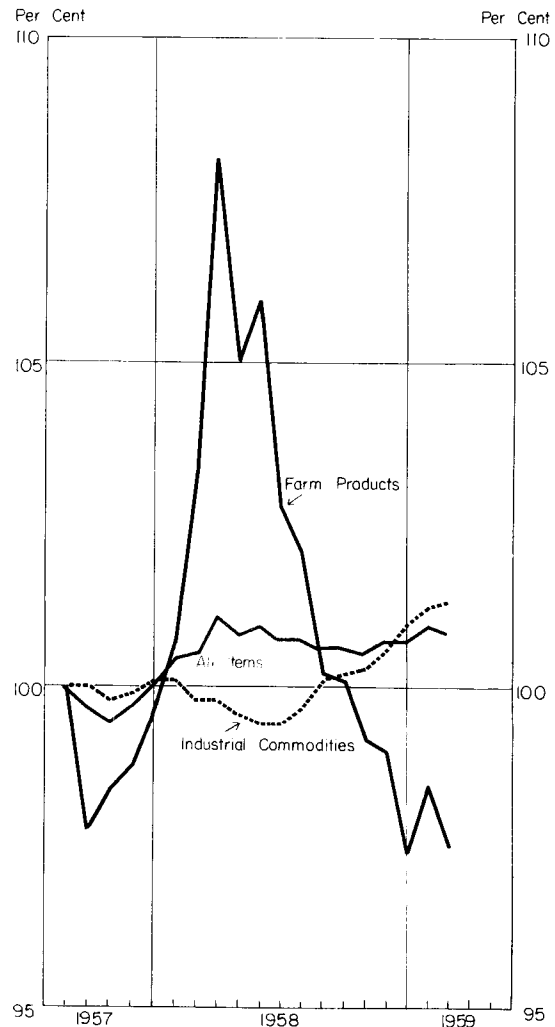


In the recovery from the April 1958 recession low, wage and salary income has grown more rapidly than nonfarm employment, reflecting increases in wage and salary rates and lengthening of the work week.

Sources:
Wages and salaries—National income and product accounts of the United States Department of Commerce. Seasonally adjusted annual rates have been converted to per cent of August 1957 rate. Lump-sum retroactive salary payments to Federal employees in July 1958 at an annual rate of \$4.6 billion have been excluded.

Nonfarm employment—Seasonally adjusted total employment in nonagricultural establishments, estimates of United States Department of Labor, Bureau of Labor Statistics. Monthly estimates have been converted to per cent of August 1957 level.

Changes in Wholesale Prices August 1957 — February 1959



During the recession and the recovery changes in prices of farm products and industrial commodities have tended to offset each other.

Source:
 Department of Labor, Bureau of Labor Statistics, Monthly Index of Wholesale Prices. Each component has been converted from 1947-49 = 100 base to August 1957 = 100 base to facilitate comparisons.

Stability of the consumer price index has limited cost of living wage increases and for the second successive quarter 1.25 million workers in the automobile and related industries received no cost of living adjustment.

Between December and January the consumer price index rose 0.1 per cent to 123.8 per cent of the 1947-49 average. Food prices increased 0.3 per cent after declining 2.5 per cent in the preceding five months. Prices of other commodities and services combined were about unchanged with seasonal reductions in apparel, household textiles, and automobiles offsetting increases in some appliances, furniture and services.

Wholesale prices of some manufactured products and industrial materials have been advancing in recent weeks. In January and February, prices of scrap steel, refined copper, textiles, hides, shoes, tires, machinery, lumber and plywood increased. Prices of lead and zinc, on the other hand, declined. Prices of farm products and foods declined further through the end of February, offsetting the increases in industrial commodities. Recent developments in livestock markets and on farms indicate that prices of farm products and foods will be under continuing pressure from large expected supplies of crops and livestock in coming months.

Discount Rates Increase

EFFECTIVE MARCH 6, discount rates, the interest rates charged on commercial bank borrowings from Federal Reserve Banks, were raised from 2½ per cent to 3 per cent at the New York, Philadelphia, Chicago and Dallas Reserve Banks. By March 16 all other Reserve Banks had taken similar moves. Rates had been at 2½ per cent since November 1958.

A year ago, during a period of recession, discount rates of the Federal Reserve Banks were marked down in several steps, reaching a low level of 1¼ per cent in April 1958. In August, as signs of improvement in business and financial activity appeared and as market rates rose rapidly, the discount rates were raised to 2 per cent. Again, in late October and early November the Reserve Banks increased their lending rates to 2½ per cent.

Discount rates of many central banks of the world are generally above the yields available on high-grade short-term money market instruments, such as the 90-day Treasury bills of this country. In Canada the discount rate is set each week at ¼ of 1 percentage point above the latest average tender rate for Treasury bills. In the United States, from December 1950 through August 1958 the discount rates on a daily average basis were nearly ¼ of 1 percentage point above the 3-month Treasury bill rate. Since 1929 the discount rates have averaged about ⅔ of 1 percentage point higher than the bill rate.

During the 7-month period from early August 1958 to early March 1959, discount rates did not maintain their customary position above money market rates despite being raised on two occasions for a total of ¼ of 1 percentage point. During most of the period discount rates have been as much as ¼ of 1 percentage point below the Treasury bill rates, at times more than ½ of 1 percentage point below.

In recent months member banks have been increasing their borrowings from the Reserve Banks. In the five months ending with July 1958, daily average borrowings of member banks were \$130 million; during August and September last year average borrowings were \$365 million; in the fourth quarter borrowings rose to \$500 million, and in the first two months of 1959 they averaged \$530 million.

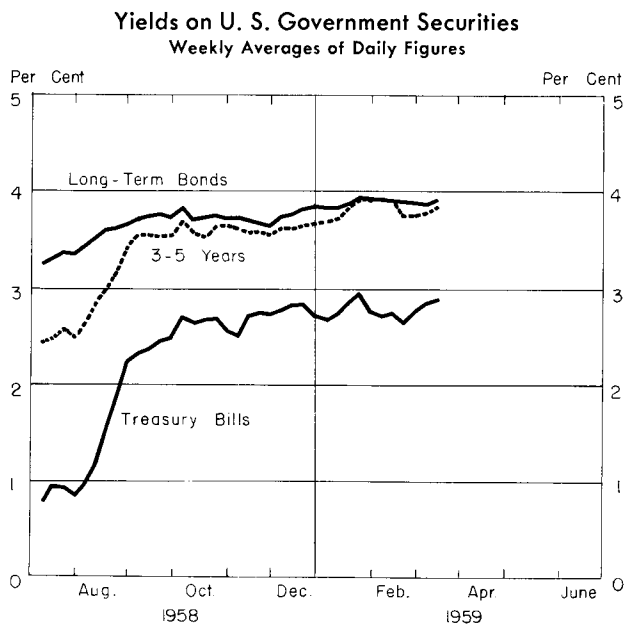
It is of some interest to compare the level of discount rates in this country with those of central banks in other countries. In most of the rest of the world central banks currently have discount rates above the 3 per cent level, although there are some nations with rates lower. The Bank rate in England was 4.0 per cent in early March, the Canadian rate was 4.32 per cent, and in France the rate was 4.25 per cent. Discount rates in selected other countries in early March were: Argentina, 6.0 per cent; Belgium, 3.25 per cent; Brazil, 10.0 per cent; Western Germany, 2.75 per cent; Greece, 10.0 per cent; Japan, 6.9 per cent; Netherlands, 2.75 per cent; New Zealand, 7.0 per cent; Sweden, 4.5 per cent; and Switzerland, 2.0 per cent.

Recent Banking Developments

During January and February outstanding credit at weekly reporting member banks decreased about the seasonal amount. Businesses reduced bank indebtedness more than they usually do at this time, in part because improvement in earnings and other cash inflows more than offset a moderate growth in inventories and other immediate needs for cash. Security loans, which rose sharply in 1958, declined about \$500 million in the two months. Also, banks sold securities on balance. On the other hand, real estate loans continued to rise markedly, and "other," including consumer, loans did not decrease the seasonal amount.

Interest Rates

From late January to early March, interest rates on marketable securities declined somewhat. The yield on three-month Treasury bills declined from 2.96 per cent on January 23 to 2.73 per cent on March 16. Over the same period the yield on a 4½-year Government bond (August 1963) fell from 4.04 per cent to 3.88 per cent.



Latest data plotted — Week ending March 13
Source: Board of Governors of the Federal Reserve System

Reportedly, the decline in yields reflected a strong demand for short-term securities by nonfinancial corporations. These corporations were seeking to invest funds which they accumulated as cash inflows exceeded cash needs. However, this source of funds to the money market may be only temporary. March tax payments will probably cause a drain on cash resources of corporations. In addition, funds may be needed to expand inventories in the near future, since inventories have declined in the past year and sales have been rising.

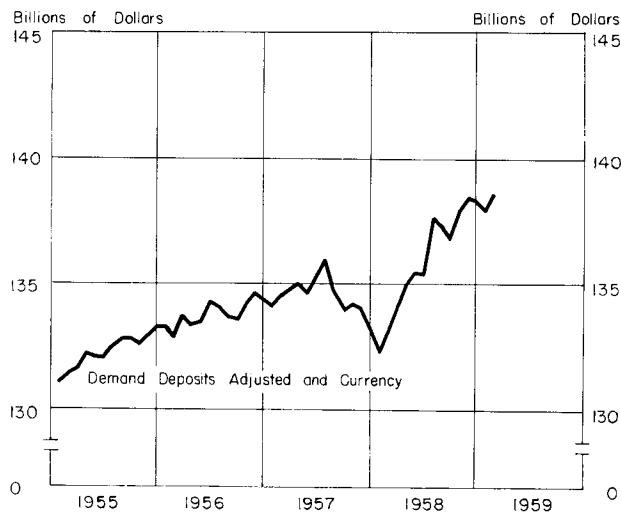
Money Supply

The active money supply adjusted for seasonal influences rose by a small amount in the first two months of 1959, according to preliminary data, a contraction in January being more than offset by an expansion in February. Never-

theless, the current volume of money may be inflationary. During 1958 the money supply rose sharply so that the volume outstanding is presently large compared with early 1958 levels. Then, too, use of the money supply, as indicated by debits to demand deposit accounts, has remained active, perhaps rising.

Active Money Supply

Seasonally Adjusted

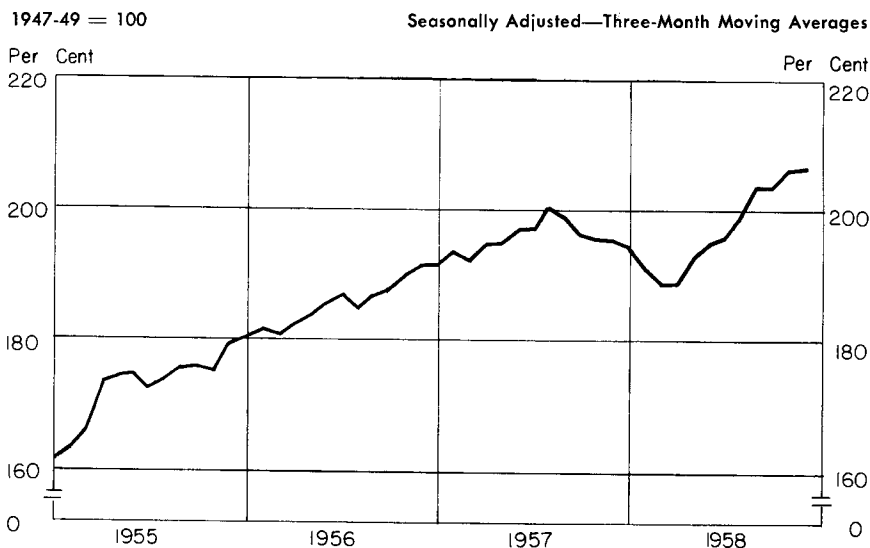


February 1959 — Preliminary Source: Board of Governors

Demand for bank credit may be increasing in forthcoming weeks and months. Business activity has been improving, which usually creates an increase in the demand for credit. The Treasury may be seeking additional funds, an unusual development at this time of year when tax receipts are seasonally large. Also, it is unlikely that nonfinancial corporations will continue to increase their liquidity as fast as they have in recent weeks.

Debits to Demand Deposit Accounts

National—Excluding New York City



Latest average plotted — December, which includes January data Source: Board of Governors

The 13b Program — An Experiment in Small Business Finance

ON AUGUST 24, 1958 President Dwight D. Eisenhower signed the Small Business Investment Act and thereby opened a new chapter in the history of Governmental aid to small business. This new legislation takes account of much of the experience gained from earlier efforts. Its scope and application was served by the commercial lending program of the Federal Reserve System, inaugurated some 25 years earlier under Section 13b of the Federal Reserve Act and terminated by the Small Business Act itself.

Federal Reserve lending under the so-called 13b program was only a part of a much larger Governmentally sponsored program of loan assistance to business which came into existence during a period of vast unemployment, financial chaos, and profound material distress, with the fervently expressed hope of assisting the nation toward economic revival. The quiet departure of 13b a quarter century later mutely testified to the fact that it had become, over that space of time, more a legal fiction than an economic reality. Yet 13b deserves an obituary for it was one of the prototypes of Government-assisted financing of small business and as such has a current relevance warranting an elaboration of the circumstances of its birth, the facts of its development, and the causes of its demise.

Sources and Uses of 13b Funds

Interestingly, there is not one word or even a hint about small business in the depression-born statute which created this program. Nevertheless, both Congressional debate and official announcement make it

perfectly clear that smaller firms were expected to be its principal beneficiaries. Thus, the Federal Reserve Board's press release on inauguration of the program stated:

... Many small industrial establishments have suffered severe capital losses during the depression and are now short of working capital. A survey made by the Federal Reserve Board through the Reserve Banks and the chambers of commerce showed that this condition is widespread and is not being met by existing facilities. Small industries find it difficult at present to obtain their requirements of working capital through the capital market, while commercial banks and other financial institutions, in many cases, are hesitant about undertaking on their single responsibility the risks involved in making relatively long-time loans for working capital purposes.¹

The Board's announcement was made in connection with Congressional action of June 1934, which pledged the financial assistance of the United States Treasury and the Federal Reserve Banks to fill such a "working capital" void and made the latter institutions the conduits through which businesses could get funds for periods up to five years for this purpose. The Treasury was tapped for a potential contribution of \$139.3 million and the Reserve Banks were authorized to use \$138.4 million of their own resources.² Thus, the program got underway with a generous endowment of almost \$280 million.

¹ *Federal Reserve Bulletin*, July, 1934, p. 429.

² Congress did not arrive upon these particular sums accidentally. \$139.3 million had been paid previously by the Reserve Banks for stock of the Federal Deposit Insurance Corporation. Congress provided that the Treasury make an identical sum of money available to the Reserve Banks for business loans. The Federal Reserve's FDIC stock was, in effect, pledged against the Treasury's contribution.

The \$138.4 million which the Reserve Banks could use from their own resources was determined on the basis of their combined surplus on July 1, 1934.

It should be made clear at this point that Congress did not intend these funds as a pool of venture capital nor, despite widespread opinion to the contrary, as artificial respiration to marginal businesses. Rather, use of the money was carefully limited to sustaining "established" or "operating" creditworthy firms. Two general methods of loan-making were provided. One involved a cooperative arrangement between the Federal Reserve and private financing institutions whereby the latter could make intermediate-term "working capital" loans to creditworthy firms and, at their own initiative, turn over such loans to a Reserve Bank. The turnover was usually made under an arrangement called a commitment, whereby the Reserve Bank promised (for a fee), prior to the private lender's initial disbursement of funds, that it would buy, or lend on, a specific loan at the lender's demand. Private lenders were, therefore, given an opportunity to make loans they might otherwise have declined. Such loans were not to be without risk to the private lender, however, since the latter was required to stand a minimum of 20 per cent of the loss on any credit transferred to the Federal Reserve.

In addition to such participation with private lenders, Reserve Banks were also permitted to make direct loans, that is, loans in which private financing institutions were not involved. This authority was carefully hedged with qualifications. It could be used only "in exceptional circumstances". Approval of the Reserve Board was required. It was mandatory that a Reserve Bank ascertain that the prospective borrower could not get financial assistance "on a reasonable basis from the usual sources". Most important, the direct loan itself could be made only "on a reasonable and sound basis".

While private lenders and the Reserve Banks were thus to be the principal participants on the lending side of the 13b program, Congress brought two other groups into loan administration. The Federal Reserve Board was given responsibility for overall supervision. Five-man advisory committees, composed of local (nonbanking) businessmen, were organized at each Reserve Bank to review and to make recommendations on each request for 13b credit.

The First Days of the Program

The Reserve Board underscored the urgent character of the legislation by the speed and manner with

which it acted to put the program into effect. On June 26, 1934, one week after President Roosevelt signed the enabling act, the Board published Regulation S, setting out the ground rules for 13b lending. The Board emphasized that it was giving the individual Reserve Banks the greatest possible measure of authority in order to facilitate and accelerate their newly authorized operations. Thus, the Regulation provided little in the way of details and was largely a reiteration of the text of the statute. It left unimpaired the broad powers which Congress had given the Reserve Banks, and made no attempt to prescribe specific definitions of "working capital", "established businesses" and the other general terms of the law. It granted blanket authority to all Reserve Banks to make direct loans. It gave each Reserve Bank considerable latitude in setting up systems and methods of loan making.

The Reserve Banks responded accordingly. Advisory committees were established by late July, and consideration of applications for credit began immediately. The first 13b loan was made at the Federal Reserve Bank of Minneapolis on August 1. By the end of that month the program was a going concern at all Reserve Banks save three and \$870,000 of 13b credit was outstanding. By the end of October 1934, 4 months after the inception of the program, System-wide lending was in effect and amounted to over \$6 million.

The Nature of the Treasury's Contribution to 13b

During the first few months of the program, organizational activities in the field were paralleled in Washington by discussions between the Treasury and the Federal Reserve which were necessitated by the failure of the statute to specify how their respective contributions were to be made available to the program. By midsummer an earlier "gentlemen's agreement" had been cast in final form. It contemplated the Treasury's supplying the first \$10 million, the Federal Reserve the second, and so on until the maximum of \$139 million from the Treasury had been utilized.³

³ The agreement provided as a matter of mechanics that each Reserve Bank would certify to the Treasury its cash disbursements of 13b credit and be reimbursed until it received its pro-rata share of the initial \$10 million advance (e.g., \$365,623.01 in the case of the Federal Reserve Bank of St. Louis). Thereafter the Reserve Bank would not receive Treasury funds until its outstanding disbursements and commitments stood at double the amount of such first payment (e.g., \$731,246.02 at St. Louis) when the alternative process would be resumed.

The law under which this financing arrangement was effected was itself a compromise between (1) the original Senate bill to fund the program in its entirety through an out-and-out Treasury grant to the Reserve Banks and (2) a House amendment requiring that all financing be done with Federal Reserve money. It provided for annual payments by each Reserve Bank to the Treasury of "up to 2 per cent of the total payment as shall be covered by net earnings of the Bank for that year derived from the use of the sum so paid by the Secretary of the Treasury . . ."⁴ This statutory language was a source of both conceptual and practical difficulties.

For example, were the payments to be derived from the total income of the Reserve Banks, or were they to stem from that portion which arose from the Bank's 13b activities only? If the former, then obviously the maximum 2 per cent payment would be made every year since the Reserve Banks operated at a profit. However, if payments on the Treasury's contribution were confined to income generated by the 13b program, the payments would be substantially smaller; indeed for several years the program operated at a loss. The statutory language was perfectly general on this point and was a source of difficulties on other matters as well. Was the Treasury's contribution a loan requiring eventual repayment or a permanent contribution of capital? Were the annual 2 per cent payments (a) interest, (b) a repayment of principal, or (c) a disbursement in the nature of a dividend? Could administrative expenses and bad debts be deducted in arriving at "net earnings"?

Pending definitive legislative action and in order to expedite the program the Federal Reserve resolved these questions by defining, for operating purposes, the source of the 2 per cent payments to the Treasury to be the net earnings from 13b operations only. Net earnings in turn were represented by the Federal Reserve as gross earnings minus bad debts and operating expenses. Such net earnings were divided between the Treasury and the Reserve Banks on the basis of Treasury and Federal Reserve funds employed. The Treasury's share was then again divid-

⁴ Actually the formula was more complex, because the annual payments were required only if annual dividends, payments, and other proceeds on the Federal Reserve's FDIC stock failed to equal 2 per cent of the Treasury's 13b contribution. No such proceeds were ever received, and consequently the condition waiving annual payments to the Treasury was inoperative.

ed; no more than 2 per cent of the Treasury's contribution was credited to the Treasurer's general account and the remainder, if any, was credited to Section 13b surplus. The share of net earnings allocated to the Reserve Banks was credited to their regular (so-called Section 7) surplus. A net loss was divided between the two surplus accounts on the same basis.⁵

Growth of the Program in 1935

The first six months' income from the 13b program was a rather unsubstantial sum to warrant such a complex formula. It amounted to less than \$137,000. Yet it was a deceptive index to the growing scope of this activity for on December 31, 1934, \$14.3 million of direct advances were outstanding and, in addition, the Reserve Banks had issued commitments amounting to \$10.0 million. These amounts were but a fraction of requested financing; over 5,000 applications for a total of \$188 million had been received. Roughly, about a fifth of that number, amounting to \$50 million, had been approved; as was noted earlier some \$24.3 million of direct advances and commitments were outstanding, and about 600 applications totaling \$41 million were pending at year end. The Reserve Banks were vigorous in pushing the program. Energetic efforts were made to publicize the availability of loans; cooperation and assistance of commercial banks and other financial institutions were solicited; and requests for credit were checked and rechecked to insure that all applications which fully complied with the stringent requirements of the law were approved.

The program continued to grow during 1935. In November of that year loans and commitments outstanding reached an all-time high of \$60.6 million and the annual average of month-end figures was \$48.6 million. In 1936 the average volume of outstandings increased to \$53.1 million, although new loans approved fell off sharply from year-earlier figures. While the Reserve Banks received a substantially smaller number of requests for a smaller dollar volume in all of 1935 than in the first six months of the program's existence, they approved a larger number and for considerably larger amounts (see table

⁵ The provision for annual payments by the Federal Reserve to the Treasury ended in October 1947, when at Congressional direction, the FDIC retired its stock via a payment to the Treasury. In effect, this meant the entire proceeds of the 13b program came from Federal Reserve sources.

below). However, in 1936 only 287 new applications totaling \$15.3 million were approved.

13b Loan Application and Approvals
1934 — 1936
(Amounts in Millions of Dollars)

	Applications Submitted		Applications Approved	
	Number	Amount	Number	Amount
1934	5,053	\$187.7	984	\$49.6
1935	2,562	119.0	1,009	79.9
1936	764	36.0	287	15.3

Causes of the Decline in 13b Lending

The foregoing decline could hardly be attributed to a lack of sympathy or a lack of interest on the part of the Federal Reserve Board. On the contrary, as early as January of 1936 the Board noted a side-wise movement in 13b activity and directed the Reserve Banks to circularize member and nonmember institutions on the availability and terms of such credit. The Banks complied in renewed promotional effort, but it was not enough. During 1936 the volume of new approvals of 13b credit had declined to \$15.3 million.

The decline occurred, in large measure, because two other sources of credit became more readily available. First, there was an expansion of intermediate credit lending by the Reconstruction Finance Corporation. Second, commercial bank loans to business evidenced their first rise from the sustained decline which set in in 1929.

For the first factor we must turn back to the original 13b statute in which the RFC was given, almost as an afterthought, six-months' authority to use \$300 million for a somewhat similar program. Here again small business was intended as a principal beneficiary. On the face of the statute both the RFC and Federal Reserve programs showed considerable parallelism. Both limited the authorized credit to five-year terms. Both provided for direct and indirect lending. Both demanded credit worthiness of prospective borrowers. Yet other elements provided the seed of profound differences, for the language setting RFC loan standards subtly but distinctly manifested a more liberal standard of borrower eligibility. Moreover, the RFC was required to take into account the potential of a prospective loan for providing "reasonable assurance of continued or increased employment".

These differences were deepened and broadened by subsequent legislative amendments of the RFC program. In January 1935, business lending became a permanent part of the Corporation's activity, restrictions on the size of loans were removed, and ten-year maturities were permitted. RFC activity was again enlarged in 1938 as a result of the preceding year's recession. In order to encourage small business and promote employment, a general relaxation of requirements was effected, particularly the provisions relating to the collateralizing of loans. As Chairman Eccles was to observe later, the lack of a corresponding liberalization of the Reserve Banks' program put them ". . . for all practical purposes . . . out of business in this particular field".

Thus, at the close of 1935, outstanding 13b credit totaled \$60.1 million as compared to the RFC's \$40 million. One year later the RFC's year-end total of \$63.5 million exceeded the Federal Reserve's \$46 million. This gap was to widen with the passing years.

Doubtless the sustained expansion of the RFC business loan program—which, in retrospect, stands out as the Corporation's primary function—sprang in large measure from the fact that Congress tended to make the RFC the principal vehicle for conveying Federal assistance to business.

The second factor restricting 13b which also began to become apparent in 1936 was the resurgence of private finance. As was noted earlier, it was in that year bank loans *first* stopped declining since the '29 crash and began a slow upward movement. This was a product of many components. First and foremost was economic recovery. Second was the host of changes that had come into American finance, especially the new lending methods that had begun to make their effect felt in the overall credit picture. Financing institutions had undertaken a reassessment of their lending conventions and had shown a willingness to part with money on other arrangements than the classic short-term, unsecured, self-liquidating loan. The term loan involving extensions of credit by single or multiple lenders for long periods was coming into increasing use. A related but distinct development was the transformation of collateral devices, such as assignments of accounts receivable and various forms of inventory security, from badges of

bankruptcy to routine conventions of commercial bank lending.

Here 13b had paved the way for its own decline, for these measures had been pioneered to a certain extent in 13b lending and participating banks had received thereby a relatively riskless lesson in new ways of doing business. Moreover, the resurgence was not confined to banks. Insurance companies, commercial finance companies and other nonbank lenders had begun their competitive drive to share the short- and intermediate-term credit market for American business. In this connection we should again stress the climate of recovery which encouraged resumption of intermediate-term credit to small business in the form of short-term notes. In effect, these developments served to reduce the number and amount of creditworthy 13b applicants, just as the liberalized RFC program preempted the field on the more marginal risks.

13b Activity from 1937 to the Present

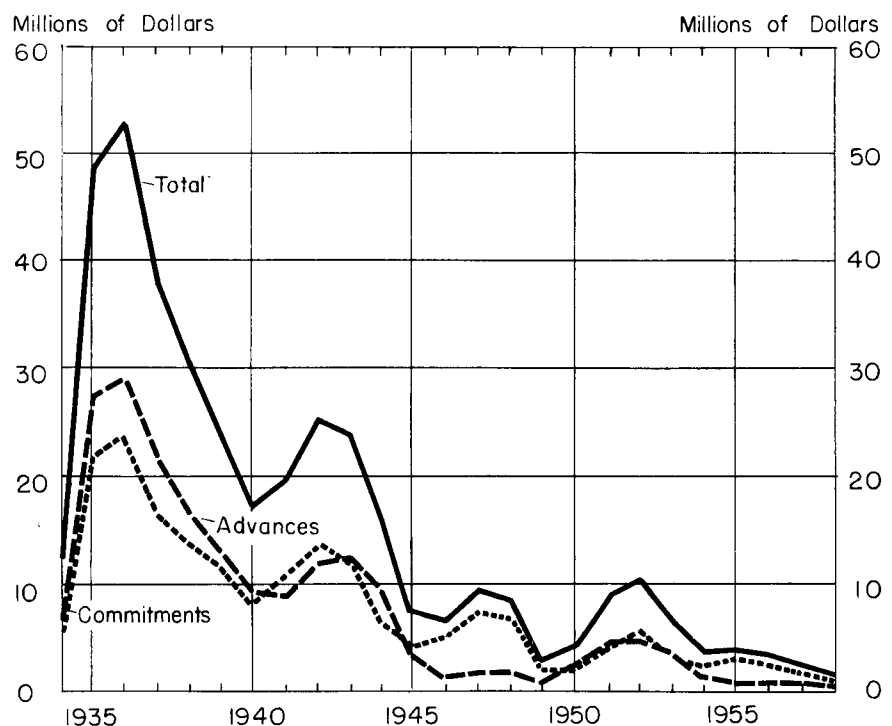
The dampening effect of these factors on 13b credit was continuing and progressive. Annual averages of month-end loans and commitments outstanding dropped from \$37.7 million in 1937 to \$30.1 million in 1938 and from \$23.9 million in 1939 to \$17.1 million in 1940. The defense program brought a turnabout and a modest increase; outstandings climbed to \$19.8 million in 1941 and reached \$25.5 million in 1942. From then on the volume of 13b credit declined as the tremendous increase in war production necessitated different credit arrangements, and the V and V-T loan programs were developed accordingly. These activities took over the bulk of the Reserve Bank credit departments (drawing substantially, it might be added, on the store of 13b experience). The latter program was shunted aside and during 1945 outstanding 13b loans averaged \$7.3

million. Although this figure rose slightly during the Korean War, reaching \$10.4 million in 1952, by 1958 only \$1.4 million remained outstanding (see chart).

Yet loan volume is a spurious index to the interest evidenced in 13b toward the end of World War II and immediately after when fears of a postwar depression were widely held. In early 1944 the Baruch-Hancock report recommended expansion of the program into a liberalized and permanent source of small business credit. Legislative suggestions for a variety of amendments to this end became hardy perennials in successive sessions of Congress. On several occasions the Board of Governors gave its blessing to proposals which would get the Reserve Banks out of the direct loan business and transform commitment activity into a stepped-up program of private loan insurance.

However, the successful transition from war to peace took the steam out of the movement to revitalize 13b, and for the last decade of its life the program existed only in skeletal form. 13b operations became dormant for all practical purposes at most Reserve Banks. Demand for credit on the terms required by the basic law had largely evaporated due

Advances, Commitments and Total 13b Credit
Annual Averages of Month-end Outstandings 1934-1958
(Millions of dollars)



Industrial Advancements and Commitments Under Section 13b, by Federal Reserve Banks

Annual Averages of Month-end Outstandings 1934-1958

(Thousands of Dollars)

	<u>System Total</u>	<u>Boston</u>	<u>New York</u>	<u>Phila- delphia</u>	<u>Cleve- land</u>	<u>Rich- mond</u>	<u>Atlanta</u>	<u>Chicago</u>	<u>St. Louis</u>	<u>Minne- apolis</u>	<u>Kansas City</u>	<u>Dallas</u>	<u>San Francisco</u>
1934	11,998	2,109	2,121	1,271	804	1,028	884	512	1,039	829	384	471	546
1935	48,641	5,360	13,761	5,158	3,140	5,590	1,702	2,263	2,271	2,026	1,687	2,079	3,604
1936	53,054	5,759	16,568	5,691	3,020	5,886	1,032	1,968	2,201	1,389	1,498	2,128	5,914
1937	37,730	4,946	11,532	4,155	2,028	4,055	555	936	1,252	831	772	1,535	5,133
1938	30,077	3,794	8,033	3,626	2,360	3,210	445	566	659	1,086	800	981	4,517
1939	23,933	2,483	4,951	3,930	1,963	2,126	875	452	455	955	770	619	4,354
1940	17,128	1,478	2,847	3,506	1,385	1,535	747	322	293	273	392	406	3,944
1941	19,787	1,841	2,480	4,731	1,520	1,648	837	853	655	451	1,033	314	3,424
1942	25,546	1,341	1,281	6,470	1,267	2,114	1,490	1,614	1,530	492	2,332	175	5,440
1943	23,863	1,938	408	6,410	1,159	1,379	343	47	1,342	158	3,048	21	7,610
1944	15,835	1,351	109	6,262	411	1,055	58	2	65	141	1,027	116	5,238
1945	7,270	263	4	5,138	118	437	2	306	30	—	18	129	825
1946	6,311	107	—	2,117	791	164	—	99	2,600	—	188	167	78
1947	9,096	9	—	2,434	1,553	91	443	168	1,849	—	2,375	12	162
1948	8,359	63	—	1,247	1,421	175	843	415	323	—	3,750	—	122
1949	2,943	44	—	1,106	1,367	120	143	21	42	12	—	—	88
1950	4,492	—	16	2,612	469	157	3	229	125	176	208	—	497
1951	9,073	—	25	4,718	1,014	212	264	1,065	42	155	635	34	909
1952	10,372	—	2	5,630	864	149	601	1,811	—	109	801	7	398
1953	6,285	—	—	3,913	749	115	470	53	—	113	813	—	59
1954	3,591	—	—	1,782	718	51	174	21	—	100	745	—	—
1955	3,708	—	—	765	532	19	76	9	—	78	2,229	—	—
1956	3,264	226	—	621	201	2	—	70	—	51	2,093	—	—
1957	2,354	319	—	347	64	—	—	82	—	31	1,511	—	—
1958	1,423	327	—	69	61	—	—	10	—	16	940	—	—

to two factors which the Board of Governors stressed in its Annual Report for 1946:

Certain provisions of (Section 13b) have proved so restrictive as seriously to impair the ability of the Reserve Banks to lend directly to business and to assist banks and other lenders in such lending . . . The basic need of the small, independently owned business enterprise is for long-term funds.

Twelve years later, Congress confirmed the Board's 1946 judgment in passing the Small Business Investment Act by which extended financing was made available to small firms through long-term Governmentally assisted loans and purchases of equity-type securities. As part and parcel of this action, Federal Reserve commercial lending, both direct and indirect, was revoked as of one year thereafter and the Reserve Banks ordered to repay the total Treasury advances within 60 days.⁶ Thus, did 13b pass into history.

An Overall Appraisal

Any overall appraisal of the program—whether the effort begins with an attempt to vindicate its success or to charge it with failure—inevitably winds up with a verdict of “not proven”. Its context is simply too tangled to admit of an orderly delineation of cause-and-effect. Nevertheless, certain by-products can be singled out.

The most apparent is the credit that was provided in the depressed years. Unquestionably the program provided a welcome source of funds for some borrowers with a consequent effect upon income and

⁶ The repayment provision settled the question as to the nature of the Treasury advances by determining, in effect, that the Treasury contribution was a loan repayable in full.

employment. Yet this aspect of the program must be dismissed as marginal. A second and largely unpremeditated result was the influence of the program on American banking conventions by providing a laboratory in which new lending techniques could be explored, tested, and refined. Here we should note again its influence on term lending, and the development of techniques, which paved the way for the massive amounts of V-loan financing.

With these considerations in mind, certain tentative conclusions are suggested by this brief review of the 13b program. First, Governmental assistance to small business should probably be administered by an agency created solely for that purpose rather than by the central bank whose major duties are credit control and bank supervision. Second, the major financial need of small firms appears to be in the area of long-term funds rather than loans with a five-year maximum term. The third point follows closely on the second; insofar as small firms require sources of risk capital, loans made to satisfy that need cannot, in a literal sense, be made “on a reasonable and sound basis”. To the extent that the 13b program proved these points—and they were all recognized in subsequent legislation—it provided knowledge that could only come of experience.

In short, we can write 13b's epitaph as an arrangement born in depression and expiring in prosperity, an arrangement which, it was hoped, would assist small business, an arrangement that fell somewhere between success and failure, and whose historical position lies in its status as a way station on the road of public assistance to private enterprise.

