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THE AVAILABILITY OF BANK CREDIT 1933–1938

By

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FOREWORD

IT IS a characteristic of periods of depression that certain elements of the economic problem are singled out and emphasized temporarily as causal factors, at times practically to the exclusion of all other factors. In the past few years banking policies in regard to loans to business enterprise have been stressed repeatedly as a dominant reason for our inability to achieve a lasting economic recovery. It has even been implied that if the policies of the banks had been more liberal, the sharp recession in 1937 could have been avoided or its intensity greatly lessened.

A properly-functioning credit mechanism is essential in the operation of the economic system, but it does not follow that by making huge reservoirs of credit available, an effective demand will spring into existence and that the resulting activity can change an adverse business situation into a favorable one. This result would follow only if a defective credit system represented the sole or principal weak link in an economy that was temporarily out of balance. Increasing the supply of credit funds and the sources through which they are available is meaningless unless there is an active or latent demand for them, based upon prospects of sound and profitable business operation.

The present volume has as its principal objective a careful appraisal of the several elements of the problem of bank credit availability to business enterprise. An attempt has been made by means of a questionnaire survey to determine the frequency of bank credit refusals and restrictions, as well as the general characteristics of those concerns that have experienced difficulties in meeting their requirements. The survey was made for the American Bankers Association at its request. A similar survey was made by the Conference Board in 1932 at the request of the Federal Reserve Bank of New York.

Developments in commercial banking since 1933 are carefully traced in the first part of the study, thereby providing the requisite background for analysis of the data derived from the questionnaire survey. In the latter part of the study the objectives and results of the industrial advance programs sponsored by the Federal Government are considered, and an attempt is made to relate the problem of bank credit availability to the broader financial problem of small enterprise.

This study has been prepared by Dr. Lewis H. Kimmel, with the assistance of Miss Elizabeth Kadish and Mr. Harold H. Rosen, of the Conference Board's research staff.

VIRGIL JORDAN,
President

New York City
June, 1939

CONTENTS

LIST OF TABLES

LIST OF CHARTS

INTRODUCTION

FUNDS used as a basis for banking operations consist principally of customers' deposits, of which a large proportion is withdrawable on demand. In formulating loan and investment policies not only must the distribution of deposits between demand and time be taken into account, but also the possible effects of seasonal and cyclical factors on both the volume and distribution of deposits. Loan and investment portfolios are at all times subject to critical appraisal by the examining authorities. Marked changes in the composition of the loan or investment portfolio may be regarded with disfavor by examiners, even though they represent the best judgment of the responsible officials.

Looking outward to the community a banker must be keenly aware that good banking implies a vital interest at all times in the welfare and development of the area which his bank serves. Decisions in regard to loans may affect the volume of business and employment and its distribution among the several industries in the community. In addition to this responsibility to the community-at-large, the banker must consider the welfare of his individual customers and that of his stockholders, and he must base the operations of his bank on the assumption that they shall show a profit.

The practical banker recognizes that his business is also affected by broad policies over which he has no immediate control. In recent years, for example, the earnings of banks have been affected by the easy money policy of the Federal Government. This policy has been justified in part on the ground that it is essential to business recovery, but the requirements of the Treasury have been the principal reason for the desire for extreme monetary and credit ease. Fiscal policies and legislation such as the Social Security Act may result in a marked increase or decrease in public obligations available for investment.

The entire economic process is dependent on banks for the facilitation of the exchange of goods and services by means of bank checks. As this study is concerned with the availability of bank credit to industrial and commercial borrowers, it is pertinent to observe that industry and trade rely on the banks for working capital credits for financing sales pending final payments, for financing purchases of raw materials and for financing the conversion of raw materials into finished products.

This study of the availability of bank credit is divided into five sections. Chapter I presents background material. The various aspects of a particular banking problem can best be considered in the light of a complete understanding of major developments and trends in the period in which the problem developed.

Chapters II and III are based primarily on data derived from a questionnaire survey of the availability of bank credit to industry. The returns analyzed provide a résumé of the recent bank credit experience of 1,755 companies, principally manufacturing concerns, which was furnished in confidence by their executives.

The outstanding results of the analysis based on the questionnaire returns are presented in Chapter II. In this chapter the returns are classified according to those reporting (1) no bank credit experience, (2) no bank credit difficulty, and (3) credit refusal or restriction. This classification shows the extent to which industry has been dependent on the banks, and the proportions of concerns reporting and concerns borrowing from banks, that experienced refusals or restrictions in recent years. The 1,755 returns are also classified by industries, by Federal Reserve Districts, and according to size.

In Chapter III the replies received from concerns reporting bank credit refusal or restriction are analyzed. What proportion of refusals and restrictions involved refusal of the entire amount requested, and what proportion involved partial refusal or restriction? What was the most recent year in which bank credit was refused or restricted? Did some of the concerns succeed in solving their credit problems by applying to other banks or to agencies authorized by the Federal Government to make industrial advances? These questions are answered before considering the purpose for which credit was requested, the debtor status of the concern at the time when the refusal or restriction occurred, the type of loan paper offered, and the reported reasons for bank credit refusal or restriction. The concerns reporting refusal or restriction are classified on the basis of their ratings for trade credit purposes by a standard rating agency, and an attempt is made to answer the question as to whether bank credit needs were involved. The last section of this chapter is concerned with the attitude of industry toward the banks, as indicated by the replies to the questionnaire.

Chapter IV deals with the industrial advance programs of the Reconstruction Finance Corporation and the Federal Reserve banks. The experience of the concerns replying to the questionnaire under the industrial advance programs is analyzed.

In Chapter V the problem of bank credit availability is considered as a part of a broader problem, which has to do with the financing of small enterprise. Proposed additions to existing financing facilities are appraised. Among these proposals are regional industrial banks which would be owned by the United States Government, industrial finance corporations to be owned and financed by the banks, and insurance by the Reconstruction Finance Corporation of business loans made by national and state commercial banks.

THE AVAILABILITY OF BANK CREDIT, 1933–1938

CHAPTER I

RECENT BANKING DEVELOPMENTS

THE PURPOSE of this chapter is to present in broad outline the principal developments affecting banking since the holiday in 1933. A brief examination of the extent of bank credit liquidation in the years just prior to 1933 seems desirable, however, to provide the essential background for those developments.

Bank Credit Liquidation, 1929–1933

On June 30, 1929, the combined loans and investments of national and state commercial banks amounted to $49 billion. The comparable figure for June 30, 1933, was $30.2 billion. In the same period loans decreased from $35.5 billion to $16.4 billion.[1] On a percentage basis, the decrease in combined loans and investments was 38%, while that for loans amounted to 54%. From 1929 to 1933 the loans and investments of all member banks of the Federal Reserve System decreased from $35.7 billion to $24.8 billion, while loans fell from $25.7 billion to $12.9 billion.[2] These decreases amounted to 31% and 50%, respectively. These figures are a reflection of the most extreme and prolonged period of bank credit liquidation in the history of the United States.

[1] Data compiled from annual reports of the Comptroller of the Currency.
[2] Member Bank Call Reports.

Among the several classes of earning assets, only investments in United States Government securities showed substantial increases.

There was also a marked reduction in the number of banks. At the end of June, 1929, there were 24,499 banks in the United States, exclusive of mutual savings banks. Four years later the comparable figure was 13,943.[1] The most important reason for this decline was that 5,788 banks suspended operations between July 1, 1929 and the banking holiday.[2] Mergers and consolidations were also considerable factors in the decline. Licensing and reopening subsequent to the holiday was a gradual process, and by no means all the banks eventually reopened had been licensed by June 30, 1933.

Brief mention should be made of the extremely severe liquidation in the year ended in June, 1932, during which loans and investments of national and state commercial banks declined by $8,716 million, or 20%. Loans and investments of member banks of the Federal Reserve System declined by $5,922 million, or 18%. There was ample reason for describing the events of the winter of 1931–1932 as "the most desperate scramble for liquidity we have ever experienced."[3]

Ameliorative Efforts

The first cooperative effort to stem the tide was the organization late in 1931 of a National Credit Corporation to discount bank assets not otherwise eligible. This corporation was established by the banks themselves at the suggestion of President Hoover.

Direct government effort to arrest deflation and mitigate the worst effects of credit liquidation began with the establishment of the Reconstruction Finance Corporation in February, 1932.[1] The government subscribed the entire capital stock of $500 million. The Corporation was also given extensive borrowing powers in order to insure that ample funds for financing its activities would be available. The Corporation was designed to take over the functions of the National Credit Corporation, together with various emergency financing functions for insurance companies, building and loan associations, railroads, agriculture, and miscellaneous finance companies.[2]

[1] "Annual Report of the Board of Governors of the Federal Reserve System, 1936," p. 124.

[2] "Annual Report of the Comptroller of the Currency, 1937," p. 796.

[3] Lauchlin Currie, "Supply and Control of Money in the United States," Cambridge, Mass., 1934, p. 124.

The Glass-Steagall Act of February, 1932, broadened the discount powers of the Federal Reserve banks and authorized the use of United States obligations as collateral for Federal Reserve Notes. In the following July the Emergency Relief and Construction Act enlarged the resources and augmented the powers of the Reconstruction Finance Corporation, enabling it to make loans to state and municipal governments for relief purposes, and to finance special agricultural credit corporations.

Finally, the Federal Home Loan Bank Act resulted in the establishment of special banks to make advances to building and loan associations, savings banks, insurance companies and individuals on first mortgages covering dwelling-house property of moderate value. A rider to this Act provided that United States bonds bearing a coupon rate of not more than $3\frac{3}{8}$% should be granted the national bank note circulation privilege for a period of three years.

Whether considered severally or collectively, these measures did not prevent the banking crisis that developed early in 1933. The rate of bank suspensions was substantially reduced after the formation of the Reconstruction Finance Corporation in February, 1932, but in June banking difficul-

[1] The Act establishing the Corporation was approved January 22, 1932.

[2] Of the loans outstanding at the end of 1932, $595 million, or more than one-half of the total under Section 5, were loans to banks and trust companies.

ties were again in evidence, particularly in the Chicago area. From July until December failures were relatively few and were mostly among small banks. In December, however, there was an increase in suspensions, followed by further increases in the early part of 1933. Banking difficulties in February led to the temporary closing of all banks by official action, first in Louisiana and Michigan, then in other states, and finally by Presidential proclamation.

The Banking Holiday

The proclamation of the President issued on March 6, 1933,[1] declared a nation-wide bank holiday to continue through the four days ending Thursday, March 9. The principal reason for this action was the necessity of devising a frontal attack on the problem of bank failures. A careful review of the condition of all banks was essential in order that reopenings could be restricted to banks in a position to meet the demands made upon them. Equitable treatment of depositors and the restoration of confidence in the banking system as a whole seemed to require the decisive course of action that was taken.

During the period of closure the banks were not to pay out any coin, bullion or currency, or to transact any other banking business whatsoever, except such as might be permitted by the Secretary of the Treasury. Regulations were issued permitting the banks to perform specified functions such as making change, completing settlements not involving currency payments, allowing access to safe-deposit boxes, and delivering documents held for safekeeping. They were also granted permission to perform functions essential in providing necessities of life, in relieving distress and in meeting payrolls. Deposits could be accepted, but they were given a

[1] The proclamation was issued under the authority of the "Trading-with-the-Enemy Act" of October 6, 1917, as amended. This Act gave the President power to regulate or prohibit transactions in foreign exchange and in gold and silver, and also to prohibit the hoarding of gold and silver coin and bullion and paper currency

special trust account status. They could be held in cash or in United States obligations, or deposited in the Federal Reserve banks. The banks were specifically enjoined from paying out gold or gold certificates, and withdrawals of currency for the purpose of hoarding were not permitted.

On March 7 the Federal Reserve banks were authorized to supply currency, extend credits and make transfers required by member banks in exercising their powers. The member banks were required to inform the Federal Reserve banks of the amounts of currency held and of the circumstances occasioning additional needs. Gold and gold certificates held by member banks were delivered to the Reserve banks. On March 8 the Federal Reserve Board requested the Federal Reserve banks to prepare lists of persons who had recently withdrawn gold or gold certificates, which had not been redeposited by March 13, and to give publicity to the request. On March 10 the President issued an executive order prohibiting the export of gold except in accordance with regulations prescribed by, or under license issued by, the Secretary of the Treasury.

At the time the proclamation declaring the banking holiday was issued, the President called a special session of the Congress to meet on March 9 to enact whatever legislation might be needed for the reopening of the banks.

The Emergency Banking Act of 1933

In his message to the special session the President asked for legislation "giving to the executive branch of the government control over banks for the protection of depositors; authority forthwith to open such banks as have already been ascertained to be in sound condition and other such banks as rapidly as possible; and authority to reorganize and reopen such banks as may be found to require reorganization to put them on a sound basis." A bill providing these powers had been drafted and was passed by both the Senate and the

House and signed by the President on March 9, the same day that the Congress convened.

The Emergency Banking Act, as it was called, confirmed all the measures adopted by the President and the Secretary of the Treasury subsequent to March 4, and also gave the President emergency powers to control foreign exchange transactions, gold and currency movements, and banking transactions.

In order to deal effectively with those banks that could not be reopened on the bases established for the general resumption of banking operations, the Act provided that the assets of a national bank could be placed in the hands of a conservator. The duties of a conservator emphasized the conservation of assets and reorganization of the institution, rather than conservation and liquidation of assets, as in the case of a receiver. National banks were authorized to issue, and the Reconstruction Finance Corporation to purchase, preferred stock. The Federal Reserve banks were granted the power to issue Federal Reserve Bank Notes secured by direct obligations of the United States up to 100% of their value, or by any notes, drafts and bills acquired by the banks up to 90% of their value. No reserves against these notes were required. Requirements governing loans to member banks were liberalized, and direct loans to individuals, partnerships and corporations were authorized when secured by United States obligations.

Reopening of the Banks

Immediately after approving the Emergency Banking Act the President issued a proclamation extending the bank holiday for an indefinite period. On March 10, an executive order granted the Secretary of the Treasury power to license member banks found to be in satisfactory condition to conduct a usual banking business. Similar powers were granted to state banking officials in respect to non-member banks.

The Federal Reserve banks were designated as agents of the Secretary for receiving applications and issuing licenses. Payment of gold and furnishing currency for hoarding were specifically forbidden.

On March 11 the Treasury authorized the reopening of the Federal Reserve banks on March 13, and reopening of other banks in the twelve Federal Reserve bank cities was set for the same day. Banks in about 250 other cities which had recognized clearing houses were reopened on March 14, and banks in other cities and towns on March 15. As a preliminary to reopenings, the President in a radio address on March 12 outlined the program that had been formulated. At the same time he stressed that the success of this program depended upon cooperation by the public.

Changed Basis for Banking Operations

When the banks reopened during the week beginning March 13, 1933, a large volume of deposit currency again became available for the conduct of ordinary business transactions, but as late as April 12, deposits amounting to almost $4 billion were tied up in about 4,200 unlicensed or restricted member and non-member banks. Reopenings and liquidations up to the end of June reduced the total to about $2.5 billion. At the close of 1933 the amount of frozen deposits was placed at $1,225 million, and the number of restricted banks at approximately 1,900, of which about 1,400 were non-member banks.[1]

The Banking Act of 1933

Of the various legislative acts affecting banking that were passed in the period from 1933 to 1938, perhaps none is so important as the Banking Act of June 16, 1933. Mention need be made only of those provisions that bear on the problem of credit supply to American industry.

[1] "Annual Report of the Federal Reserve Board, 1933," p. 23.

Several of its provisions were designed to promote the solvency of the banks and to diminish the possibility of failure. The minimum capital for new national banks was fixed at $100,000, but a minimum of $50,000 was permitted for banks in communities of 6,000 inhabitants or less. In cities of more than 50,000 population the minimum was placed at $200,000, except that in outlying districts of such cities a capital of not less than $100,000 was permitted, provided that the laws of the state permit the organization of state banks with a capital of $100,000 or less. The Federal Reserve Act was amended to provide that state banks might be admitted to the privileges of membership in the system only if they were able to meet the capital requirements for national banks in the same place. Membership was permitted to state banks having a capital of not less than $25,000 in towns and villages with a population not over 3,000, provided these banks were organized before June 16, 1933.

A number of the changes in the banking statutes made by the Banking Act of 1933 operated to increase the authority and prestige of the Federal Reserve Board. It provided for the establishment of the Federal Open Market Committee, thereby giving statutory recognition to a cooperative practice instituted in 1923. Open-market operations were brought more directly under the control of the Federal Reserve Board, and they were permitted only when in accordance with the Board's regulations.

The Federal Reserve Board was given the power to fix for each Federal Reserve district the percentage of individual member bank capital and surplus which could be represented by loans secured by stock or bond collateral. The amount of such loans to any one borrower was made subject to a general limitation of 10% of unimpaired capital and surplus. This section of the law represented an attempt to attain a greater measure of qualitative credit control, particularly over speculative collateral loans. Another section of the law

required that each Federal Reserve bank should keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining if there were an excessive use of bank credit for speculative purposes.

By far the most important change instituted by the Act, however, was the introduction of deposit insurance on a national scale. It provided that a temporary insurance fund should become effective January 1, 1934, and a permanent plan on July 1, 1934. Under the temporary plan, deposits of any one depositor in any participating bank were insured up to a maximum of $2,500. The Federal Deposit Insurance Corporation was established as the administrative agency. It is unnecessary to stress that the introduction of federal deposit insurance altered the basis for the conduct of commercial banking operations. The ultimate safety of depositors' funds was no longer dependent solely on the value of banking assets and sound management.

Recapitalization of the Banks

In the aggregate, the banks of the United States "had no capital and surplus prior to the aid extended to them by the Reconstruction Finance Corporation late in 1933."[1] This statement does not imply that from an accounting standpoint a combined balance sheet for all banks would have shown a negative quantity for net capital funds or net worth. Bank assets were not appraised at market value, but on a so-called long-range or recovery basis, which had the sanction of the examining authorities. If the appraisal had been based on market quotations there would doubtless have been a negative quantity of capital funds.

In brief, federal deposit insurance was to be superimposed on a banking system that probably was entirely devoid of

[1] H. P. Willis and J. M. Chapman, "The Banking Situation," Columbia University Press, New York, 1934, p. 105.

capital, if the strictest standards were applied. It was evident that the capital structure of the banking system would have to be improved before the federal deposit insurance system became effective. Far more important, however, was the fact that additional capital was essential for the rehabilitation of the banking structure.

The basis for federal action aimed at improving the capital position of the banks was the authority granted to the Reconstruction Finance Corporation to invest in the capital of banking institutions. Immediately after the banking crisis this power was used primarily in connection with bank reorganizations which were designed to make essential banking services available in communities in which they were lacking. During the summer of 1933 a survey was made to determine the amount of new capital that might be required to strengthen active banks prior to their participation in the deposit insurance plan. By the end of the year applications for additional capital had been received from about 5,000 banks, or more than one-third of all active banks. Two-thirds of the applicants were non-member banks.[1]

At the end of 1933, the Reconstruction Finance Corporation had outstanding a total of $264 million on account of purchases of preferred stock, capital loans and debentures of banks and trust companies, and loans secured by preferred stock. Loans to banks and trust companies outstanding, including loans to aid in the reorganization or liquidation of closed banks, amounted to $711 million.[2] On June 30, 1938, the Corporation reported a total of $725 million outstanding on account of loans and other authorizations to banks and trust companies. Included in this total were $419 million in subscriptions to preferred stock and $134 million in purchases of capital notes and debentures.[3]

[1] "Annual Report of the Federal Reserve Board, 1933," p. 25.

[2] Quarterly Report of the Reconstruction Finance Corporation for the period ended December 31, 1933, p. 44.

[3] Quarterly Report of the Reconstruction Finance Corporation for the period ended June 30, 1938, Table 5.

Devaluation of the Dollar

Withdrawal of gold for hoarding was one of the factors that led to the proclamation of the banking holiday. From the time of the holiday the free gold standard ceased to exist. Developments immediately thereafter suggested that the character of the unit in which banking operations are conducted would be permanently changed.

The Thomas Amendment[1] to the Agricultural Adjustment Act of May 12, 1933 empowered the President to reduce the weight of the gold dollar by not more than 50%. The Gold Reserve Act approved on January 30, 1934 provided that the weight of the dollar should be fixed at not more than 60% of the old weight of 25.8 grains of standard gold. On January 31 the weight of the dollar was fixed by presidential proclamation at 15 5/21 grains, or approximately 59.06% of its previous weight. The reason given for the devaluation was that it was necessary in order to stablize domestic prices and to protect our foreign trade against the adverse effect of depreciated foreign currencies.

Other Legislation in 1933–1934

Loans by the Federal Reserve banks to non-member banks upon approved security and after a thorough examination of the borrowing institution were authorized by the Act of March 24, 1933.

In addition to the grant of authority to devalue the dollar, the Act of May 12, 1933 gave the President the power to direct the Secretary of the Treasury to issue unsecured United States notes in amounts totalling not more than $3 billion outstanding at any one time, the notes to be used for the purpose of meeting maturing federal obligations and of purchasing United States bonds and other interest-bearing obligations. These notes and other notes and coins issued thereafter were made unqualified legal tender. The same

[1] Title III.

Act authorized the purchase of $3 billion of Treasury bills or other United States obligations, in addition to those held on the date of enactment, on the basis of joint agreements between the Secretary of the Treasury and the Federal Reserve Board. Finally, the Federal Reserve Board, with the approval of the President, was given the authority to declare that an emergency exists by reason of credit expansion and to increase or decrease the reserve balances that member banks are required to maintain against demand or time deposits.

The temporary plan for the insurance of bank deposits was extended to June 30, 1935, by the Act of June 16, 1934. The maximum amount of deposits of any depositor in one bank subject to insurance was increased from $2,500 to $5,000, but deposits in mutual savings banks were excepted under certain circumstances.

An Act approved on June 19, 1934 added a new section to the Federal Reserve Act, authorizing the Federal Reserve banks, under the authority of the Federal Reserve Board, to make loans to, or purchase obligations of, an established industrial or commercial business which is unable to obtain requisite financial assistance from the usual sources. Such advances were restricted to loans and purchases for working capital purposes, and could not have a maximum maturity of more than five years.

The Federal Reserve banks were authorized to acquire working capital obligations of industrial or commercial businesses from banks or financing institutions by discount or purchase and to make loans on the security of such obligations. The law required each such financing institution to obligate itself to the satisfaction of the Federal Reserve bank for at least 20% of any loss which might be sustained, or to furnish at least 20% of the working capital advanced to the business.[1]

[1] The industrial advance programs are considered in detail in Chapter IV.

The Banking Act of 1935[1]

The permanent plan of deposit insurance was revised in the Banking Act of 1935, which was approved on August 23.[2] The maximum amount of deposits of any one depositor insured under the plan was fixed at $5,000, the same amount as under the temporary plan then in effect. Insured banks were made subject to an annual net assessment of one-twelfth of 1% based on total deposits, payable semi-annually. The Federal Deposit Insurance Corporation was given authority to establish a separate insurance fund for mutual savings banks, with a lower rate of assessment. Deposit insurance was made mandatory for national banks and state banks that are members of the Federal Reserve System, while non-member banks could become insured under certain conditions. The Corporation was given control over the rates of interest paid on deposits by insured non-member banks.

The Federal Reserve Board was reorganized under this Act. As of February 1, 1936, its composition was changed to seven appointive members. Formerly there were six, with two ex-officio members, the Secretary of the Treasury and the Comptroller of the Currency. The official name of the Board was changed to the Board of Governors of the Federal Reserve System. The composition of the Federal Open Market Committee was changed to include the seven members of the Board of Governors and five representatives of the Federal Reserve banks, instead of one member from each Federal Reserve district. The new law made the Committee completely responsible for the formulation of open-market policies. Participation in operations recommended by the Committee was made obligatory upon the several Federal Reserve

[1] The Banking Act of 1935 included numerous provisions in addition to those considered in this section. A complete synopsis of the Act will be found in the "Annual Report of the Board of Governors of the Federal Reserve System, 1935," p. 49 ff.

[2] The temporary fund was extended from July 1, 1935, to August 31, 1935, by a joint resolution of Congress.

banks. Debt obligations guaranteed as to principal and interest by the United States were made eligible for open-market purchase, but the purchase of new federal issues including guaranteed issues directly from the Treasury or issuing authority was specifically prohibited.

The provision of the Federal Reserve Act authorizing any Federal Reserve bank to make advances to any member bank on such of its time or demand notes as are secured to the satisfaction of the bank was enacted as a permanent part of the statute, but in amended form.[1] Restrictions limiting these advances to cases involving exceptional and exigent circumstances and to instances when the member banks could not obtain adequate credit accommodations under other provisions of the Federal Reserve Act were eliminated. The rate of interest was fixed at not less than ½% higher than the highest discount rate in effect at the Federal Reserve bank. The maximum maturity was placed at four months.

The aggregate amount of real estate loans which a national bank is permitted to hold was changed to 100% of paid-in and unimpaired capital and surplus, or to 60% of time and savings deposits, whichever is the greater. The former limitation was 25% of capital and surplus, or 50% of savings deposits. The Act of 1935 eliminated the former requirement that real estate upon which loans are made must be located in the Federal Reserve district in which the bank is located, or within 100 miles of the location of the bank. The limitation as to the amount that can be loaned on a given property was changed from 50% of actual value to 50% of appraised value.

The section of the Federal Reserve Act giving the Board authority to increase or decrease the reserve requirements of member banks was amended so as to remove the necessity for a declaration, supported by the affirmative vote of five Board members and approved by the President, that an emergency exists by reason of credit expansion. In the amended form,

[1] This provision had expired by limitation on March 3, 1935.

the Board is given authority to alter the reserve requirements of member banks "in order to prevent injurious credit expansion or contraction." The affirmative vote of not less than four members of the Board is necessary to effect any change. The maximum reserves that could be required were fixed at double those required on the effective date of the Banking Act of 1935, and it was provided that they could not be lowered below the level that then prevailed.

Banking Trends, 1933–1938

Appraisal of the results of the questionnaire survey of the availability of bank credit to industry must necessarily presuppose a knowledge of major banking trends in the period to which the survey relates. Were there any important changes in the number of commercial banking institutions? Did failures or suspensions seriously interfere with the orderly functioning of the banking system? What were the relative changes in the loan and investment totals of commercial banks? Were there any marked changes in the types of loans made by commercial banks?

The Number of Banks

From June 30, 1933, to December 31, 1934, there was an increase of 1,520 in the number of commercial banks. Exclusive of mutual savings banks, the number of banks on the latter date was 15,463.[1] This increase resulted primarily from the licensing of banks that were not reopened immediately after the banking holiday, and should not be construed as a normal trend. The licensing of banks following the banking holiday had been substantially completed by the end of 1934.[2] From 1934 to 1938 there was a gradual decline

[1] "Annual Report of the Board of Governors of the Federal Reserve System, 1937," p. 106.

[2] According to a tabulation in the *Federal Reserve Bulletin* for November, 1937, only 50 banks were licensed after January 1, 1935.

in the number of banks, the total on March 7, 1938 being reported at 15,348.[1]

The slight downward trend in number in these years should not be interpreted as the equivalent of a corresponding decrease in banking facilities. Mergers and consolidations accounted for a substantial part of the reduction, and in some cases no reduction in the number of actual banking offices resulted. The number of banking offices of all banks other than mutual savings and private banks showed a decrease of only 103 for the three years ended December 31, 1937.[2]

Bank Suspensions

As compared with the period from 1929 to 1933, bank suspensions from 1934 through 1937 were almost negligible. The number reported for this four-year period was 194, and only twelve of these were member banks of the Federal Reserve System.[3] The deposits of the banks that suspended operation were only $78 million, of which the twelve member banks accounted for approximately $15 million.

Member Bank Loans and Investments

The statistics for the member banks of the Federal Reserve System will be used as the basis for anlyzing trends in loans and investments in the period since 1933. Member banks account for approximately 84% of the loans and investments of all banks other than mutual savings banks.

On June 30, 1938, the combined loans and investments of all member banks amounted to $30.7 billion. (See Table 1.) The comparable total for June 30, 1933 was $24.8 billion. Practically all the increase for the five-year period was accounted for by investments in United States Government

[1] *Federal Reserve Bulletin*, August, 1938, p. 707.

[2] "Annual Report of the Board of Governors of the Federal Reserve System, 1937," p. 158.

[3] "Annual Report of the Board of Governors of the Federal Reserve System, 1937," p. 164.

CHART 1: LOANS AND INVESTMENTS OF MEMBER BANKS, 1933–1938

Source: Federal Reserve Board, Member Bank Call Reports

Billions of Dollars

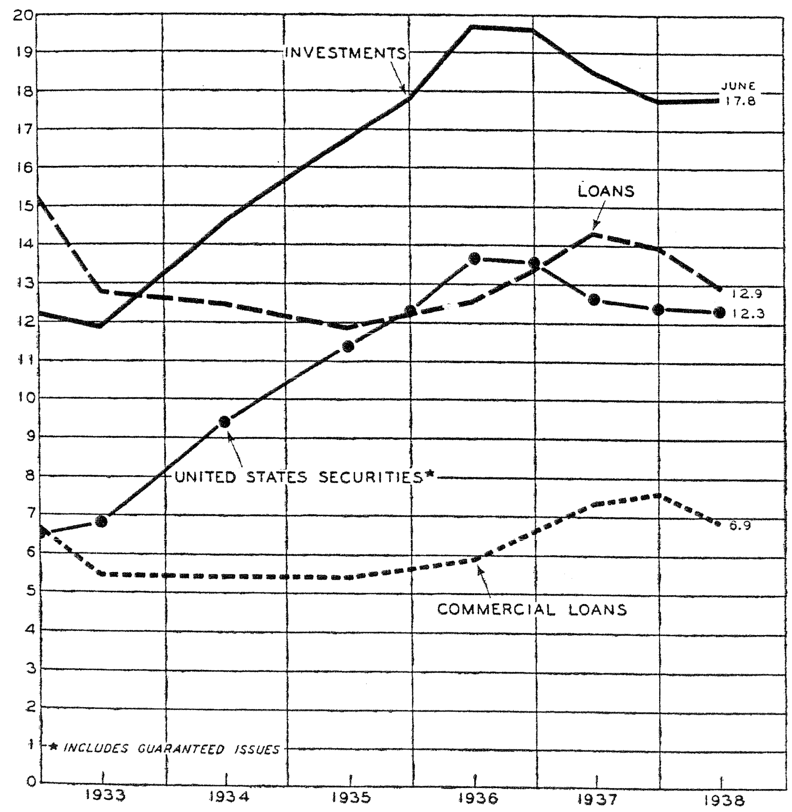


Table 1: Loans and Investments, All Member Banks, 1933–1938

Source: Federal Reserve Board, Member Bank Call Reports

Millions of Dollars

	June 30, 1933	June 30, 1934	June 29, 1935	December 31, 1935	June 30, 1936	December 31, 1936	June 30, 1937	December 31, 1937	March 7, 1938	June 30, 1938
Loans and investments	24,786	27,175	28,785	29,985	32,259	33,000	32,739	31,752	31,521	30,721
Loans	12,858	12,523	11,928	12,175	12,542	13,360	14,285	13,958	13,546	12,938
Eligible paper	1,977	2,059	2,050	2,095	2,052	2,484	2,713	. .	. .	. .
Other	10,881	10,464	9,878	10,080	10,490	10,876	11,572	. .	. .	. .
Investments	11,928	14,652	16,857	17,810	19,717	19,640	18,454	17,794	17,975	17,783
United States Government securities, direct obligations	6,887	9,137	9,871	10,501	11,721	11,639	10,870	10,574	10,625	10,215
United States Government securities, guaranteed obligations	. .	276	1,558	1,768	1,950	1,906	1,819	1,797	1,827	2,128
Other	5,041	5,239	5,427	5,541	6,045	6,095	5,765	5,422	5,523	5,440
Eligible paper and United States Government securities	8,865	11,472	13,480	14,363	15,723	16,029	15,402	. .	. .	. .

Table 2: Index Numbers of Loans and Investments, All Member Banks, 1933–1938

June 29, 1929 = 100

Source: Federal Reserve Board, Member Bank Call Reports

Computed by The Conference Board

	June 30, 1933	June 30, 1934	June 29, 1935	December 31, 1935	June 30, 1936	December 31, 1936	June 30, 1937	December 31, 1937	March 7, 1938	June 30, 1938
Loans and investments	69.4	76.1	80.6	84.0	90.3	92.4	91.7	88.9	88.3	86.0
Loans	50.1	48.8	46.5	47.5	48.9	52.1	55.7	54.4	52.8	50.4
Eligible paper	45.0	46.9	46.7	47.7	46.7	56.6	61.8	. .	. .	. .
Other	51.2	49.2	46.4	47.4	49.3	51.1	54.4	. .	. .	. .
Investments	118.7	145.8	167.7	177.2	196.1	195.4	183.6	177.0	178.8	176.9
United States Government securities, direct and guaranteed obligations	165.8	226.5	275.1	295.3	329.1	326.0	305.4	297.8	299.7	297.1
United States Government securities, direct obligations	165.8	219.9	237.6	252.7	282.1	280.1	261.6	254.5	255.7	245.9
Other	85.5	77.5	92.0	94.0	102.5	103.3	97.7	91.9	93.6	92.2
Eligible paper and United States Government securities	103.7	134.3	157.8	168.1	184.0	187.6	180.3	. .	. .	. .

TABLE 3: LOANS AND INVESTMENTS IN DETAIL, ALL MEMBER BANKS, 1933–1938

Source: Federal Reserve Board, Member Bank Call Reports

Millions of Dollars

	June 30, 1933	June 30, 1934	June 29, 1935	December 31, 1935	June 30, 1936	December 31, 1936	June 30, 1937	December 31, 1937	March 7, 1938	June 30, 1938
Loans	12,858	12,523	11,928	12,175	12,542	13,360	14,285	13,958	13,546	12,938
Commercial loans	5,452	5,415	5,434	5,658	5,912	6,675	7,299	7,638	7,352	6,889
Loans to banks	330	153	119	98	81	85	115	70	96	120
Loans on securities[1]	4,704	4,598	4,098	4,136	4,209	4,195	4,365	3,703	3,543	3,316
To brokers and dealers in New York	788	1,082	975	1,047	1,079	1,144	1,278	738	675	523
To brokers and dealers elsewhere	165	208	192	196	266	266	258	212	203	178
To others	3,752	3,309	2,931	2,893	2,863	2,785	2,829	2,752	2,665	2,614
Real estate loans, farm	308	288	259	251	256	258	265	265	269	273
Real estate loans, other	2,064	2,068	2,019	2,033	2,084	2,146	2,241	2,283	2,287	2,340
Investments	11,928	14,652	16,857	17,810	19,717	19,640	18,454	17,794	17,975	17,783
United States Government securities, direct obligations	6,887	9,137	9,871	10,501	11,721	11,639	10,870	10,574	10,625	10,215
United States Government securities, guaranteed obligations	..	276	1,558	1,768	1,950	1,906	1,819	1,797	1,827	2,128
State, county and municipal securities	1,744	1,832	2,102	2,159	2,264	2,209	2,133	2,032	2,194	2,128
Public utility securities	712	712	765	856	926	1,002	871	794	775	763
Railroad securities	1,679	736	825	822	948	992	957	886	866	833
All other securities		1,133	961	951	1,111	1,114	1,043	1,000	965	1,002
Miscellaneous investments	552	550	529	509	545	542	533	529	545	536
Foreign government securities	202	202	173	179	190	186	183	141	138	140
Foreign corporate securities	152	75	74	65	60	50	45	40	40	38

1 Exclusive of loans to banks.

TABLE 4: INDEX NUMBERS OF LOANS AND INVESTMENTS IN DETAIL, ALL MEMBER BANKS, 1933–1938

June 29, 1929 = 100

Source: Federal Reserve Board, Member Bank Call Reports

Computed by THE CONFERENCE BOARD

	June 30, 1933	June 30, 1934	June 29, 1935	December 31, 1935	June 30, 1936	December 31, 1936	June 30, 1937	December 31, 1937	March 7, 1938	June 30, 1938
Loans	50.1	48.8	46.5	47.5	48.9	52.1	55.7	54.4	52.8	50.4
Commercial loans	45.2	44.9	45.0	46.9	49.0	55.3	60.5	63.3	60.9	57.1
Loans to Banks	49.2	22.8	17.7	14.6	12.0	12.7	17.1	10.4	14.3	18.0
Loans on securities[1]	48.2	47.1	42.0	42.4	43.1	43.0	44.7	37.9	36.3	34.0
To brokers and dealers in New York	38.9	53.4	48.1	51.7	53.3	56.5	63.1	36.5	33.3	25.9
To brokers and dealers elsewhere	17.9	22.5	20.8	21.3	28.9	28.9	28.0	23.0	22.0	19.3
To others	55.1	48.6	43.0	42.5	42.0	40.9	41.5	40.4	39.1	38.4
Real estate loans, farm	76.3	71.4	64.0	62.2	63.4	63.9	65.5	65.6	66.5	67.5
Real estate loans, other	74.8	74.9	73.1	73.6	75.5	77.8	81.2	82.7	82.9	84.8
Investments	118.7	145.8	167.7	177.2	196.1	195.4	183.6	177.0	178.8	176.9
United States Government securities, direct and guaranteed obligations	165.8	226.5	275.1	295.3	329.1	326.0	305.4	297.8	299.7	297.1
United States Government securities, direct obligations	165.8	219.9	237.6	252.7	282.1	280.1	261.6	254.5	255.7	245.9
State, county and municipal securities	152.4	160.1	183.6	188.7	197.9	193.0	186.4	177.6	191.7	186.0
Public utility securities	76.4	76.4	82.1	91.8	99.4	107.5	93.4	85.2	83.1	81.8
Railroad securities	[a]	88.4	99.2	98.8	114.0	119.2	115.0	106.5	104.1	100.1
All other securities	[a]	86.0	72.9	72.2	84.3	84.6	79.2	75.9	73.3	76.1
Miscellaneous investments	53.2	53.0	51.0	49.1	52.6	52.2	51.4	51.0	52.5	51.7
Foreign government securities	65.5	65.4	55.9	58.0	61.5	60.3	59.4	45.7	44.7	45.3
Foreign corporate securities	46.6	22.9	22.5	19.9	18.5	15.5	13.7	12.4	12.3	11.6

1 Exclusive of loans to banks.

a Data not available separately.

Table 5: Percentage Distribution of Loans and Investments, All Member Banks, 1933–1938

Source: Federal Reserve Board, Member Bank Call Reports

Computed by The Conference Board

	June 30, 1933	June 30, 1934	June 29, 1935	December 31, 1935	June 30, 1936	December 31, 1936	June 30, 1937	December 31, 1937	March 7, 1938	June 30, 1938
Loans and investments	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Loans	51.9	46.1	41.4	40.6	38.9	40.5	43.6	44.0	43.0	42.1
Eligible paper	8.0	7.6	7.1	7.0	6.4	7.5	8.3	..	..	..
Other	43.9	38.5	34.3	33.6	32.5	33.0	35.3	..	..	..
Investments	48.1	53.9	58.6	59.4	61.1	59.5	56.4	56.0	57.0	57.9
United States Government securities, direct obligations	27.8	33.6	34.3	35.0	36.3	35.3	33.2	33.3	33.7	33.3
United States Government securities, guaranteed obligations	..	1.0	5.4	5.9	6.0	5.8	5.6	5.7	5.8	6.9
Other	20.3	19.3	18.9	18.5	18.7	18.5	17.6	17.1	17.5	17.7
Eligible paper and United States Government securities	35.8	42.2	46.8	47.9	48.7	48.6	47.0	..	..	..

Table 6: Percentage Distribution of Loans and Investments in Detail, All Member Banks, 1933–1938

Source: Federal Reserve Board, Member Bank Call Reports

Computed by The Conference Board

	June 30, 1933	June 30, 1934	June 29, 1935	December 31, 1935	June 30, 1936	December 31, 1936	June 30, 1937	December 31, 1937	March 7, 1938	June 30, 1938
Loans	51.9	46.1	41.4	40.6	38.9	40.5	43.6	44.0	43.0	42.1
Commercial loans	22.0	19.9	18.9	18.9	18.3	20.2	22.3	24.1	23.3	22.4
Loans to banks	1.3	0.6	0.4	0.3	0.3	0.3	0.4	0.2	0.3	0.4
Loans on securities[1]	19.0	16.9	14.2	13.8	13.0	12.7	13.3	11.7	11.2	10.8
To brokers and dealers in New York	3.2	4.0	3.4	3.5	3.3	3.5	3.9	2.3	2.1	1.7
To brokers and dealers elsewhere	0.7	0.8	0.7	0.7	0.8	0.8	0.8	0.7	0.6	0.6
To others	15.1	12.2	10.2	9.6	8.9	8.4	8.6	8.7	8.5	8.5
Real estate loans, farm	1.2	1.1	0.9	0.8	0.8	0.8	0.8	0.8	0.9	0.9
Real estate loans, other	8.3	7.6	7.0	6.8	6.5	6.5	6.8	7.2	7.3	7.6
Investments	48.1	53.9	58.6	59.4	61.1	59.5	56.4	56.0	57.0	57.9
United States Government securities, direct obligations	27.8	33.6	34.3	35.0	36.3	35.3	33.2	33.3	33.7	33.3
United States Government securities, guaranteed obligations	..	1.0	5.4	5.9	6.0	5.8	5.6	5.7	5.8	6.9
State, county and municipal securities	7.0	6.7	7.3	7.2	7.0	6.7	6.5	6.4	7.0	6.9
Public utility securities	2.9	2.6	2.7	2.9	2.9	3.0	2.7	2.5	2.5	2.5
Railroad securities	6.8	2.7	2.9	2.7	2.9	3.0	2.9	2.8	2.7	2.7
All other securities		4.2	3.3	3.2	3.4	3.4	3.2	3.1	3.1	3.3
Miscellaneous investments	2.2	2.0	1.8	1.7	1.7	1.6	1.6	1.7	1.7	1.7
Foreign government securities	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.4	0.4	0.5
Foreign corporate securities	0.6	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1

[1] Exclusive of loans to banks.

ecurities, including guaranteed obligations. On June 30, 938, loans were less than $100 million larger than on June 30, 933. It should not be assumed, however, that the amount of oans remained practically constant throughout the period. From June, 1937, to June, 1938, there was a contraction of approximately $1,350 million in member bank loans as a re- sult of the business recession.

Data for member bank loans for the years 1933 to 1938 may afford some clue as to whether or not the credit require- ments of industry and trade were being met in a satisfactory manner. The basic data for this period will be found in Tables 1 and 3, while Tables 2 and 4 show member bank loans and investments on an index number basis. Tables 5 and 6 show percentage distributions of the data in Tables 1 and 3.

Commercial loans did not begin to show an upward trend until 1935, as may be seen in Table 3 and Chart 1. At the end of June, 1935, the total was approximately the same as in June, 1933. The index for both months was only 45 on the basis of 100 for June, 1929. By the end of 1935 the index had risen to 47. There is nothing unusual about the relatively stable level of commercial loans in 1934 and the first half of 1935. A large proportion of commercial and industrial financ- ing in the early stages of recovery is ordinarily accomplished with working capital that has been lying idle or has been temporarily invested in short-term securities, pending the time when it will be required for business uses. In a period of revival and recovery, a lag in borrowing by business must be regarded as normal, as long as the majority of businesses have abundant working capital for financing operations at or near their average level over a period of years.[1]

There was a decrease in commercial loans in the first two months of 1936, but in March there was a pronounced in-

[1] For a more complete discussion, see Clyde L. Rogers, "Government Monopoly of the Banking Process and Its Implications," *The Annalist*, April 20, 1934, pp. 622–24.

crease in industrial and commercial borrowings. The up- ward trend continued through 1936 and 1937. The increase in commercial loans in the two years amounted to about $2 billion. At the end of 1937 the commercial loans index stood at 63, an increase of 16 points over that for December, 1935. In the first half of 1938, however, there was a decrease of approximately $750 million in this class of loans because of the business recession.

At no time in the recent period did commercial loans account for as much as 25% of combined loans and invest- ments. At the end of 1937 this class of loans represented 24% of all loans and investments, as compared with 19% at the end of 1935. The comparable percentages on a basis that excludes investments in United States Government securities, including guaranteed issues, were 32% at the end of 1935 and 39% at the end of 1937. These increases are very significant. The data in Tables 3 and 4, considered in conjunction with Table 6, show clearly that when adjustments in portfolios were necessitated by the increases in reserve requirements in 1936 and 1937, there was no retrenchment in commercial loans by all member banks combined. Both the amount of loans classed as commercial and the ratio to combined loans and investments continued to increase until the end of 1937.[1]

In June, 1938, member bank loans on securities were at their lowest level for the period covered in Table 3. Except for the decrease in the latter part of 1937 and the first half of 1938, there was no pronounced trend in loans on securities in the entire period. In 1935 and 1936 loans on farm real estate were well below the 1933 level. From the end of 1936 to 1938 there was a slight upward trend in this class of loans, and on June 30, 1938, the index stood at 67.5, as compared with 76 for June, 1933. Other real estate loans, principally on urban properties, showed an upward trend from 1935 to

[1] The increases in the ratio of commercial loans to total loans and investments in 1936 and 1937 were the only increases registered in the entire period after 1920.

1938. In June, 1938, the index for other real estate loans was 85, compared with 75 for June, 1933.

From June, 1933, to June, 1936, member bank investments were increased by about $7.8 billion. All but $1 billion of this increase was accounted for by United States Government securities, including obligations guaranteed by the Treasury. The increase in government holdings was particularly large in the calendar year 1934, when member bank holdings of direct federal issues were increased by about $2,650 million, and an additional billion was placed in guaranteed obligations. A part of the guaranteed issues was obtained in exchange for mortgage loans.

In 1935, holdings of direct federal obligations were increased by only $600 million, while guaranteed issues showed an increase of $780 million. The relatively small increase in holdings of direct obligations was attributable in part to the retirement of bonds bearing the national bank circulation privilege. These bonds had been held almost exclusively by national banks. There was an increase in all other investments of a little more than $300 million. The increases for all classes of investments were confined very largely to banks in central reserve and reserve cities.

Member bank investments continued to increase in the early part of 1936, but declined in the last half of the year. For all classes of investments combined, the decrease was only $77 million. In the first six months, holdings of United States Government securities, including guaranteed issues, were increased by almost $1.4 billion. The decrease in governments in the last half of the year amounted to $126 million, and was accounted for solely by New York City banks, which reduced their holdings of governments by $554 million. The reduction in New York bank holdings was attributed to several factors: (1) adjustments of the reserve positions of the banks in anticipation of possible increases in reserve requirements,[1] (2) the smaller volume of new borrowing by the Treasury, and (3) a change in the type of securities offered.[2]

The year 1937 witnessed the first decline in bank holdings of governments since the period of deficit financing began in 1931. Member bank holdings, including both direct and guaranteed issues, decreased by about $1,175 million. For the banking system as a whole, the decline was considerably smaller, principally because of net purchases by mutual savings banks and the Federal Reserve banks. The trend in member bank holdings of governments turned upward in the last quarter of 1937, and there was a further small increase in the first quarter of 1938. In the second quarter of 1938 there was a decrease of $410 million in holdings of direct federal obligations, but this was largely offset by an increase of $300 million in guaranteed obligations.

Member bank holdings of state and municipal securities increased from 1933 until the early part of 1937. In the latter part of the period covered in Table 3 there were irregular changes in this class of investment. Combined federal, state and local obligations, including federal guaranteed issues, accounted for 47% of member bank loans and investments on June 30, 1938. The largest proportion for any date included in Table 6 was 49% on June 30, 1936.

Member Bank Deposits

Two principal factors tended to increase the volume of member bank deposits from 1933 to 1938. First, the Federal Government borrowed large sums. The sale of federal securities to the banks resulted in an increase in deposits, first in government deposits, and, when expended, in other deposits. The second factor was the additions to gold stocks, which resulted in an increase in deposits at commercial banks, ex-

[1] Changes in reserve requirements, which affected the trend in investment holdings, especially governments, in 1936 and 1937, are considered elsewhere (see pp. 32 f.).

[2] "Annual Report of the Board of Governors of the Federal Reserve System, 1936," p. 24.

cept in those cases where importers paid for the gold by drawing on balances held abroad by banks in this country. In 1936 and 1937 a third factor, an increase in commercial loans, brought about an increase in deposits.

Average member bank deposits for the third month of each quarter from June, 1933, to June, 1938, are shown in Table 7,

TABLE 7: AMOUNT OF DEPOSITS AND RESERVES, DAILY AVERAGES, ALL MEMBER BANKS, 1933–1938

Source: Annual Reports of the Federal Reserve Board

Millions of Dollars

Month	Deposits, Daily Average for Month			Reserves, Daily Average for Month		
	Total	Net Demand	Time	Total	Required	Excess
1933—June	22,974	14,241	8,732	2,160	1,797	363
September	23,140	14,027	9,113	2,451	1,777	675
December	23,646	14,567	9,078	2,588	1,822	766
1934—March	25,288	15,851	9,437	3,345	1,970	1,375
June	26,698	16,988	9,711	3,790	2,105	1,685
September	27,615	17,806	9,809	3,947	2,192	1,754
December	28,538	18,769	9,769	4,037	2,290	1,748
1935—March	29,586	19,554	10,031	4,452	2,388	2,065
June	31,003	20,899	10,103	4,979	2,541	2,438
September	31,336	21,179	10,157	5,243	2,615	2,628
December	32,480	22,200	10,280	5,716	2,733	2,983
1936—March	32,887	22,412	10,474	5,420	2,767	2,653
June	34,199	23,505	10,694	5,484	2,891	2,593
September	35,375	24,532	10,843	6,345	4,493	1,852
December	36,234	25,352	10,882	6,665	4,619	2,046
1937—March	36,241	25,073	11,169	6,704	5,333	1,371
June	36,016	24,718	11,299	6,878	6,002	876
September	36,005	24,467	11,538	6,854	5,954	900
December	35,301	23,860	11,441	6,879	5,808	1,071
1938—March	35,219	23,664	11,555	7,326	5,802	1,524
June	35,409	23,888	11,521	7,878	5,116	2,762

while Table 8 shows changes in member bank deposits in this period on an index number basis. In 1934 net demand deposits increased by about $4.2 billion, and time deposits increased by $700 million. The largest element in the growth of deposits in 1934 was an increase in the deposits of customers other than banks and governmental units. The purchase of about $1.4 billion of gold during the year also op-

erated to raise the level of deposits. Even more important in this connection was the creation of deposits through the sale of federal obligations to the banks.

The upward trend in deposits continued through 1935 and 1936. In 1935 the rise was attributable principally to the following: (1) an increase in the monetary gold stock of $1.7

TABLE 8: INDEX NUMBERS OF DEPOSITS AND RESERVES, DAILY AVERAGES, ALL MEMBER BANKS, 1933–1938

June, 1929 = 100

Source: Annual Reports of the Federal Reserve Board

Computed by THE CONFERENCE BOARD

Month	Deposits			Reserves	
	Total	Net Demand	Time	Total	Required
1933—June	72.3	76.9	65.9	93.3	79.0
September	72.9	75.7	68.8	105.8	78.1
December	74.4	78.7	68.6	111.7	80.1
1934—March	79.6	85.6	71.3	144.4	86.6
June	84.1	91.7	73.3	163.6	92.6
September	86.9	96.1	74.1	170.4	96.4
December	89.9	101.3	73.8	174.3	100.7
1935—March	93.2	105.6	75.8	192.2	105.0
June	97.6	112.9	76.3	215.0	111.7
September	98.7	114.4	76.7	226.4	115.0
December	102.3	119.9	77.6	246.8	120.2
1936—March	103.5	121.0	79.1	234.0	121.7
June	107.7	126.9	80.8	236.8	127.1
September	111.4	132.5	81.9	274.0	197.6
December	114.1	136.9	82.2	287.8	203.1
1937—March	114.1	135.4	84.3	289.5	234.5
June	113.4	133.5	85.3	297.0	263.9
September	113.4	132.1	87.1	295.9	261.8
December	111.1	128.8	86.4	297.0	255.4
1938—March	110.9	127.8	87.3	316.3	255.1
June	111.5	129.0	87.0	340.2	225.0

billion, after deducting $200 million for reduction of member bank balances held abroad, (2) an increase in holdings of direct and guaranteed federal obligations amounting to about $1.4 billion, and (3) an increase of approximately $500 million in other loans and investments.[1] A relatively small offsetting

[1] "Annual Report of the Board of Governors of the Federal Reserve System, 1935," p. 21.

factor was a rise of $300 million in the amount of money in circulation. A further substantial rise in member bank deposits occurred in 1936. Increases of more than $1 billion in loans and $2 billion in investments, together with the addition of over $1 billion to the monetary gold stock, were the major factors accounting for this rise. Currency in circulation showed an increase of almost $700 million, which tended to retard the rate of increase in deposits.

In 1937 the upward trend in member bank deposits was arrested, the total at the end of the year declining almost $1 billion from that at the end of 1936. This decrease was in part a reflection of a decrease of about $1,250 million in member bank loans and investments. There was a further increase of $1.5 billion in monetary gold stock, but all except $300 million of the increase was placed in the inactive gold fund by the Treasury. As Treasury deposits with the Federal Reserve banks were not established by issuing gold certificates to the banks, the Treasury had to draw on its existing balances in the Federal Reserve banks and depositary banks or increase its borrowings for the purpose of meeting obligations, which otherwise would have been met by drawing on the credits established by issuing the certificates. There was little change in the level of member bank deposits in the first half of 1938.

In the period covered by Tables 7 and 8 the increase in demand deposits was considerably more rapid than that for time deposits. The index of demand deposits rose from 77 for June, 1933, to 137 for December, 1936. On the other hand, the index of time deposits rose from 66 for June, 1933, to a peak of 87.3 in March, 1938.

The Problem of Excess Reserves

Table 7 shows the total reserve balances of member banks of the Federal Reserve System, together with the amount of required reserves and excess reserves. There is perhaps no better indication of extreme credit ease during most of the period under review than the large amounts of excess reserves and the unusual steps taken to control them.

Excess reserves, of course, mean reserves in excess of those required. Prior to the approval of the Thomas Amendment in May, 1933, the reserve requirements for member banks were fixed by statute. Member banks in central reserve cities were required to maintain a reserve of 13% against demand deposits, member banks in reserve cities a reserve of 10%, and country banks a reserve of 7%. On time deposits a reserve of 3% was required, regardless of the location of the bank. The required reserves shown in Table 7 were computed at these percentages through the first half of 1936.

It will be observed from the data in Table 7 that excess reserves showed a marked upward trend from 1933 to 1936. In December, 1934, average daily reserve balances were $1,450 million larger than in December, 1933, and excess reserves showed an increase of approximately $1 billion. A large increase in the monetary gold stock was the principal factor leading to increased reserves in 1934. There was a further large increase in reserve balances in 1935. On the basis used in Table 7 the increase amounted to almost $1.7 billion, while excess reserves showed an increase of over $1.2 billion. The increase in reserve funds resulting from the growth of $1.9 billion in the monetary gold stock and of $400 million in silver money was partly offset by reductions in reserves caused by an increase of $350 million in money in circulation, an increase of $400 million in Treasury deposits at the Federal Reserve banks, and an increase of nearly $100 million in non-member deposits and other accounts at the Federal Reserve banks.

Reserves continued at a high level in 1936. The daily average for December, 1936, shown in Table 7, was about $1 billion above that for December, 1935. For the year as a whole, gold imports were the most important factor increasing reserves, and an increase in money in circulation was a leading factor tending to reduce reserves. During the summer, the redemption of the soldiers' bonus bonds resulted in a rapid increase in reserves.[1]

In order to eliminate a part of the excess reserves, thereby minimizing the possibility of injurious credit expansion, the Board of Governors of the Federal Reserve System decided to raise the reserve requirements for member banks by 50%. The decision was reached on July 14 and was made effective as of August 16, 1936. This action eliminated about $1.5 billion of excess reserves. Reserves continued to increase in the latter part of 1936 and, after a careful review of the monetary and credit situation, the Board decided on January 30, 1937 to increase reserves by an additional 50% of original requirements, or one-third of required reserves after the increase of August, 1936. One-half of the increase was made effective on March 1 and the other half on May 1. The final increase on May 1 raised reserves to the full extent permitted by statute.

Not all member banks were in an equally good position to meet the increases in reserve requirements. According to an analysis by the Board, however, only 197 member banks were unable to meet the new requirements by using existing reserve balances plus one-half of their balances with correspondent banks.[2] Adjustments to the new requirements, together with the withdrawal of balances by interior banks, led to considerable selling of government bonds by several large banks in New York. Yields of these bonds and corporate bonds increased. Purchases of Treasury bonds in April in the amount of $96 million for the account of the Federal Reserve System helped to stabilize the market.

After the final increase in reserve requirements became

[1] "Annual Report of the Board of Governors of the Federal Reserve System, 1936," p. 10.

[2] "Annual Report of the Board of Governors of the Federal Reserve System, 1937," p. 4.

effective on May 1, 1937, member banks had excess reserves of about $900 million, and they did not fall below $700 million in the remainder of 1937. In the first half of 1938 there was an increase of about $1 billion in total reserves, and for June the average excess reserves were $2.8 billion. A decrease in the level of deposits contributed to the latter result. Of greater importance, however, was the reduction in reserve requirements as a part of the pump-priming program announced on April 14, 1938. Effective April 16, the reserve requirements for demand deposits were reduced from 26% to 22¾% for central reserve city banks, from 20% to 17½% for reserve city banks, and from 14% to 12% for country banks. The required reserve for time deposits was reduced from 6% to 5%, regardless of the location of the bank.

The third, or credit, phase of the pump-priming program included the elimination of the inactive gold fund. On April 14, 1938, a total of $1,392 million was transferred to the gold certificate fund of the Federal Reserve System. The amount transferred included $1,183 million from the inactive gold account and $209 million from the working balance. The deposits thus created at the Federal Reserve banks augment bank reserves when they are used to cover expenditures in excess of receipts.

Other Banking Factors

Table 9 shows the trends from 1933 to 1938 in various other banking factors. Increases in monetary gold stock, currency in circulation and United States securities held by member banks have been mentioned earlier. Member bank borrowings at the Federal Reserve banks were almost negligible during most of the period covered, and federal reserve credit outstanding was represented almost exclusively by federal obligations held by the Federal Reserve banks.

TABLE 9: CURRENCY IN CIRCULATION, MONETARY GOLD STOCK AND OTHER BANKING FACTORS, 1933–1938

Source: Annual Reports of the Federal Reserve Board

Computed by THE CONFERENCE BOARD

Month	Currency in Circulation—End of Month	Monetary Gold Stock—End of Month	United States Government Securities Held by Member Banks[1,2]	Member Bank Borrowings[1]	Federal Reserve Credit Outstanding	Debits to Individual Accounts
	Millions of Dollars					
1933—June	5,434	4,031	6,887	191	2,220	31,745
September	5,363	4,037	..	..	2,421	26,395
December	5,519	4,036	7,254	143	2,688	28,395
1934—March	5,394	7,694	8,848	91	2,545	31,783
June	5,373	7,856	9,413	35	2,472	32,416
September	5,456	7,978	..	..	2,464	25,871
December	5,536	8,238	10,895	13	2,463	33,200
1935—March	5,493	8,567	11,021	17	2,471	33,948
June	5,568	9,116	11,430	9	2,480	33,871
September	5,683	9,368	..	..	2,477	31,339
December	5,882	10,125	12,268	6	2,486	39,170
1936—March	5,877	10,184	12,444	11	2,474	40,036
June	6,241	10,608	13,672	6	2,473	40,381
September	6,267	10,845	..	..	2,473	36,021
December	6,543	11,258	13,545	15	2,500	49,389
1937—March	6,377	11,574	12,718	18	2,458	45,190
June	6,447	12,318	12,689	16	2,562	39,624
September	6,542	12,741	..	..	2,579	36,333
December	6,550	12,760	12,372	12	2,612	42,357
1938—March	6,355	12,795	12,452	28	2,611	32,109
June	6,461	12,963	12,343	11	2,596	32,797
	Index Numbers, June, 1929 = 100					
1933—June	121.9	99.9	165.8	15.9	158.6	43.1
September	120.3	100.0	..	..	172.9	35.9
December	123.8	100.0	174.6	11.9	192.0	38.6
1934—March	121.0	190.6	212.9	7.6	181.8	43.2
June	120.5	194.6	226.5	2.9	176.6	44.0
September	122.4	197.6	..	..	176.0	35.1
December	124.2	204.1	262.2	1.1	175.9	45.1
1935—March	123.2	212.2	265.2	1.4	176.5	46.1
June	124.9	225.8	275.1	0.8	177.1	46.0
September	127.5	232.1	..	..	176.9	42.6
December	131.9	250.8	295.3	0.5	177.6	53.2
1936—March	131.8	252.3	299.5	0.9	176.7	54.4
June	140.0	262.8	329.0	0.5	176.6	54.8
September	140.5	268.6	..	..	176.6	48.9
December	146.7	278.9	326.0	1.3	178.6	67.1
1937—March	143.0	286.7	306.1	1.5	175.6	61.4
June	144.6	305.1	305.4	1.3	183.0	53.8
September	146.7	315.6	..	..	184.2	49.4
December	146.9	316.1	297.8	1.0	186.6	57.5
1938—March	142.5	316.9	299.7	2.3	186.5	43.6
June	144.9	321.1	297.1	0.9	185.4	44.5

[1] Call date in month indicated.
[2] Includes direct and guaranteed obligations.

MONEY RATES AND BOND YIELDS

Low rates prevailed in the money markets from 1933 to 1938. Heavy gold inflows and the small demand for banking funds in their customary uses tended to force money rates to extremely low levels. Throughout the entire period governmental policy was directed toward easy money. The increase in money rates and bond yields in the spring of 1937, or just before the final increase in member bank reserves, does not contradict this statement. The reversal in trend was the result of a temporary conflict between the policy of maintaining easy money conditions and the policy of preventing an injurious credit expansion.

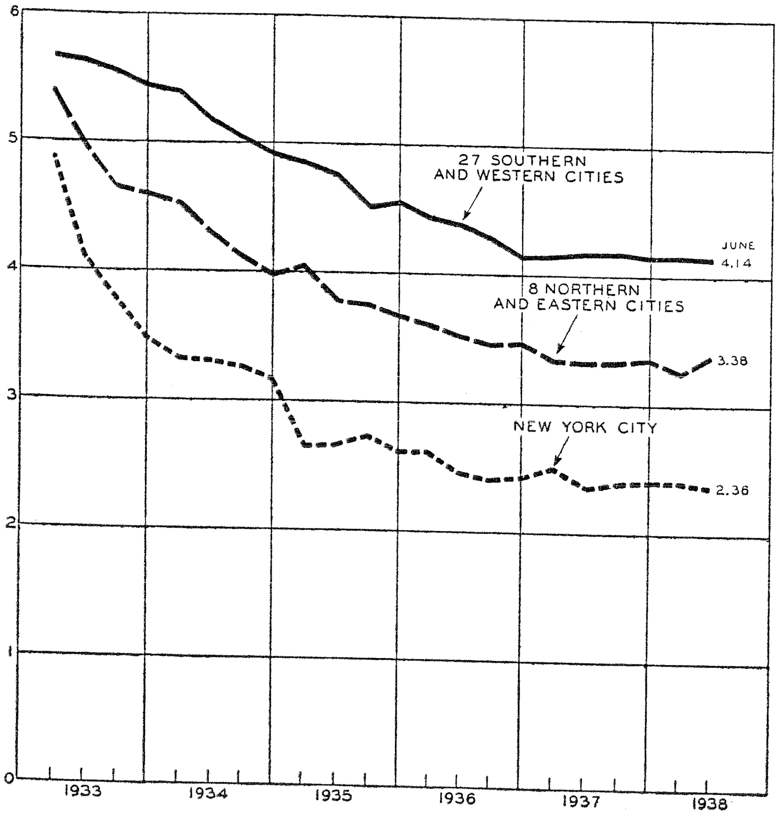
There were two important reasons for the official "easy money" policy. First, during the entire period the Treasury engaged in extensive borrowing and refunding operations, and it was to its advantage to meet its requirements at low rates, thereby keeping interest costs at a minimum. Second, the continued availability of credit at low rates for current business requirements was regarded as one of the essential conditions for a period of sustained recovery. Because of the strong downward tendency in money rates, the easy money policy of the Treasury was a passive policy during most of the period; that is, it was not necessary to take definite steps to bring about the rate levels that were desired.

Table 10 and Chart 2 show the rates charged customers by banks in principal cities from 1933 to 1938. The data shown are averages for the years and months indicated, based on rates reported for three types of customers' loans: commercial loans, demand loans on securities, and time loans on securities. At the time of the bank holiday in March, 1933, rates charged were at their highest level since the early part of 1930. A very sharp decline in the next few months was followed by a more or less gradual downward trend. For each group of banks the annual average for each year was lower

Chart 2: Rates Charged Customers by Banks in Principal Cities, 1933–1938

Source: Annual Reports of the Federal Reserve Board

Per Cent



than that for the preceding year. The 1937 average for banks in New York City was considerably less than one-half as large as that for 1929. The 1937 average for eight other northern and eastern cities was not much above one-half of

Table 10: Rates Charged Customers by Banks in Principal Cities,[1] 1933–1938

Source: Annual Reports of the Federal Reserve Board

Per Cent

Month	New York City	Eight Northern and Eastern Cities Excluding New York	Twenty-seven Southern and Western Cities
1933	4.02	4.83	5.56
March	4.88	5.39	5.66
June	4.10	4.97	5.62
September	3.79	4.65	5.55
December	3.48	4.59	5.43
1934	3.33	4.29	5.17
March	3.31	4.52	5.40
June	3.30	4.30	5.19
September	3.26	4.11	5.04
December	3.18	3.98	4.92
1935	2.70	3.86	4.69
March	2.64	4.05	4.85
June	2.66	3.78	4.76
September	2.72	3.75	4.51
December	2.61	3.67	4.55
1936	2.49	3.52	4.35
March	2.61	3.60	4.44
June	2.44	3.51	4.39
September	2.40	3.45	4.29
December	2.43	3.46	4.14
1937	2.43	3.36	4.17
March	2.50	3.34	4.15
June	2.34	3.32	4.18
September	2.39	3.33	4.18
December	2.40	3.36	4.15
1938	..	..	..
March	2.40	3.25	4.15
June	2.36	3.38	4.14

[1] For methods of weighting employed, see the "Annual Report of the Federal Reserve Board for 1937," p. 101.

the 1929 level. The average for banks in twenty-seven southern and western cities declined by about one-third from 1929 to 1937.

Short-term open-market rates in New York City, shown in

Table 11 for the period from 1933 to 1938, indicate further the ease of credit conditions. These uses of banking funds were not attractive from an earning standpoint during the greater part of the period. At no time after the early part of 1933 did either the bankers' acceptance rate or the yield on Treasury bills rise to the level of 1%.

Table 11: Short-Term Open-Market Rates in New York City, 1933–1938

Source: Annual Reports of the Federal Reserve Board

Per Cent

Month	Prime Commercial Paper	Prime Bankers' Acceptances	Stock-Exchange Time Loans	Stock-Exchange Call Loans	United States Treasury Bills 91 Day[1]
1933—March	3.00	2.38	3.00	3.27	2.29[2]
June	1.75	.38	.88	1.00	.27[2]
September	1.38	.25	.63	.75	.10[2]
December	1.38	.63	1.00	.94	.70[2]
1934—March	1.13	.38	.88	1.00	.24
June	.88	.19	.88	1.00	.15
September	.88	.19	.88	1.00	.21
December	.88	.13	.88	1.00	.23
1935—March	.75	.13	.88	1.00	.15
June	.75	.13	.25	.25	.15
September	.75	.13	.25	.25	.20
December	.75	.13	1.00	.75	.15
1936—March	.75	.13	1.00	.75	.20
June	.75	.13	1.25	1.00	.20
September	.75	.19	1.25	1.00	.16
December	.75	.19	1.25	1.00	.12
1937—March	.88	.44	1.25	1.00	.38
June	1.00	.47	1.25	1.00	.36
September	1.00	.44	1.25	1.00	.31
December	1.00	.44	1.25	1.00	.11
1938—March	.88	.44	1.25	1.00	.08
June	.88	.44	1.25	1.00	.05

[1] Monthly averages of daily quotations.
[2] Three-month bills.

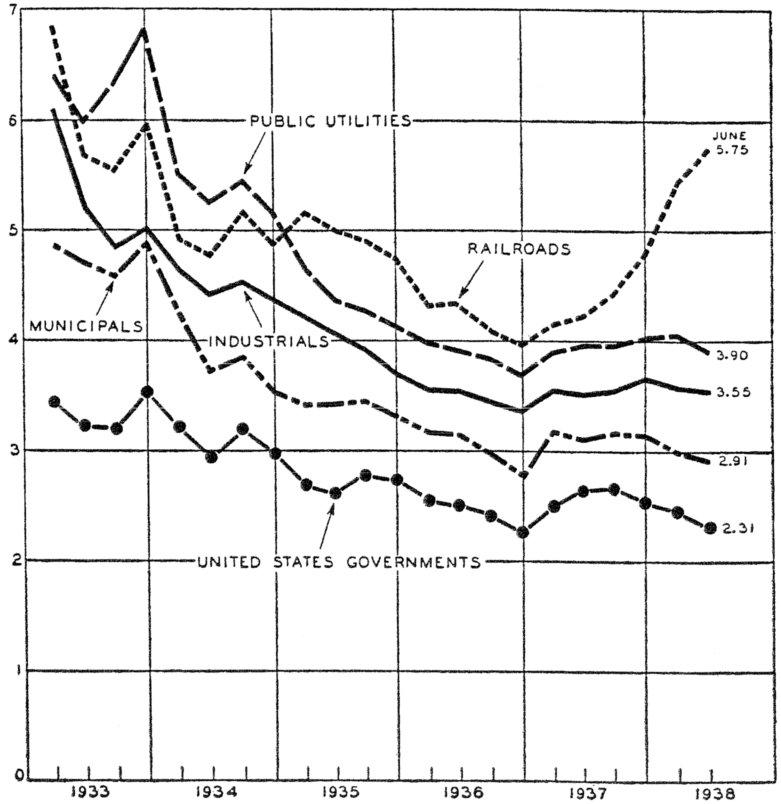
Bond Yields

Table 12 and Chart 3 show the yields of corporate and government bonds. From 1933 to 1937 the trend in corporate bond yields was downward, owing partly to the upward trend in business activity, but especially to the prevail-

Chart 3: Bond Yields, 1933–1938

Source: Moody's Investors Service; Annual Reports of the Federal Reserve Board

Per Cent



ing easy-money conditions. Portfolio adjustments in the early part of 1937 resulted in increased bond yields. The business recession caused a continuance of this trend through 1937 and into 1938. The reversal of the trend was decidedly marked in the case of railroad bonds, which were affected not only by reduced earnings but also by the serious financial difficulties of some roads. In general, the trend in the yield of United States Government securities followed that for corporate bonds. There was an increase in the early part of 1937, followed by another period of declining yields.

TABLE 12: YIELDS[1] OF CORPORATE BONDS, MUNICIPAL BONDS AND UNITED STATES BONDS AND TREASURY NOTES, 1933–1938

Source: Moody's Investors Service; Annual Reports of the Federal Reserve Board

Per Cent

Month	Corporate			Government		
	Industrials	Railroads	Public Utilities	Municipals	United States Bonds	United States Treasury Notes[2]
1933—March	6.10	6.87	6.41	4.88	3.44	3.09
June	5.21	5.68	5.99	4.71	3.22	2.53
September	4.87	5.54	6.31	4.59	3.20	2.31
December	5.03	5.95	6.82	4.89	3.53	3.23
1934—March	4.65	4.91	5.50	4.24	3.21	2.43
June	4.41	4.78	5.24	3.73	2.94	1.73
September	4.52	5.15	5.43	3.84	3.20	2.25
December	4.38	4.86	5.15	3.52	2.97	1.78
1935—March	4.20	5.14	4.65	3.41	2.69	1.21
June	4.07	4.99	4.37	3.42	2.61	1.15
September	3.91	4.91	4.27	3.44	2.78	1.46
December	3.71	4.73	4.12	3.31	2.73	1.25
1936—March	3.56	4.32	3.98	3.18	2.54	1.10
June	3.54	4.35	3.91	3.16	2.50	1.13
September	3.44	4.09	3.83	2.97	2.41	1.10
December	3.37	3.96	3.69	2.76	2.27	1.04
1937—March	3.55	4.15	3.90	3.19	2.50	1.44
June	3.51	4.22	3.97	3.11	2.64	1.54
September	3.55	4.43	3.96	3.18	2.67	1.50
December	3.66	4.79	4.03	3.15	2.54	1.27
1938—March	3.58	5.44	4.05	2.99	2.45	1.01
June	3.55	5.75	3.90	2.91	2.31	.67

[1] Average of daily figures, except municipals, which are averages of Wednesday figures.
[2] Three to five years.

FEDERAL FISCAL POLICIES

Banking developments since 1933 have been influenced by federal fiscal policies to an unprecedented extent. The purpose of this section is to consider briefly those policies that directly or indirectly affected banking and business developments.

Bases of Federal Fiscal Policy

Attempts to justify the successive federal deficits have been based principally on two grounds. In the early years of deficit financing, emphasis was placed on balancing the budget over the period covered by a complete business cycle and on the theory of compensatory action. It was pointed out that those who insisted on an annual balance did not take into account the fundamental fact that cyclical movements in business activity extend over a period of years. Fiscal policy, therefore, should not be based on the desirability of an annual balance. Rather, it should have as its objectives the moderation of the decline when general business activity turns downward, and prevention of an excessive rate of expansion when the upswing begins. If a recession occurs, an excess of expenditures over revenue receipts will tend to increase incomes, create new bank deposits, and produce additional buying power. Conversely, in a period of revival and prosperity, an excess of receipts over expenditures tends to moderate the growth of spending and to offset the expansion of private bank credit.

This approach to the fiscal problem has been called the theory of compensatory action. It implies a willingness to run counter to private business behavior at all stages of the business cycle. In its broadest aspect, it is a variant of the consumer-purchasing-power approach to the economic problem, since the basic objective is the adjustment of buying power with a view to maintaining business activity at a satisfactory level. In practice, the idea of a compensatory fiscal policy has proved to be unworkable. Application of the compensatory principle would have required a balanced budget for 1935, or 1936 at the latest, but large deficits were incurred in both years.

When the period from 1933 through 1938 is considered as a whole, the maintenance of consumer purchasing power must be accorded first place as an objective of federal fiscal policy. The principal difference between this approach and the compensatory principle is that emphasis is here placed solely on the beneficial effects of public expenditures, particularly expenditures in excess of revenues. In other words, the necessity or desirability of the retirement in a later period of the debt incurred is not stressed. The pump-priming program announced in April, 1938, and made effective by legislation approved in June, represents perhaps the outstanding application of the consumer-purchasing-power approach to the economic problem in the entire period of deficit financing.

Another objective of fiscal policy was the prevention of oversaving. The undistributed profits tax enacted in 1936 was based in part on the belief that business savings accumulated from earnings were frequently excessive and that if larger proportions of earnings were distributed to stockholders, expenditures by consumers would be increased. The high level of surtax rates for the personal income tax also found theoretical support in the oversaving theory.

In general, federal fiscal policy in the period from 1933 through 1938 was a speculative policy. Large drafts were made on the federal credit in the hope that expenditures in excess of receipts would bring about and accentuate an upward trend in business activity and that, after a high level had been reached, it could be retained indefinitely, even though the artificial support afforded by federal spending was withdrawn. Developments in 1937 and the first part of 1938

made the attainment of the desired objective seem highly questionable.

Federal Deficits and the Deposit Level

The net deficit of the Federal Government for the five-year period ended June 30, 1938, amounted to $15.2 billion.[1] Of the direct debt obligations issued during this period, the commercial banks and mutual savings banks absorbed slightly over $6 billion.[2] In addition, the commercial banks and mutual savings banks purchased $2.7 billion of obligations of governmental corporations and agencies that were guaranteed by the United States Goverment.

From the standpoint of the banking system, the principal significance of the huge additions to bank holdings of government securities is their effect on the level of deposits. Purchases by the banks result in the first instance in deposits to the credit of the Treasury. When the deposits are used by the government or governmental agencies in paying for goods, services and interest on obligations held by individuals and businesses, a large part of the payments are deposited to the credit of customers' accounts. Subject to the maintenance of required reserves, these deposits in turn become available for loans and purchases of investments. In the absence of opportunities for profitable alternative employments, the increase in customers' deposits affords a basis for further purchases of government issues.

To the extent that the purchases by the banks are financed from savings, the effect on the level of deposits does not differ materially from that of purchases of comparable amounts of new private obligations. In this connection it is important

[1] On the basis of the accounting procedure effective July 1, 1938. The amount shown represents the excess of expenditures other than debt retirements chargeable against general and special account receipts over these receipts.

[2] Computed on basis of an estimate of $8,032 million for June 30, 1933 in Joseph B. Hubbard, "Absorption of the United States Debt," in *The Review of Economic Statistics*, August, 1936, and on total holdings of $14.1 billion for June 30, 1938, as shown in the *Bulletin of the Treasury Department*, February, 1939.

to observe that from 1933 to 1938 net purchases by banks of United States Government obligations, including guaranteed issues, exceeded net additions to time and savings deposits by $5.2 billion. This total should not be construed as more than a rough indication of the bank credit expansion attributable to deficit financing and the activities of government corporations. Not all time deposits in commercial banks are savings deposits in a strict sense, for a part represent unemployed balances of businesses that temporarily do not require them for working-capital purposes. Inability to measure changes in this item, among other factors, precludes the possibility of measuring the extent to which bank purchases of federal issues have been financed from actual savings, on the one hand, and through credit expansion, on the other.

Easy-Money Policy and Bank Earnings

The easy-money policy, together with other factors tending to keep interest rates at a low level, has had an adverse effect on bank earnings. According to a recent study,[1] the earning power of the commercial bank dollar in 1937 was less than half what it was in 1929. A weighted index of approximate yield on the earning assets of the banks indicated a composite earning rate of 2.80% for 1937, as compared with 5.76% for 1929.

The desire to finance the deficit on a low-cost basis has not been the sole factor inducing an easy-money policy, but it has been a dominant consideration. In this connection it has been observed that:

> It has always been characteristic of Federal Treasury policy to assume that low interest rates and low investment yield on government paper are normal phenomena. Many devices and expedients have been tried in the effort to preserve this illusion. In the present case it appears to have been assumed that the extremely favorable credit conditions of the depression must continue until the period of deficit financing ends, however long that may be. Accordingly, the Government has become committed to the maintenance of easy money, low interest rates, and low investment yield, and to the manipulation of the market in order to preserve this status.[1]

[1] "The Earning Power of Banks," published by the Research Council of the American Bankers Association, January, 1939.

Of the other reasons advanced in support of easy money, the one most frequently emphasized is that it facilitates business recovery. It is also regarded as a safeguard for certain debtor groups, particularly the farmers and homeowners. Finally, an easy-money policy is strongly advocated by those who are interested in bringing about a redistribution of income.

Tax Policies

The most controversial development in federal taxation from 1933 to 1938 was the adoption of the undistributed profits tax. This tax, which was first imposed on 1936 incomes, was not made applicable to banks and trust companies. It is of interest in connection with the present study primarily because of its effect on the financing of small industries.

Adjusted net income was defined as net income minus the sum of the normal corporation tax and interest on obligations of the United States and its instrumentalities. Undistributed net income was defined as the adjusted net income minus the sum of dividends paid and certain special credits in the case of contracts restricting the payment of dividends. The rates for the surtax on undistributed profits were graduated from 7% on undistributed net income equal to the first 10% of adjusted net income, to 27% on the final 40%. The principle of the undistributed profits tax was retained in the Revenue Act of 1938, but only with respect to corporations having net incomes of more than $25,000. These corporations are now allowed a credit on account of dividends paid of not more

[1] Harley L. Lutz, "Federal Depression Financing and Its Consequences," *Harvard Business Review*, Winter Number, 1938, p. 134.

than 2.5% of adjusted net income. This credit applies to the tentative tax computed at 19% of adjusted net income.

From the standpoint of the supply and flow of capital, the level of surtaxes for the personal income tax and the method of treating capital gains and losses under the income tax statutes are important considerations. Prior to the depression the surtaxes were graduated from 1% on the first $4,000 of net income in excess of $10,000 to 20% on net income above $100,000. The rates were increased by later Revenue Acts to the present range of 4% on the first $2,000 of surtax net income in excess of $4,000, to 75% on all surtax net income above $5 million. Both the present schedule and the predepression one were presumed to be roughly in conformity with ability to pay.[1]

Most important among the new levies to the business community were the social security taxes. The federal tax for unemployment compensation purposes became effective in 1936. The initial rate on payrolls was 1%, which was increased to 2% for 1937 and 3% for 1938 and thereafter. An excise tax on employers for old-age purposes was made effective as of January 1, 1937, at the rate of 1%. An income tax of 1% on the wages of employees became effective at the same time.[2]

[1] The methods of taxing capital gains and losses and changes therein are not considered in detail. They are too technical for inclusion in this brief summary.

[2] For a detailed description of the federal social security taxes and the relationship of state unemployment levies to the federal tax, see National Industrial Conference Board, "Cost of Government in the United States, 1935–1937," Chapter V.

CHAPTER II

THE BANK CREDIT PROBLEM

IN THE past few years it has been repeatedly stated or implied that the banks have adopted too cautious an attitude toward industrial and commercial loans. First, it is charged that restrictive banking policies retarded the upward trend in business that ended in 1937 and contributed to the sharp recession in 1937–1938. Second, it is asserted that as long as the banks do not accept their proper responsibilities, government has no alternative, and must attempt to supply the void in existing credit facilities.

The banks, on the other hand, have maintained that credit has been made available in all cases where reasonable credit requirements could be met. In defense of this contention bankers have pointed to the differential between the rate of return on the average industrial and commercial loan, as compared with the rates obtainable in alternative employments of banking funds. They state unequivocally that in fairness to themselves and their stockholders they can not afford to refuse credit accommodation to worthy borrowers. Because of their responsibility to depositors, however, they frankly admit that they do not regard it as their function to assume credit risks that are of questionable merit.

Nature and Purpose of the Questionnaire

The data used as a basis for the analysis of the bank credit problem in this chapter and the one that follows were obtained by means of a questionnaire. Six questions were included in the body of a letter addressed to 9,000 corporations, practically all of which were manufacturing corporations. Most of the data in this chapter were derived from the replies to the first question: "Do you now find, or have you recently found, any difficulty in obtaining from your bank the credit accommodation required for legitimate business purposes?" The second question was designed to obtain specific details of those cases in which credit had been refused or restricted. The third and fourth questions were designed to ascertain if the concerns had had any experience with government lending agencies and if they believed that these agencies were necessary for meeting the credit requirements of industry.

Suggestions for the improvement of the credit situation of industry were invited in the fifth question, and the sixth was designed to obtain the names of other concerns that had experienced credit difficulties. In addition to these questions, the normal number of employees during the period between January 1, 1935, and June 30, 1937, was requested, in order that a careful distinction might be drawn between small, medium-sized, and large concerns.

Only two of the questions called for specific detailed information, and the entire group of questions required only two-thirds of a page. In planning the questions, the principal objective was a concise coverage of the several phases of the problem. The industrial executive could write the replies on the margins of the second page of the letter he received, or he could cover the subject in extreme detail, as he saw fit. A number of replies were received in the form of answers on the margins, while, at the other extreme, one executive dictated a ten-page letter. In general, the degree of completeness of the basic details supplied was entirely adequate.

Replies to the questionnaire were received from 1,755 concerns, or 19.5% of those to which the questionnaire was sent. There were returns from each of the twelve Federal Reserve districts. As would be expected in a survey of industrial experience, there was a marked concentration of replies from the industrial areas in the East and Middle West, comprising the First, Second, Third, Fourth and Seventh Federal Reserve districts. The boundaries of these districts are shown in Chart 4.

Limitations of the Results

In considering the inferences and conclusions drawn from the data, the reader will be interested in the nature and adequacy of the sample. The names of the 9,000 concerns that received the questionnaire were chosen in the following manner. A list of 2,000 selected names used in connection with another study prepared by THE CONFERENCE BOARD in 1937 was regarded as acceptable.[1] This list was supplemented with 7,000 names selected at random from "Thomas' Register of American Manufacturers."

Three restrictions were placed on the selection of the 7,000 names: (1) All identifiable subsidiaries were excluded, (2) not more than eighteen names were taken from any page of the directory, and (3) a minimum of seven firms with low capital ratings was taken from each page. It is believed that this procedure assured as satisfactory a cross-section of industrial concerns as any that could have been chosen. It was especially desirable to include a substantial number of small concerns in the sample, for the reason that in the opinion of those stressing the existence of a bank credit problem the most serious difficulties were believed to be encountered by the small concerns.

The information obtained from the replies has been furnished by only one of the two parties to the credit contract, by the borrower or potential borrower. In a survey of this kind it is not possible to obtain the banker's viewpoint on specific instances of credit refusal or restriction without violating the confidence in which the information was obtained from the borrower. The banker's side of the problem, in so far as specific communities are concerned, was quite ade-

[1] "Experience Under the Undistributed Profits Tax," *Conference Board Bulletin*, October 13, 1937.

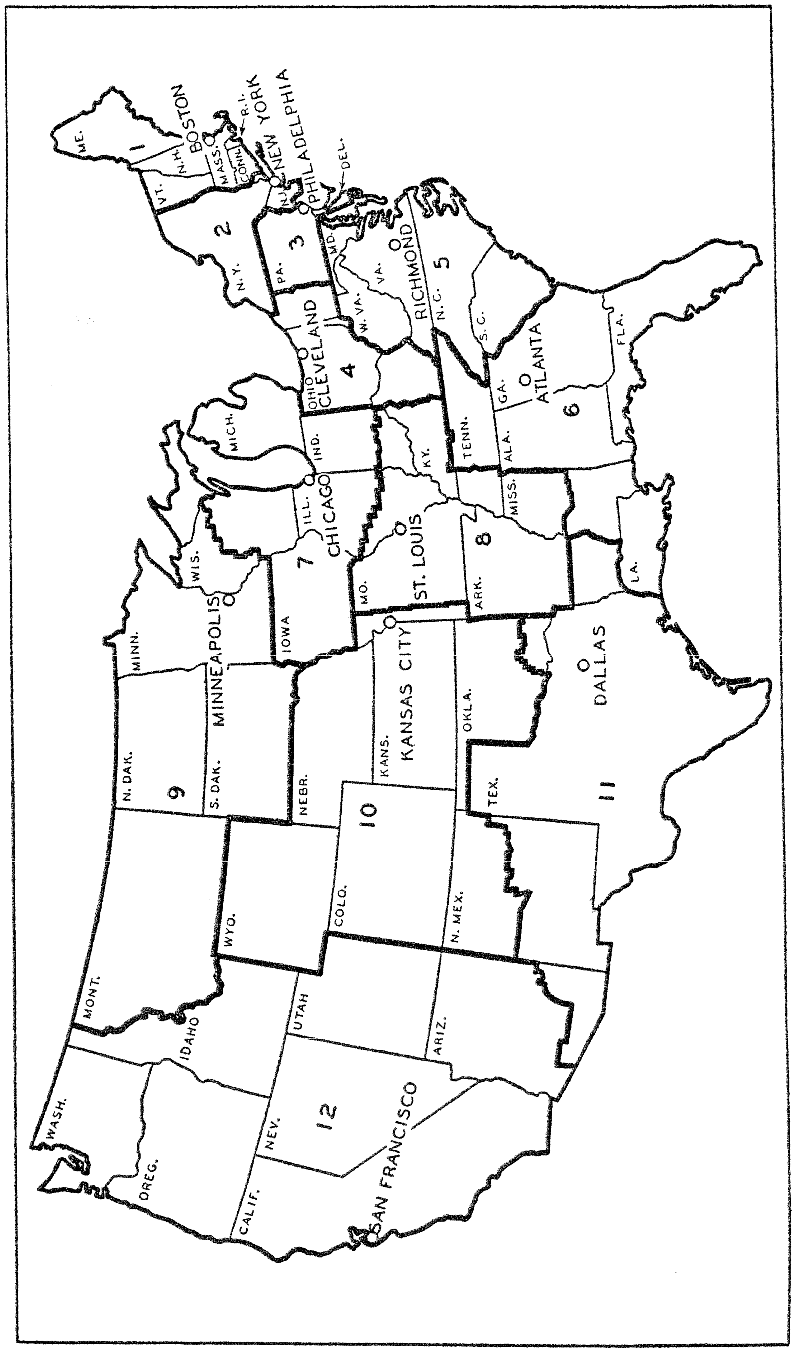


CHART 4. FEDERAL RESERVE DISTRICTS

quately presented by a number of industrial executives who serve as directors of banking institutions. In their replies these executives voluntarily presented the impressions they had gained in their role of bank director. These comments, however, are of little value for the purpose of offsetting whatever degree of bias enters into the results by reason of the fact that only one party was canvassed. Those who essayed the dual role of corporation executive and bank director uniformly wrote in general terms about the credit situation in their communities and did not mention specific cases.

Perhaps the most satisfactory method of counterbalancing the bias that results from obtaining the essential information from the borrower only is to subject every case reporting credit refusal or restriction to a very careful examination. While it is probable that no perfect procedure exists, the standard credit ratings afford a valuable check against the corporation executive's own estimate of the credit worthiness of his concern.

Another important element in the situation is whether or not the borrower required bank credit in its ordinary and conventional uses. To regard every reported case of credit refusal as valid, without further analysis of the period for which funds were requested and the purpose for which they were to be employed, would accentuate whatever bias is present. For this reason, the analysis of the question whether bank credit needs were involved, presented in Chapter III, is among the most important sections of the entire study.

There is also a question as to which class of concern, viewed from the standpoint of credit experience, replied more readily to the questionnaire. On first thought one would probably conclude that the concerns that had not experienced any credit difficulty would reply more readily than those that had been refused bank credit. Some of the executives of companies in the latter class would doubtless be reluctant to furnish any information in regard to credit refusals or restrictions, particularly if in their own judgment the action of the banks was warranted. On the other hand, dictation of a reply to the questionnaire afforded those executives who felt a deep-seated grievance against their banks an opportunity to give vent to their resentment. This factor probably counterbalanced the reticence of those in the other category.

There is another factor that doubtless tended to reduce the number of replies received from concerns that had not had any recent credit experience. Of the concerns in this category that replied, a large number expressed regret that they were unable to be of any assistance in the survey because they had not been borrowers at banks for many years. It may be assumed that other companies without recent experience as borrowers refrained from replying on the ground that their replies would not contribute to the value of the survey.

The survey relates principally to the credit experiences of manufacturing concerns. Of the total of 1,755 replies that were tabulated, 1,574, or 90% were received from them. There were 37 replies from extractive industries, 62 from companies engaged in wholesale and retail trade, 8 from service concerns, and 74 that were unclassifiable.[1] Railroad corporations and public utilities were purposely excluded from the sample.

No less than 669 of the manufacturing concerns are classed under metal working and machine manufacturing. Chemicals, paint and varnish ranked second with 137. Other manufacturing groups with more than 100 returns include textiles with 117, food with 113, and lumber, millwork and furniture with 103. The number of returns received for the other classifications may be seen in Table 13.

Principal Results of the Survey

The most important finding of the survey is that over 91% of the concerns reported either no bank credit experience or no bank credit difficulty in recent years. Out of the 1,755

[1] These replies were sent unsigned and in plain envelopes.

returns tabulated, 448, or 25.5%, stated that they had not had any credit experience with banks, and 1,153, or 65.7%, reported that they had not had any difficulty in obtaining sufficient bank credit to meet their legitimate business requirements. As the question did not call for a careful differentiation between non-borrowers and concerns experiencing no difficulty, it is probable that a considerable number of the concerns classed as having no difficulty were not dependent on banks for any part of their working capital requirements. In the absence of any basis for classification other than the replies to the first question, it will be assumed that the replies classed under "no difficulty" were mainly from concerns relying on banks for at least occasional credit accommodation. A total of 154 concerns, or 8.8% of those reporting, stated that bank credit had been refused to them or that they had been granted credit accommodation in smaller amounts than were necessary for the satisfactory conduct of their business operations. The returns for these 154 concerns will be analyzed in detail in the following chapter.

The fact that over 91% of the concerns reporting had no bank credit experience, or had not experienced any credit difficulty, becomes more significant when the characteristics of the period to which the survey relates are taken into account. The larger part of the period was characterized by gradual business improvement, but the recovery was followed by a very sharp recession. The Federal Reserve index of industrial production rose from 76 for 1933 (1923–1925 = 100) to 110 for 1937. On a monthly basis,[1] the low point was 59 for March, 1933, and the highest level reached was 121 for December, 1936. There was a decline during the recession of 1937–1938 from 117 for August, 1937, to 76 for May, 1938. The dual nature of the period covered by the survey should enhance the value of the findings.[2]

[1] Adjusted for seasonal variation.

[2] The cases reporting bank credit refusal or restriction are considered by years in which credit was refused or restricted in Chapter III.

The large number of concerns reporting no credit experience is in part a reflection of corporate policy. One of the basic tenets of the financial policy of many corporations is the attainment of the highest possible degree of independence of banks and other financial institutions. To the extent that these concerns maintain deposit balances with commercial banks, they contribute to the supply of, rather than to the demand for, bank credit funds. For concerns reporting no credit difficulty, the record for recent years must be construed as a reflection of sound financial management. The ability to obtain all the bank credit desired during a period of business recovery and also in a period of sharp recession implies that the applying concern is managing its affairs with proper regard for the vicissitudes of the business cycle. There are few more justifiable bases for refusal of credit than overexpansion of inventories during business recovery based on the assumptions of increasing prices and unending prosperity.

A notable fact disclosed by the survey is that a number of concerns reported that the banks had voluntarily offered them funds in excess of their current requirements, or had offered lines of credit even though none had been requested. In their replies, 103 concerns specifically reported that banks had taken the initiative in offering credit accommodations. As this subject was not covered in the questionnaire, it is probable that the practice has been more prevalent than is indicated by this figure. With a plethora of funds available for employment and extremely low rates on United States Government securities, one would expect that the banks would desire every opportunity to increase the commercial and industrial loans in their portfolios. Active solicitation would seem to be a logical concomitant of the extreme ease that has prevailed in the money markets in recent years.

Concerns Reporting, Classified by Industry and Bank Credit Status

The 1,755 returns that were tabulated are classified according to industry and bank credit status in Table 13. One of the purposes of this table is to differentiate between concerns that reported no bank credit problem and those reporting credit refusal or restriction.

Table 13: Concerns Reporting, Classified by Industry and Bank Credit Status

Source: The Conference Board, 1938 Bank Credit Survey

Industry	Total Number of Concerns Reporting	Concerns Reporting No Bank Credit Problem			Concerns Reporting Refusal or Restriction of Bank Credit	Concerns Dependent on Banks[1]
		Total	No Experience	No Difficulty		
Total	1,755	1,601	448	1,153	154	1,307
Metal working and machine manufacturing	669	621	197	424	48	472
Paper and pulp	76	68	15	53	8	61
Textiles	117	106	30	76	11	87
Food	113	107	22	85	6	91
Clothing	57	56	4	52	1	53
Chemicals, paint and varnish	137	129	45	84	8	92
Lumber, millwork and furniture	103	80	12	68	23	91
Leather	46	43	6	37	3	40
Stone, clay and glass	88	74	38	36	14	50
Rubber	22	19	4	15	3	18
Tobacco	12	12	4	8	..	8
Liquors and beverages	13	10	..	10	3	13
Printing	30	30	3	27	..	27
Miscellaneous manufacturing	91	76	25	51	15	66
Extractive industries	37	33	13	20	4	24
Trade	62	59	13	46	3	49
Service	8	7	4	3	1	4
Unclassifiable	74	71	13	58	3	61

[1] Concerns reporting no credit difficulty plus those reporting refusal or restriction of bank credit.

Concerns Reporting No Credit Experience or No Credit Difficulty

The number of concerns in each industrial classification that reported either no bank credit experience or no bank credit difficulty is shown in Table 13, and the ratios of concerns in these categories to total concerns reporting are shown in Table 14. Table 15 shows percentage distributions of the number of concerns in each bank credit classification among the several industries. The data in these tables show clearly

TABLE 14: RATIOS OF CONCERNS REPORTING NO BANK CREDIT PROBLEM AND REFUSAL OR RESTRICTION OF BANK CREDIT TO TOTAL NUMBER REPORTING

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Per Cent

Industry	Concerns Reporting No Bank Credit Problem			Concerns Reporting Refusal or Restriction of Bank Credit
	Total	No Experience	No Difficulty	
Total	91.2	25.5	65.7	8.8
Metal working and machine manufacturing	92.8	29.4	63.4	7.2
Paper and pulp	89.5	19.7	69.7	10.5
Textiles	90.6	25.6	65.0	9.4
Food	94.7	19.5	75.2	5.3
Clothing	98.2	7.0	91.2	1.8
Chemicals, paint and varnish	94.2	32.8	61.3	5.8
Lumber, millwork and furniture	77.7	11.7	66.0	22.3
Leather	93.5	13.0	80.4	6.5
Stone, clay and glass	84.1	43.2	40.9	15.9
Rubber	86.4	18.2	68.2	13.6
Tobacco	100.0	33.3	66.7	..
Liquors and beverages	76.9	..	76.9	23.1
Printing	100.0	10.0	90.0	..
Miscellaneous manufacturing	83.5	27.5	56.0	16.5
Extractive industries	89.2	35.1	54.1	10.8
Trade	95.2	21.0	74.2	4.8
Service	87.5	50.0	37.5	12.5
Unclassifiable	95.9	17.6	78.4	4.1

that the concerns reporting no credit experience and no credit difficulty were not concentrated in certain industrial groups.

None of the 12 tobacco manufacturing concerns or of the 30 printing firms reported any bank credit problems. Other industrial groups for which the ratio of concerns reporting no bank credit problem was higher than the figure of 91.2%, the

ratio for all groups combined, include (1) clothing, (2) trade, (3) chemicals, paint and varnish, (4) food, (5) leather, (6) metal working and machine manufacturing and (7) the unclassifiable group.

The 13 liquor and beverage concerns reporting uniformly

TABLE 15: DISTRIBUTION BY INDUSTRY OF TOTAL NUMBER OF CONCERNS REPORTING AND OF CONCERNS REPORTING NO CREDIT EXPERIENCE, NO CREDIT DIFFICULTY AND CREDIT REFUSAL OR RESTRICTION

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Per Cent

Industry	Total Number of Concerns Reporting	Concerns Reporting No Bank Credit Problem			Concerns Reporting Refusal or Restriction of Bank Credit
		Total	No Experience	No Difficulty	
Total	100.0	100.0	100.0	100.0	100.0
Metal working and machine manufacturing	38.1	38.8	44.0	36.8	31.2
Paper and pulp	4.3	4.2	3.3	4.6	5.2
Textiles	6.7	6.6	6.7	6.6	7.1
Food	6.4	6.7	4.9	7.4	3.9
Clothing	3.2	3.5	0.9	4.5	0.6
Chemicals, paint and varnish	7.8	8.1	10.0	7.3	5.2
Lumber, millwork and furniture	5.9	5.0	2.7	5.9	14.9
Leather	2.6	2.7	1.3	3.2	1.9
Stone, clay and glass	5.0	4.6	8.5	3.1	9.1
Rubber	1.3	1.2	0.9	1.3	1.9
Tobacco	0.7	0.7	0.9	0.7	..
Liquors and beverages	0.7	0.6	..	0.9	1.9
Printing	1.7	1.9	0.7	2.3	..
Miscellaneous manufacturing	5.2	4.7	5.6	4.4	9.7
Extractive industries	2.1	2.1	2.9	1.7	2.6
Trade	3.5	3.7	2.9	4.0	1.9
Service	0.5	0.4	0.9	0.3	0.6
Unclassifiable	4.2	4.4	2.9	5.0	1.9

stated that they had had credit experience in recent years. At the other extreme, one-half of the service concerns and 43% of those engaged in the manufacture of stone, clay and glass products reported that they had not had any bank credit experience. For all groups combined the ratio was 25.5%.

Clothing and printing ranked first and second in the proportion of concerns reporting no bank credit difficulty with ratios of 91.2% and 90%, respectively. At the other extreme, only 3 of the 8 service concerns reported no credit difficulty, while the stone, clay and glass group showed the comparatively low ratio of 40.9%. For all groups combined the ratio was 65.7%.

Concerns Reporting Credit Refusal or Restriction

The 154 concerns reporting credit refusal or restriction include at least one concern in each industrial group, with the exception of tobacco manufactures and printing. Lumber, millwork and furniture was the only group for which a large number of replies was received that showed a ratio of refusals or restrictions in excess of 20%. The ratio for this group was 22.3%. A slightly larger proportion of refusals or restrictions was reported by the liquor and beverage group, but only 13 returns were received. Miscellaneous manufacturing, with 16.5%, ranked next to lumber, millwork and furniture, and was followed by stone, clay, and glass with 15.9%. The largest number of refusals or restrictions for any group was 48, for metal working and machine manufacturing industries, but the ratio for this group was only 7.2%.

There is little reason to believe that bank credit refusals or restrictions are a characteristic of the industry in which the concerns are engaged. As will be shown later, the size of the concern is a more important factor. Two groups, however, appear to be partial exceptions to this statement. The lumber, millwork and furniture, and the stone, clay and glass groups, which show high ratios of refusals or restrictions, were affected by the lag in the construction industry in the period of recovery from 1933 to 1937.

Concerns Reporting, Classified by Federal Reserve District

The five Federal Reserve districts—Boston, New York, Philadelphia, Cleveland and Chicago—in which industrial production is concentrated, accounted for 1,334 returns, or 76% of the total.[1] The Chicago Federal Reserve district ranked first in the number of returns with 397, the New York district second with 332, and the Cleveland district third with 258. The number of returns received from each of the other Federal Reserve districts is shown in Table 16.

Table 16: Concerns Reporting, Classified by Credit Status and Federal Reserve District

Source: The Conference Board, 1938 Bank Credit Survey

Federal Reserve District	Total Number of Concerns Reporting	Concerns Reporting No Experience		Concerns Reporting No Difficulty		Concerns Reporting Refusal or Restriction	
		Number	Per Cent of Total	Number	Per Cent of Total	Number	Per Cent of Total
Total	1,755	448	25.5	1,153	65.7	154	8.8
Boston	231	63	27.3	151	65.4	17	7.4
New York	332	108	32.5	197	59.3	27	8.1
Philadelphia	116	30	25.9	73	62.9	13	11.2
Cleveland	258	74	28.7	159	61.6	25	9.7
Richmond	73	22	30.1	43	58.9	8	11.0
Atlanta	45	8	17.8	33	73.3	4	8.9
Chicago	397	94	23.7	272	68.5	31	7.8
St. Louis	92	20	21.7	62	67.4	10	10.9
Minneapolis	47	7	14.9	36	76.6	4	8.5
Kansas City	45	4	8.9	35	77.8	6	13.3
Dallas	15	3	20.0	11	73.3	1	6.7
San Francisco	104	15	14.4	81	77.9	8	7.7

Concerns Reporting No Credit Experience or No Credit Difficulty

Table 16 shows the number of concerns in each Federal Reserve district that reported no credit experience and no credit difficulty, together with the ratios of concerns in these

[1] The 74 returns that could not be classified by industry were classified by Federal Reserve district according to the postmarks on the envelopes.

classifications to the total number of concerns reporting. The New York Federal Reserve district ranked first in concerns with no bank credit experience with 108, or 32.5% of all concerns reporting. This proportion was the highest for any district. The Richmond and Cleveland districts ranked second and third, with 30.1% and 28.7%, respectively. At the other extreme, only 8.9% of the concerns reporting from the Kansas City district stated they had had no credit experience. The concerns in each district that reported no bank credit experience are shown by industry in Table 17.

The proportion of concerns reporting no bank credit difficulty ranged from a maximum of almost 78% for the Kansas City and San Francisco Federal Reserve districts to a minimum of approximately 59% for the New York and Richmond districts. It is of interest to observe the relatively small variations in the ratios for the several Federal Reserve districts from the combined ratio for all districts. The concerns in each district that reported no bank credit difficulty are shown by industry in Table 18.

Concerns Reporting Credit Refusal or Restriction

In the Kansas City district, 13.3% of the concerns reporting stated that they had been refused bank credit or that their needs had not been fully met. The Philadelphia district ranked next with 11.2%, followed by the Richmond district with 11%. Three other districts, Cleveland, Atlanta and St. Louis show higher ratios of credit refusals or restrictions than that of 8.8% for all districts combined. At the other extreme, the ratio for the Dallas district was only 6.7%. A distribution by industries of the concerns in each district that reported credit refusal or restriction is shown in Table 19.

The ratios for the several districts are influenced by the industrial classification of the concerns reporting. For example, 9 of the 45 concerns reporting from the Atlanta dis-

TABLE 17: CONCERNS REPORTING NO BANK CREDIT EXPERIENCE, CLASSIFIED BY INDUSTRY AND FEDERAL RESERVE DISTRICT

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Industry	Total	Federal Reserve District											
		Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Total	448	63	108	30	74	22	8	94	20	7	4	3	15
Metal working and machine manufacturing	197	30	29	11	43	5	1	57	10	3	2	1	5
Paper and pulp	15	4	3	1	2	1	..	2	2	..	..	..	..
Textiles	30	13	3	2	3	7	..	1	..	..	..	..	1
Food	22	..	10	..	1	2	2	4	2	..	1	..	..
Clothing	4	..	3	..	..	..	..	1	..	..	..	..	..
Chemicals, paint and varnish	45	3	19	4	3	2	..	9	1	..	1	1	2
Lumber, millwork and furniture	12	2	2	2	..	..	2	2	1	..	..	..	1
Leather	6	3	1	1	1	..	..	..	..	..	..	..	..
Stone, clay and glass	38	2	10	4	9	1	2	4	2	2	..	..	2
Rubber	4	..	1	..	2	..	..	..	1	..	..	..	..
Tobacco	4	..	3	..	..	1	..	..	..	..	..	..	..
Printing	3	..	..	..	1	1	..	1	..	..	..	..	..
Miscellaneous manufacturing	25	4	8	3	1	..	..	8	1	..	..	..	..
Extractive industries	13	..	5	2	3	..	..	..	..	1	..	1	1
Trade	13	..	7	..	1	1	1	1	..	..	..	..	2
Service	4	..	1	..	2	..	..	1	..	..	..	..	..
Unclassifiable	13	2	3	..	2	1	..	3	..	1	..	..	1

Table 18: Concerns Reporting No Bank Credit Difficulty, Classified by Industry and Federal Reserve District

Source: The Conference Board, 1938 Bank Credit Survey

Industry	Total	Federal Reserve District											
		Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Fran-cisco
Total	1,153	151	197	73	159	43	33	272	62	36	35	11	81
Metal working and machine manufacturing	424	51	57	28	78	10	7	129	20	10	10	3	21
Paper and pulp	53	9	11	3	5	2	..	12	3	2	1	..	5
Textiles	76	14	23	4	4	15	4	6	1	2	..	2	1
Food	85	1	7	3	10	1	3	26	7	7	6	1	13
Clothing	52	7	14	3	2	3	2	10	3	1	3	1	3
Chemicals, paint and varnish	84	11	23	9	11	2	2	15	2	..	3	..	6
Lumber, millwork and furniture	68	7	8	4	6	2	4	15	9	4	2	1	6
Leather	37	8	7	6	5	..	2	3	1	..	..	1	4
Stone, clay and glass	36	3	5	..	10	1	1	4	3	1	4	..	4
Rubber	15	4	1	2	5	..	..	..	..	1	1	..	1
Tobacco	8	..	1	1	..	2	..	2	1	..	..	..	1
Liquors and beverages	10	1	..	2	..	1	..	..	2	3	..	..	1
Printing	27	8	6	4	2	..	..	6	..	..	..	1	..
Miscellaneous manufacturing	51	8	10	1	4	1	1	19	3	2	..	1	1
Extractive industries	20	..	4	1	4	1	2	3	1	..	2	..	2
Trade	46	6	11	1	4	1	2	9	1	1	2	..	8
Service	3	..	1	..	..	..	1	1	..	..	..	..	..
Unclassifiable	58	13	8	1	9	1	2	12	5	2	1	..	4

Table 19: Concerns Reporting Refusal or Restriction of Bank Credit, Classified by Industry and Federal Reserve District

Source: The Conference Board, 1938 Bank Credit Survey

Industry	Total	Federal Reserve District											
		Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Fran-cisco
Total	154	17	27	13	25	8	4	31	10	4	6	1	8
Metal working and machine manufacturing	48	2	5	3	15	2	..	16	..	1	2	..	2
Paper and pulp	8	1	2	1	1	..	..	3	..	..	..	..	..
Textiles	11	5	3	2	..	..	..	1	..	..	..	..	..
Food	6	1	..	..	1	1	..	..	..	1	2	..	..
Clothing	1	..	..	..	1	..	..	..	..	..	..	..	..
Chemicals, paint and varnish	8	1	3	..	1	..	..	1	1	..	..	..	1
Lumber, millwork and furniture	23	2	3	..	2	3	3	3	4	..	..	1	2
Leather	3	..	2	..	..	..	..	1	..	..	..	..	..
Stone, clay and glass	14	3	1	3	2	..	..	3	1	..	1	..	..
Rubber	3	..	..	..	1	..	1	..	..	..	..	..	1
Tobacco	..	..	..	..	..	..	..	..	..	..	..	..	..
Liquors and beverages	3	..	..	..	..	..	..	..	2	..	..	..	1
Printing	..	..	..	..	..	..	..	..	..	..	..	..	..
Miscellaneous manufacturing	15	1	7	2	..	..	..	2	1	1	1	..	..
Extractive industries	4	..	..	1	1	..	..	..	1	1	..	..	..
Trade	3	..	..	..	..	2	..	1	..	..	..	..	..
Service	1	..	1	..	..	..	..	..	..	..	..	..	..
Unclassifiable	3	1	..	1	..	..	..	..	..	..	..	..	1

trict are in the lumber, millwork and furniture group, and 3 of these concerns reported credit refusal or restriction. This group, as has been pointed out, showed next to the largest proportion of refusals or restrictions among the several industrial groups.

Concerns Reporting, Classified According to Capital Employed

The amount of capital employed is probably the most satisfactory indicator of size of concern for the study of any credit problem. It is universally recognized that there is a very definite, although not precisely definable, relationship between capital and credit. This principle is well illustrated by the practice of various rating services, which require a certain minimum capital before they will consider giving a firm the highest credit rating.

Of the total concerns for which returns were tabulated, 226, or 12.9%, were classified as very small concerns, having total capital of $50,000 or less. There were 685 returns from concerns with capital of more than $50,000 and not over $500,000, and 138 from companies with capital of $500,000 to $1 million. These two groups accounted for 39% and 7.9%, respectively, of all returns. There were 631 returns from corporations with capital of over $1 million. This group accounted for 36% of all returns.[1]

Concerns Reporting No Credit Experience or No Credit Difficulty

Table 20 shows the number of concerns in each capital classification reporting no credit experience. Table 21 shows a percentage distribution of the concerns reporting no credit experience according to size class, and also the ratio of concerns reporting no credit experience to total number in each

[1] With a few exceptions, the capital ratings used were taken from the "Reference Book of Dun & Bradstreet," for September, 1938.

size group. Similar information for companies reporting no credit difficulty will be found in the same tables.

A very high proportion of the large concerns, having capital of over $1 million, reported either no experience or no difficulty in obtaining bank credit. The proportion for both groups combined was 97.8%. Firms with capital of more than $1 million accounted for 41.7% of all companies report-

Table 20: Number of Concerns Reporting, Classified by Amount of Capital Employed and Credit Status

Source: The Conference Board, 1938 Bank Credit Survey

Amount of Capital	Total Number of Concerns Reporting	Concerns Reporting No Bank Credit Problem			Concerns Reporting Refusal or Restriction of Bank Credit	Concerns Dependent on Banks[1]	Ratio of Concerns Reporting Refusal or Restriction of Bank Credit to Concerns Dependent on Banks
		Total	No Experience	No Difficulty			
Total	1,755	1,601	448	1,153	154	1,307	11.8%
Very Small							
$50,000 and under	226	177	64	113	49	162	30.2%
Small							
$50,001–$500,000	685	609	153	456	76	532	14.3%
Medium							
$500,001–$1,000,000	138	127	31	96	11	107	10.3%
Large							
Over $1,000,000	631	617	187	430	14	444	3.2%
Unclassifiable	75	71	13	58	4	62	6.5%

[1] Concerns reporting no difficulty plus those reporting refusal or restriction of bank credit.

ing no credit experience and 37.3% of concerns reporting no credit difficulty. Both these figures exceed the numerical ratio of firms in this size class to the total concerns reporting. In other words, refusals or restrictions of bank credit were less prevalent among the large concerns than among those with smaller capital.

Concerns Reporting Credit Refusal or Restriction

Credit refusals and restrictions reported were largely confined to the two groups classed as small and very small, that is, to concerns with capital of $500,000 or less. The data in Tables 20 and 21 provide the basis for several interesting comparisons, which will indicate the extent of the concentration of refusals or restrictions among smaller concerns. The

TABLE 21: PERCENTAGE DISTRIBUTION OF CONCERNS REPORTING, CLASSIFIED BY AMOUNT OF CAPITAL EMPLOYED AND CREDIT STATUS

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Amount of Capital	Total Number of Concerns Reporting	Concerns Reporting No Bank Credit Problem			Concerns Reporting Refusal or Restriction of Bank Credit	Concerns Dependent on Banks[1]
		Total	No Experience	No Difficulty		
Distribution by Amount of Capital Employed						
Total	100.0	100.0	100.0	100.0	100.0	100.0
Very Small $50,000 and under	12.9	11.1	14.3	9.8	31.8	12.4
Small $50,001–$500,000	39.0	38.0	34.2	39.5	49.4	40.7
Medium $500,001–$1,000,000	7.9	7.9	6.9	8.3	7.1	8.2
Large Over $1,000,000	36.0	38.5	41.7	37.3	9.1	34.0
Unclassifiable	4.3	4.4	2.9	5.0	2.6	4.7
Distribution by Credit Status						
Total	100.0	91.2	25.5	65.7	8.8	74.5
Very Small $50,000 and under	100.0	78.3	28.3	50.0	21.7	71.7
Small $50,001–$500,000	100.0	88.9	22.3	66.6	11.0	77.7
Medium $500,001–$1,000,000	100.0	92.0	22.5	69.6	8.0	77.5
Large Over $1,000,000	100.0	97.8	29.6	68.1	2.2	70.4
Unclassifiable	100.0	94.7	17.3	77.3	5.3	82.7

[1] Concerns reporting no difficulty plus those reporting refusal or restriction of bank credit.

small and very small concerns together accounted for 81.2% of all credit refusals or restrictions, but for only 51.9% of the number of concerns reporting. Of the small and very small concerns, 11% and 21.7%, respectively, reported bank credit refusal or restriction. The ratio for all groups combined was

8.8%. Of the concerns in these groups that were dependent on banks, 14.3% of those classed as small and 30.2% of those classed as very small reported credit refusal or restriction. The ratio for all groups combined was 11.8%.

At the other extreme, firms with capital of more than $1 million accounted for only 9.1% of the concerns reporting credit refusal or restriction, as compared with 36% of all concerns reporting. Only 2.2% of the concerns in this group experienced refusals or restrictions.

CONCERNS REPORTING, CLASSIFIED ACCORDING TO NUMBER OF EMPLOYEES

A classification of the concerns reporting according to the number of employees will serve to complement the classification by capital employed. The basis for the classification is information furnished by the industrial executives that replied to the questionnaire. The normal employment total during the period between January 1, 1935 and June 30, 1937 was requested. This period was chosen because it provides a more representative basis for classification than August, 1938. Information in regard to the number of employees was not furnished by 528 firms, or approximately 30% of all concerns reporting, but this fact does not detract from the conclusions suggested by the data.

Concerns Reporting No Credit Experience or No Credit Difficulty

The number of firms in each size group that reported no bank credit experience or no credit difficulty is shown in Table 22, while Table 23 shows the percentage distribution of concerns in these categories by size classes, together with ratios to total concerns in each size group. The number of concerns with 250 or fewer employees reporting no bank credit problem was proportionately less than the ratio of the number in the group to total concerns reporting.

The data in the lower half of Table 23 are particularly suggestive. Only 76.6% of the concerns with 20 or fewer employees reported that they had not had any bank credit problem. For the next group, 21 to 50 employees, the proportion was 87.9%. At the other extreme, 118 of the 119 concerns with more than 2,500 employees reported the absence of any bank credit problem.

TABLE 22: CONCERNS REPORTING, CLASSIFIED BY NUMBER OF EMPLOYEES AND BANK CREDIT STATUS

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Number of Employees	Total Number of Concerns Reporting	Concerns Reporting No Bank Credit Problem			Concerns Reporting Refusal or Restriction of Bank Credit	Concerns Dependent on Banks[1]	Ratio of Concerns Reporting Credit Refusal or Restriction to Concerns Reporting Dependence on Banks
		Total	No Experience	No Difficulty			
Total	1,755	1,601	448	1,153	154	1,307	11.8%
Very Small							
20 and under	128	98	35	63	30	93	32.3%
21–50	206	181	47	134	25	159	15.7%
51–100	189	167	37	130	22	152	14.5%
Small							
101–250	203	182	36	146	21	167	14.3%
Medium							
251–500	142	135	26	109	7	116	6.0%
Large							
501–1,000	136	132	26	106	4	110	3.6%
Very Large							
1,001–2,500	104	103	20	83	1	84	1.2%
2,501 and over	119	118	28	90	1	91	1.1%
Unclassifiable	528	485	193	292	43	335	12.8%

[1] Concerns reporting no credit difficulty plus those reporting refusal or restriction of bank credit.

Concerns Reporting Credit Refusal or Restriction

The data in Tables 22 and 23 reinforce the principal conclusion reached as a result of the analysis of the returns on the basis of the amount of capital employed. The classification on the basis of number of employees clearly indicates that bank credit refusals or restrictions are almost entirely confined to concerns classed as small and very small. Of the 111 cases of credit refusal or restriction that could be classi-

TABLE 23: PERCENTAGE DISTRIBUTION OF CONCERNS REPORTING, CLASSIFIED BY NUMBER OF EMPLOYEES AND CREDIT STATUS

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Number of Employees	Total Number of Concerns Reporting	Concerns Reporting No Bank Credit Problem			Concerns Reporting Refusal or Restriction of Bank Credit	Concerns Dependent on Banks[1]
		Total	No Experience	No Difficulty		
Distribution by Number of Employees						
Total	100.0	100.0	100.0	100.0	100.0	100.0
Very Small						
20 and under	7.3	6.1	7.8	5.5	19.5	7.1
21–50	11.7	11.3	10.5	11.6	16.2	12.2
51–100	10.8	10.4	8.3	11.3	14.3	11.6
Small						
101–250	11.6	11.4	8.0	12.7	13.6	12.8
Medium						
251–500	8.1	8.4	5.8	9.5	4.5	8.9
Large						
501–1,000	7.7	8.2	5.8	9.2	2.6	8.4
Very Large						
1,001–2,500	5.9	6.4	4.5	7.2	0.6	6.4
2,501 and over	6.8	7.4	6.3	7.8	0.6	7.0
Unclassifiable	30.1	30.3	43.1	25.3	27.9	25.6
Distribution by Credit Status						
Total	100.0	91.2	25.5	65.7	8.8	74.5
Very Small						
20 and under	100.0	76.6	27.3	49.2	23.4	72.7
21–50	100.0	87.9	22.8	65.0	12.1	77.2
51–100	100.0	88.4	19.6	68.8	11.6	80.4
Small						
101–250	100.0	89.7	17.7	71.9	10.3	82.3
Medium						
251–500	100.0	95.1	18.3	76.8	4.9	81.7
Large						
501–1,000	100.0	97.1	19.1	77.9	2.9	80.9
Very Large						
1,001–2,500	100.0	99.0	19.2	79.8	1.0	80.8
2,501 and over	100.0	99.2	23.5	75.6	0.8	76.5
Unclassifiable	100.0	91.7	36.6	55.3	8.1	63.4

[1] Concerns reporting no credit difficulty plus those reporting refusal or restriction of bank credit.

fied according to the number of employees, only 13 were reported by concerns with more than 250 employees.

Concerns with 20 or fewer employees accounted for more than one-fourth of all credit refusals or restrictions that could be classified according to the number of employees and almost one-fourth of these extremely small concerns reported credit refusal or restriction. Credit difficulties were relatively almost twice as numerous for this group as for the next larger group, consisting of firms with 21 to 50 employees. The marked difference between the ratio of refusals or restrictions to total concerns reporting for the group with 251 to 500 employees and the comparable ratio for concerns with 501 to 1,000 employees should also be noted.

Importance of the Small Enterprise

The conventional opinion is that our industrial system is distinguished for its organization under the control of large, highly integrated units, which utilize mass production methods and employ thousands of workers. Large-scale operations and efficiency in manufacturing have come to be regarded as almost synonymous by the public, with the result that the average person is inclined to regard the small enterprise as a high-cost and relatively inefficient concern.

In this section attention will be directed principally to three questions. What proportion of industrial wage earners are employed by small concerns? Is the small firm responsible for a substantial part of the output of industry? Are the small concerns relatively unprofitable and, therefore, comparatively poor credit risks?

Some of the most significant characteristics of manufacturing industry are shown in Table 24. In 1935 almost 92% of all manufacturing establishments in the United States had 100 or fewer employees. These establishments accounted for only about 29% of industrial employment, as measured by the number of wage earners. It is interesting to observe that

in the period of more than a quarter of a century covered by Table 24 there was no important change in the ratio of firms employing not more than 100 wage earners to total manufacturing concerns. Over a period of years, however, there was a gradual decline in the proportion of industrial employment attributable to this group.

Firms employing more than 500 wage earners represented

Table 24: Percentage Distribution of Manufacturing Establishments, Classified as to Size by Number of Wage Earners, 1909–1935

Source: United States Bureau of the Census

Number of Wage Earners Per Establishment[1]	1909	1914	1919	1921	1922	1929	1933	1935
By Number of Establishments in Size Class								
20 and under	73.0	73.2	74.8	75.5	72.4	74.2	71.8	73.1
21 to 50	13.4	12.9	11.7	12.2	12.8	11.9	13.1	12.5
51 to 100	6.3	6.3	5.8	5.6	6.3	5.9	6.5	6.2
101 to 500	6.3	6.6	6.4	5.8	7.1	6.7	7.3	6.9
501 to 2,500	1.0	1.2	1.3	0.9	1.4	1.2	1.2	1.2
2,501 and over						0.1	0.1	0.1
By Number of Wage Earners in Size Class								
20 and under	12.5	11.4	9.5	11.7	9.4	9.8	10.0	9.5
21 to 50	11.8	10.7	9.1	11.2	9.3	9.2	9.9	9.2
51 to 100	12.1	11.5	9.8	11.3	10.1	10.1	10.0	10.2
101 to 500	34.9	34.7	31.5	33.7	33.2	33.1	35.1	33.2
501 to 2,500	28.6	31.6	40.0	32.1	38.1	26.3	25.1	25.8
2,501 and over						11.5	9.0	12.1

[1] The groupings used in Tables 22 and 23 could not be followed in this table, for the reason that the data for some years were not compiled on the basis of more detailed classes.

only 1.3% of all manufacturing establishments in 1935, but they were responsible for almost 38% of industrial employment. In the same year firms employing more than 100 wage earners but not over 500 accounted for about 7% of all manufacturing establishments and approximately one-third of the total number of wage earners.

The data in Table 25 indicate that there is considerable variation among industries in the proportion of wage earners accounted for by the small concerns. These data have not

Table 25: Manufacturing Establishments Classified by Number of Wage Earners and by Industry Groups, 1929

Source: United States Bureau of the Census, Census of Manufactures

Industry Group	Total	50 Wage Earners and Under		51 to 100 Wage Earners		101 to 250 Wage Earners	
		Number	Per Cent of Total	Number	Per Cent of Total	Number	Per Cent of Total
Number of Establishments							
All industries	210,959	181,739	86.1	12,467	5.9	10,195	4.8
Food and kindred products	56,320	53,803	95.5	1,353	2.4	843	1.5
Textiles and their products	27,404	21,090	77.0	2,602	9.5	2,255	8.2
Forest products	26,912	23,238	86.3	1,739	6.5	1,330	4.9
Paper and allied products	3,126	1,953	62.5	517	16.5	479	15.3
Printing, publishing and allied industries	27,522	26,300	95.6	661	2.4	392	1.4
Chemicals and allied products	8,278	7,272	87.8	533	6.4	299	3.6
Products of petroleum and coal	1,497	1,070	71.5	158	10.6	151	10.1
Rubber products	525	292	55.6	65	12.4	66	12.6
Leather and its manufactures	4,277	2,985	69.8	505	11.8	482	11.3
Stone, clay and glass products	8,514	7,050	82.8	686	8.1	540	6.3
Iron and steel and their products, not including machinery	6,640	4,361	65.7	733	11.0	817	12.3
Nonferrous metals and products	7,522	6,511	86.6	450	6.0	305	4.1
Machinery, not including transportation equipment	12,955	9,734	75.1	1,288	9.9	1,097	8.5
Transportation equipment, air, land and water	2,550	1,751	68.7	212	8.3	222	8.7
Railroad repair shops	2,297	1,140	49.6	305	13.3	421	18.3
Miscellaneous industries	14,620	13,189	90.2	660	4.5	496	3.4
Number of Wage Earners							
All industries	8,838,743	1,689,907	19.1	891,671	10.1	1,589,040	18.0
Food and kindred products	753,247	323,945	43.0	96,017	12.7	128,105	17.0
Textiles and their products	1,707,798	289,840	17.0	187,510	11.0	353,526	20.7
Forest products	876,383	256,099	29.2	124,505	14.2	206,903	23.6
Paper and allied products	233,393	38,426	16.5	37,207	15.9	75,462	32.3
Printing, publishing and allied industries	357,988	166,526	46.5	46,069	12.9	59,367	16.6
Chemicals and allied products	280,868	71,386	25.4	37,238	13.3	45,963	16.4
Products of petroleum and coal	147,216	14,178	9.6	10,720	7.3	23,927	16.3
Rubber products	149,148	4,130	2.8	4,882	3.3	9,988	6.7
Leather and its manufactures	318,415	41,628	13.1	36,631	11.5	75,125	23.6
Stone, clay and glass products	328,417	76,130	23.2	49,190	15.0	83,610	25.5
Iron and steel and their products, not including machinery	880,882	58,969	6.7	54,193	6.2	130,967	14.9
Nonferrous metals and products	314,741	65,473	20.8	31,362	10.0	47,044	14.9
Machinery, not including transportation equipment	1,091,269	127,868	11.7	91,477	8.4	169,418	15.5
Transportation equipment, air, land and water	583,355	24,650	4.2	15,201	2.6	35,664	6.1
Railroad repair shops	398,156	21,443	5.4	22,615	5.7	67,284	16.9
Miscellaneous industries	417,467	109,216	26.2	46,854	11.2	76,687	18.4

been compiled for any year later than 1929, but it is probable that the changes since 1929 have been relatively small. The minor changes in Table 24 afford at least a partial reason for accepting the 1929 ratios for particular industries as more or less typical for the recent period.

In printing, publishing and allied industries, concerns with not over 50 wage earners accounted for 46.5% of all wage earners. The comparable proportion of firms engaged in the

Table 26: Percentage Distribution of Manufacturing Establishments, Classified According to Value of Products, 1929

Source: United States Bureau of the Census

Value of Products In Thousands	Number of Establishments		Wage Earners, Average Number		Value of Products		Value Added by Manufacture	
	Number	Per Cent	In Thousands	Per Cent	Millions of Dollars	Per Cent	Millions of Dollars	Per Cent
Total	210,959	100.0	8,839	100.0	70,435	100.0	31,885	100.0
Very Small								
Under $20	69,423	32.9	203	2.3	771	1.1	479	1.5
$20–$100	75,225	35.7	693	7.8	3,588	5.1	2,084	6.5
Small								
$100–$250	28,704	13.6	779	8.8	4,568	6.5	2,416	7.6
$250–$500	15,449	7.3	894	10.1	5,456	7.7	2,759	8.7
Medium								
$500–$1,000	10,395	4.9	1,122	12.7	7,295	10.4	3,541	11.1
Large								
$1,000–$5,000	9,909	4.7	2,706	30.6	19,963	28.3	9,427	29.6
Very Large								
$5,000 and over	1,854	0.9	2,442	27.6	28,794	40.9	11,179	35.1

production of food and kindred products was 43%. For both these groups, concerns with 100 or fewer wage earners accounted for more than one-half of the total for the industry. At the other extreme, concerns in the rubber products industry employing 50 or fewer wage earners accounted for only 2.8% of total employment. In the same industry, firms with 100 or fewer wage earners accounted for only 6.1% of employment.

Value of products and value added by manufacture afford additional bases for classifying manufacturing concerns according to size. As in the preceding tabulation, the data are not available for any year later than 1929. Establishments manufacturing products with a value of $100,000 or less accounted for about 69% of all manufacturing concerns in 1929, approximately 10% of all wage earners, over 6% of the total value of manufactured products, and 8% of total value added by manufacture. If all concerns with an annual product of $500,000 or less are regarded as small, the small establishments accounted for about 89% of all manufacturing concerns, 29% of the wage earners, roughly 20% of the total value of manufactured products, and over 24% of value added by manufacture.

It is popularly believed that large-scale enterprise is generally more profitable than small and medium-sized enterprises. The data for all manufacturing corporations in Table 27 show that in 1933 and 1934, the combined operations of all manufacturing corporations with assets of less than $100,000 resulted in a deficit, while all corporations submitting balance sheets showed a profit of 1.2% for 1933 and 3.7% for 1934. For 1935, the combined data for manufacturing corporations with assets of less than $50,000 indicate a deficit, while all manufacturing corporations combined showed a profit of 6.6%. Further examination of the data in Table 27 shows that, of the corporations reporting a net income, the relatively small firms showed the largest rate of profit. Similarly, of the corporations that reported deficits, the relatively small ones showed the highest ratio of deficits to net worth. The principal conclusion to be derived from Table 27 is that the smaller manufacturing corporations show a wider variation in the ratio of profit or loss to net worth than the larger corporations, at least under the conditions prevailing from 1933 to 1935.

The data in this section definitely indicate that large enterprise plays a more important role in American industry than

TABLE 27: RATIO OF COMPILED NET PROFIT OR DEFICIT TO NET WORTH OF MANUFACTURING CORPORATIONS BY SIZE OF TOTAL ASSETS, 1933–1935

Source: Treasury Department, Bureau of Internal Revenue, Annual Reports on Statistics of Income

Per Cent

Asset Class (In Thousand Dollars)	1933	1934	1935
All Corporations			
Under 50	−20.9	−13.8	−11.1
50–100	− 5.6	− 1.5	0.7
100–250	− 2.4	0.8	2.9
250–500	0.3	2.5	4.8
500–1,000	1.0	3.2	5.9
1,000–5,000	1.4	3.8	6.7
5,000–10,000	2.3	4.8	7.0
10,000–50,000	1.7	4.1	7.5
50,000 and over	1.7	4.4	7.4
Total	1.2	3.7	6.6
Reporting Net Income			
Under 50	10.2	12.8	12.9
50–100	9.1	11.0	11.6
100–250	9.5	10.9	11.9
250–500	9.6	11.1	12.1
500–1,000	9.9	11.2	12.6
1,000–5,000	8.8	9.9	11.7
5,000–10,000	9.5	10.4	11.7
10,000–50,000	8.5	8.9	11.4
50,000 and over	4.9	8.4	10.0
Total	7.0	9.4	11.0
Corporations Reporting No Net Income			
Under 50	−36.7	−36.3	−35.7
50–100	−15.8	−15.2	−14.3
100–250	−12.2	−11.7	−12.0
250–500	− 8.7	− 9.9	− 8.9
500–1,000	− 8.4	− 8.6	− 8.3
1,000–5,000	− 7.0	− 6.2	− 5.5
5,000–10,000	− 5.6	− 4.8	− 5.2
10,000–50,000	− 6.3	− 4.1	− 2.6
50,000 and over	− 2.3	− 0.7	[a]
Total	− 5.5	− 4.5	− 4.3

[a] Less than 0.05%.

does the small concern. Viewed from the standpoint of employment, value of product, and value added by manufacture, however, the contribution of the small enterprise is substantial. It is impossible, of course, to measure the importance of small enterprise solely by ratios of the type that have been presented. The existence of thousands of small concerns assumes added significance when weight is given to freedom of enterprise as a basic tenet or guiding principle in our economic system.

Although bank credit refusals or restrictions have been confined almost entirely to small concerns, there is no reason to believe that the basis for credit refusal or restriction is found solely, or even principally, in the size of the concern. To the extent that the size of the capital is a limiting factor in the granting of credit, however, size does play a determining role. In addition, it should be pointed out that in a dynamic economy the small concerns include some that are expanding and are definitely on the up-grade, others that are relatively constant in size, and others that have deteriorated over a period of years. The inclusion in the sample of companies in the latter category tends to increase the proportion of credit refusals or restrictions reported by the small concerns.

Finally, it must be emphasized that the analysis in this chapter has been largely quantitative. A great deal of significance should not be attached to the ratio of bank credit refusals or restrictions to total concerns reporting that has been developed, without first subjecting the returns of the concerns reporting credit refusal or restriction to more careful analysis. Such an examination will be found in Chapter III.

Availability of Bank Credit to Customers or Dealers

A small number of concerns voluntarily referred to the credit problems of their customers or dealers. In several cases the information furnished was unusually comprehensive. Of the eleven concerns that referred to the credit facilities available to their customers or dealers, three either commended the credit facilities the banks were supplying or commented favorably on the increases in bank credit that had been made available for distribution purposes. One firm doing a nationwide business noted an expansion of almost $10 million in the amount of credit made available to its distributors during 1937 and 1938. This increase was construed as indicating a greater interest in distribution credits on the part of commercial bankers. The same concern observed that the attitude of bankers toward such credits is decidedly uneven. Another concern commended its bank for having installed a time-sales division and the service it was providing, while a third merely mentioned the advantages accruing from the increasing tendency of local bankers to finance instalment sales.

Three of the eleven concerns specifically stated that the bank credit supplied to dealers was inadequate. As a consequence, manufacturers were compelled to assume a burden in carrying accounts which they believed was properly a function of the banks. One executive frankly stated that it may be necessary for bankers to be stricter than business concerns in extending lines of credit, but that, with proper safeguards, the banks could be more lenient than at present in lending to small distributors.

The other five returns that included comments on this matter are best described as neutral. Two of the concerns reported that bank credit had been refused to their customers, but stated that excessive inventories or poor current ratios afforded justification for the decisions of the banks. The remaining three cases involved long-term credits that the banks did not see fit to handle. One of these concerns plainly required additional equity capital for the purpose of financing a venture in the field of distribution that had not advanced beyond the promotional stage.

CHAPTER III

THE BASIS OF BANK CREDIT REFUSAL OR RESTRICTION

THE statistical analysis of the reasons for bank credit refusal or restriction that follows is based primarily on the replies to the second question of the questionnaire and on other information derived from the letters received. Details about which information was asked were: the time of refusal, the amount of credit requested, the period for which accommodation was desired, whether the request was refused wholly or partly, and the grounds on which the refusal was based.[1]

Credit Refusals and Restrictions and Years in Which They Occurred

Throughout the analysis, the concerns that reported that they had not succeeded in obtaining the credit accommodation desired are classified under the general heading of "credit refusals or restrictions." It should be understood that the concerns so classified include a substantial number that were granted a part of the credit requested. In some cases the concern reported that it had been granted all the short-term credit it required, but that a request for a loan to be amortized over a period of years had been denied. In Table 28, concerns in both of these categories are classified under restrictions. Those that were refused additional accommodation, although enjoying a substantial line of credit at the time of refusal, are also classed as restrictions.

[1] The exact wording of the second question was: "If credit accommodation was refused to you: (a) When was it refused? (b) In what amount and for what period was credit requested? (c) Was your request refused in whole or only in part? If the latter, please give the percentage of request granted. (d) On what grounds was credit refused? (e) What bank refused the credit?"

Of the 154 refusals and restrictions reported, 65 are classified as restrictions in Table 28. The restrictions amounted to 42% of refusals and restrictions combined and to 3.7% of all concerns reporting. Complete refusals of credit accommodation numbered 89, or 58% of refusals and restrictions combined and 5.1% of all concerns reporting.

Table 28: Concerns Reporting Credit Refusals and Credit Restrictions, Classified by Federal Reserve District and Year of Most Recent Refusal or Restriction

Source: The Conference Board, 1938 Bank Credit Survey

Year of Most Recent Refusal or Restriction	Total	Federal Reserve District					
		Boston	New York	Phila-delphia	Cleve-land	Chicago	All Other
		Total Refusals and Restrictions					
Total	154	17	27	13	25	31	41
1933	5	..	..	..	2	3	..
1934	10	1	1	..	..	2	6
1935	5	1	..	..	1	..	3
1936	8	..	1	..	1	4	2
1937	19	3	4	3	1	4	4
1938	65	8	16	5	9	14	13
Unclassifiable	42	4	5	5	11	4	13
		Refusals					
Total	89	12	17	9	13	16	22
1933	3	..	..	..	1	2	..
1934	8	1	1	..	..	2	4
1935	4	1	..	..	1	..	2
1936	5	..	1	..	1	2	1
1937	10	..	3	2	1	3	1
1938	40	8	9	4	5	6	8
Unclassifiable	19	2	3	3	4	1	6
		Restrictions					
Total	65	5	10	4	12	15	19
1933	2	..	..	..	1	1	..
1934	2	..	..	..	..	..	2
1935	1	..	..	..	..	..	1
1936	3	..	..	..	..	2	1
1937	9	3	1	1	..	1	3
1938	25	..	7	1	4	8	5
Unclassifiable	23	2	2	2	7	3	7

The percentage of the request granted, or information that was valuable although not absolutely definite, was given by 26 of the concerns reporting restriction. More than 50% of the amount requested was obtained by 5 of these concerns, exactly 50% by 7 firms, 40% by 1 concern and 20% by 2 concerns. Three concerns obtained a small part of the loan desired, while 8 obtained all the short-term credit requested, but were denied loans for longer periods.

The concerns are also classified according to the year of the most recent credit refusal or restriction in Table 28. Of the 112 concerns which could be classified on this basis, 65 reported refusals or restrictions in 1938. This figure should not be construed as indicating that refusals and restrictions were much more numerous in 1938 than in the preceding years. In some cases it was stated that credit had been refused a number of times beginning in 1934 or 1935. These concerns are classified only under 1938 in Table 28.

Concerns reporting that they had been refused bank credit at the time of, or before, the banking holiday are not included under refusals or restrictions, unless they were refused accommodation at some later time. For all others the basis for inclusion was an affirmative answer to the question as to whether the concern had recently found any difficulty in obtaining the credit accommodation required for legitimate business purposes.

Finally, it should be pointed out that the credit problems of a number of concerns reporting refusals or restrictions were solved wholly or partly prior to the time of the survey. Two firms reported that they had been refused credit by their banks, but that a few months later their requests were reconsidered and a favorable decision reached. Nine concerns stated that their credit problems had been solved as a result of applications for accommodation at other banks, and two reported that their problems were partially solved following application at other banks. In each of these 13 cases

a credit problem existed for only a relatively brief period. Applications to the Reconstruction Finance Corporation or to the Federal Reserve banks resulted in solution of the problems of 20 concerns and partial solutions in 12 additional cases. The credit problems of 109 concerns were not solved even partly at the time of the survey. Of these, 40 had applied to, and had been refused accommodation by, the Reconstruction Finance Corporation or the Federal Reserve banks.[1]

Purpose for Which Credit Was Requested

The cases of credit refusal or restriction are classified in Table 29 according to the purpose for which credit was requested. In 87% of the cases bank credit was needed for working capital, in 7% for fixed capital, and in 6% for a combination of fixed and working capital.

At least three reasons may be offered in explanation of the fact that credit was needed for working capital by so large a proportion of the concerns reporting credit refusal or restriction. First, many of these concerns operated at a loss from 1929 through 1933, and operating losses ordinarily mean a reduction in working capital resources. Second, the firms that earned substantial profits in 1936 and 1937 could retain their earnings for working capital only if they paid a substantial penalty in the form of the undistributed profits tax. Because of the pressure for additional working capital, the tax was paid by many firms. In the aggregate, however, the amount of earnings retained was less than if the tax had not been imposed. Third, the credit refusals or restrictions were confined very largely to small concerns, which frequently operate on a lower ratio of owned working capital to total working capital than do large concerns.

The fact that a relatively small percentage of the concerns reporting credit refusal or restriction had requested credit for fixed capital purposes should not be interpreted as indicating

[1] The industrial advance programs of these agencies are considered in Chapter IV.

that in the overwhelming majority of instances credit was requested for a short period, and that the banks were to be repaid from the proceeds of particular business transactions. In 101 cases, or roughly 62%, no more specific purpose could be identified than that of general working capital. It may be assumed that in many of these cases it was planned to repay the loan out of earnings and not from the proceeds of completed transactions. Many of these requests, if granted, would have involved semi-fixed capital loans repayable over a period of from two to five years, and in some instances over a longer period.

ABLE 29: CASES OF CREDIT REFUSAL OR RESTRICTION, CLASSIFIED BY SPECIFIC PURPOSE OF THE CREDIT REQUESTED[1]

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Purpose of Credit	Total	Federal Reserve District					
		Boston	New York	Phila-delphia	Cleveland	Chicago	All Other
'or working-capital purposes.	143	17	25	12	20	31	38
. Meeting current payrolls...	5	1	1	1	..	..	2
. Purchase of raw materials..	7	..	2	..	2	1	2
. Production of inventories..	12	1	1	1	1	2	6
. Improving cash position...	3	..	1	..	..	1	1
. Filling orders or executing contracts.............	11	1	1	2	1	3	3
. Repayment or refunding of outstanding working-capital credits............	3	1	..	..	1	..	1
. General working capital...	101	13	19	8	15	23	23
. Replacing working-capital tied up in lawsuit.......	1	..	..	..	..	1	..
'or fixed-capital purposes....	12	1	1	1	5	1	3
1. Re-equipment of plant....	3	1	..	1	..	..	1
2. Expansion of plant........	8	..	1	..	4	1	2
3. Refunding fixed-capital obligations..............	1	..	..	..	1	..	..
For combined fixed and working-capital purposes.....	9	1	2	..	1	1	4
1. Expansion of plant and new general working capital...	8	1	2	..	..	1	4
2. Unclassifiable...........	1	..	..	..	1	..	..

The total number of cases, 164, exceeds the total number of returns tabulated, 154, for the reason that the information ed in a few cases warranted a double classification.

Among the specific purposes for which additional working capital was needed, production of inventories was mentioned most frequently, a total of twelve times. In most of these cases it was desired to finance production in anticipation of seasonal peaks. The request for the loan was in no way related to the financing of particular transactions. Filling orders or executing contracts ranked second among the specific purposes reported. Eleven concerns stated that requests for bank credit for these purposes had been denied or that the amount granted was less than that requested. These loans, it seems, would have been of the self-liquidating type that one associates with short-term industrial and commercial loans. Poor credit standing, or the presence of a known moral risk which might mean that the proceeds of the orders or contracts would not be applied to the bank obligation, would be valid reasons, of course, for refusing loans of this type.

DEBTOR STATUS OF CONCERNS REPORTING CREDIT REFUSAL OR RESTRICTION

The debtor status of the concern at the bank at the time credit was refused or restricted is an important consideration, especially in the case of fairly large concerns located in small towns. Thirteen of the 154 concerns stated that they had been granted loans up to the legal limit of the bank's lending power. Even though bank loans represented a small proportion of the working capital used by these concerns, the banks had no alternative other than to observe the legal limitation on loans to a single firm.

The indicated debtor status of 116 of the 154 concerns reporting credit refusal or restriction is shown in Table 30. The remaining 38 returns could not be classified. In 56 cases, or almost 50% of those classified, the concern applying for bank credit was in debt to a bank that was not pressing for repayment. In all but two of these cases the creditor bank and the bank to which application for credit was made were the same. Pressure for repayment at or about the time the refusal or restriction occurred was indicated in 18 returns, or about 16% of those classified.

Concerns not in debt at any bank at the time credit was refused or restricted numbered 38, or about one-third of those classified. In some instances these concerns had not been borrowers at banks since the banking holiday. When expanding activity resulted in a need for additional working capital, the bank either curtailed the line of credit previously granted or refused the application entirely. In some cases the action of the bank was regarded as arbitrary, while in others the applicant frankly stated that its financial state-

BLE 30: CASES OF CREDIT REFUSAL OR RESTRICTION, CLASSIFIED BY REPORTED DEBTOR STATUS

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Debtor Status	Total	Federal Reserve District					
		Boston	New York	Phila-delphia	Cleveland	Chicago	All Other
oncerns	154	17	27	13	25	31	41
In debt to bank at time of credit application but not being pressed to repay	54	4	10	4	10	14	12
In debt to bank at time of credit application but being pressed to repay	18	1	5	2	2	5	3
In debt to another bank at time of credit application and not being pressed to repay	2	..	..	1	1	..	..
Not in debt to any bank at time of credit application but being accustomed to credit accommodation	38	5	9	2	4	8	10
Not in debt to any bank for years because of no need for banking accommodation	2	..	1	..	..	..	1
In debt to failed bank and unable to obtain credit with successor or elsewhere	2	..	..	..	1	..	1
Unclassifiable	38	7	2	4	7	4	14

ment did not justify the renewal of the line of credit granted in the earlier period.

TYPE OF LOAN PAPER OFFERED BY CONCERNS REPORTING CREDIT REFUSAL OR RESTRICTION

Table 31 shows a classification of the credit refusals or restrictions according to the type of loan paper involved. One

TABLE 31: CASES OF CREDIT REFUSAL OR RESTRICTION, CLASSIFIED BY GENERAL PURPOSE OF CREDIT REQUESTED AND TYPE OF LOAN PAPER INVOLVED[1]

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

General Purpose of Credit and Type of Loan Paper	Total	Federal Reserve District					
		Boston	New York	Phila-delphia	Cleveland	Chicago	All Other
I. General working-capital credits	139	17	25	12	19	30	36
1. Acceptances and other two-name paper	6	2	..	..	1	1	2
2. Loan paper based on or secured by:							
a. Receivables collateral	10	1	1	..	2	4	2
b. Securities collateral (stocks and bonds)	1	..	1	..	..	..	..
c. Real estate mortgage collateral	5	2	..	..	1	1	1
d. Chattel mortgage collateral	3	1	1	..	..	..	1
e. Warehouse receipts	1	..	..	..	..	..	1
3. Loan paper otherwise secured and unsecured—probably mostly unsecured	112	11	22	12	15	24	28
4. Unclassifiable loan paper	1	..	..	..	..	..	1
II. Fixed-capital credits	12	1	1	1	5	1	3
1. Loan paper based on or secured by:							
a. Securities collateral	1	..	..	..	1	..	..
b. Real estate mortgage collateral	5	1	..	1	1	1	1
2. Unclassifiable loan paper	6	..	1	..	3	..	2
III. Combination of fixed and working-capital credits	10	1	3	..	1	1	4
1. Loan paper based on or secured by real estate mortgage collateral	5	1	1	..	..	1	2
2. Loan paper otherwise secured or unsecured	5	..	2	..	1	..	2

[1] The total number of cases, 161, exceeds the total number of returns tabulated, 154, for the reason that the information supplied in a few cases warranted a double or triple classification.

of the most striking facts brought out by this table is that in only six cases of refusal or restriction did the paper offered consist of acceptances or other two-name paper. In only one instance was paper secured by warehouse receipts declined. These two categories of loan paper are customarily regarded as carrying an absolute minimum of risk, assuming, of course, the high credit standing of both names in the case of acceptances and other two-name paper. It is probable that in no more than these seven cases was it anticipated that the bank would be repaid from the proceeds of specific transactions of a commercial character.

In 117 of the 161 tabulated cases, or about 73% of the total, the loan paper offered was unsecured, or else the type of security offered was not reported. In approximately three-fourths of these cases it was either stated or clearly inferred that the request for the loan was based on the general credit of the firm. It is probable that specific security was not offered by most of the other concerns. In reporting credit refusal or restriction when collateral had been offered, it was customary for the firms to stress the fact that they had been denied credit accommodation, even though security had been offered. It would seem to be a reasonable inference, therefore, that if no reference was made to collateral of any kind, the paper offered was generally unsecured.

Loan paper secured by real estate or chattel mortgage collateral was offered by only eighteen concerns, 11% of those reporting. Included in this total were ten firms that desired loans for fixed capital purposes or combined fixed and working capital purposes. Paper secured by accounts receivable was offered in ten cases, or 6% of the total. In two instances, paper secured by stock and bond collateral was declined by the bank to which the firm applied for credit.

The fact that so small a percentage of the loan paper offered had its origin in specific transactions, the proceeds of which were to be used in liquidating the obligations at the

bank, should not be construed as indicating that the refusals and restrictions of bank credit that were reported were justifiable in all but relatively few cases. Loan paper of this high-quality, self-liquidating type is not the principal basis for the extension of bank credit to industrial and commercial borrowers. For many years the line of credit based on the general credit worthiness of the firm or individual, or based wholly or in part on the pledging of acceptable collateral, has been the principal basis for the extension of bank credit to these classes of borrowers.

It would be illogical to expect that many of the concerns reporting refusals or restrictions would have self-liquidating paper of the highest commercial type to offer to their banks. The customs and practices within a trade are the principal factor in determining the form of the accounts receivable. In many of the industries reporting refusals or restrictions of bank credit, the sale of the finished product does not ordinarily result in the creation of acceptances or other paper, which after discounting becomes two-name paper. A number of concerns reporting bank credit restriction stated that they could obtain credit accommodation through occasional discounts of acceptances, but that these funds were not ample for their needs.

Reported Reasons for Credit Refusal or Restriction

A considerable variety of reasons for credit refusal or restriction was furnished in answer to the request for the grounds on which accommodation was declined or limited to a smaller amount than was desired. These reasons are classified in Table 32 according to whether credit refusal or restriction was based upon legal limitations and requirements of examiners, the condition of the bank, the policy of the bank, or the condition of the applying concern.

Legal limitations and requirements of examiners accounted for 12% of the stated reasons, the condition of the bank for a

Table 32: Cases of Credit Refusal or Restriction, Classified by Specific Reason Reported[1]

Source: The Conference Board, 1938 Bank Credit Survey

Reason for Refusal or Restriction	Total	Federal Reserve District: Boston	New York	Phila-delphia	Cleveland	Chicago	All Other
Total number of stated reasons	213	24	38	22	29	42	58
I. Reasons based upon legal limitations and requirements of examiners	26	3	2	6	3	5	7
1. Loans extended to legal limit permitted to one borrower	13	2	..	2	1	3	5
2. Loans of type disapproved by bank examiner	13	1	2	4	2	2	2
II. Reasons based upon condition of bank	3	..	..	..	1	..	2
1. Recent bank merger, or other change in banking facilities required new credit connections	2	..	..	..	1	..	1
2. Bank in unliquid condition	1	..	..	..	..	..	1
III. Reasons based upon policy of bank	114	13	21	8	18	19	35
1. Loan policy too conservative; specific reason not stated	41	6	9	1	6	10	9
2. Funds required for longer period than bank willing to consider	32	2	5	2	6	4	13
3. No loans granted on plant and equipment or real estate	6	1	1	1	1	..	2
4. Collateral unacceptable or inadequate	6	1	2	..	1	1	1
5. No loans made without collateral security	6	..	2	2	1	1	..
6. No loans granted for acquiring fixed assets	5	..	1	..	2	..	2
7. Line of credit deemed sufficient	3	..	..	1	..	..	2
8. No loans made to very small concerns	2	..	..	..	..	2	..
9. Trade acceptances not wanted for discount	2	..	..	..	..	..	2
10. Lines of credit against policy of bank	1	..	1	..	..	..	..
11. Endorsed notes receivable refused for discount because maker was not customer of bank	1	1	..	..	..	..	..
12. Endorsed notes receivable refused for discount because the Federal Reserve bank had ruled them not acceptable for rediscount	1	..	..	..	..	1	..
13. Loan not made because bank would be compelled to borrow from its Federal Reserve bank	1	..	..	1	..	..	..
14. Loan refused because of customer's obligation to a closed bank	1	..	..	..	..	..	1
15. Industrial loans not desired	1	1	..	..	..	..	..
16. No loans made on installment paper	1	..	..	..	1	..	..
17. Bank's funds must be conserved to aid farmers	1	1	..	..	..	..	..
18. No loans where security consists of crops in shipment	1	..	..	..	..	..	1
19. Policy not to make any distillery loans	1	..	..	..	..	..	1
20. Bank unfamiliar with type of business	1	..	..	..	..	..	1
IV. Reasons based upon the condition of concern applying for credit	70	8	15	8	7	18	14
1. Current earnings unsatisfactory	18	1	6	2	1	6	2
2. Financial statement unsatisfactory	16	2	4	2	2	2	4
3. Unstable market conditions in applicant's industry	9	1	2	1	2	1	2
4. Ratio of current assets to current liabilities unsatisfactory	8	1	1	1	..	3	2
5. Inventories too high	5	2	1	1	..	1	..
6. Ratio of invested capital to borrowed capital too low	4	..	..	..	2	..	2
7. Applicant borrowed up to credit limit	2	1	..	..	..	1	..
8. Payment on previous loans too slow	2	..	1	..	..	1	..
9. Cash balances inadequate	1	..	..	1	..	..	..
10. Decline in volume of business done	1	..	..	..	..	..	1
11. Applicant not in business long enough to prove earning capacity	1	..	..	..	..	..	1
12. Business does not need assistance at present time	1	..	..	..	..	1	..
13. Working capital tied up by law suit	1	..	..	..	..	1	..
14. Concern in receivership; loans limited to 50% of accounts receivable	1	..	..	..	..	1	..

[1] The total number of cases, 213, exceeds the total number of returns tabulated, 154, because the information supplied in some cases warranted a double classification. Eight returns could not be classified.

little more than 1%, the policy of the bank for 54%, and the financial condition of the reporting concern for 33%. In considering the fact that more than one-half of the stated reasons have to do with the policy of the bank, it should be remembered that the information was furnished by the borrower or potential borrower. It is only natural that a concern whose application for credit has been refused should stress those bases for refusal that pertain to banking policies, rather than those which have to do with the financial condition of the business. Another element of bias doubtless results from the fact that in some instances the bank may not wish to imply that the financial condition of the concern does not warrant the loan requested, and will base the refusal upon some secondary consideration relating to banking policy.

Thirteen concerns stated that additional credit had been denied them for the reason that loans had been extended to the legal limit permitted for one borrower. In a number of cases for which this reason was reported, a fairly large concern was located in a small town with limited banking facilities. In some instances the credit problem was solved by establishing banking connections in larger cities. Disapproval by bank examiners of loans of the types which were requested was reported by thirteen concerns as the reason for credit refusal or restriction.

Among the reasons based upon the policy of the bank, that of excess conservatism was mentioned most frequently, or forty-one times. Next was that the funds were required for a longer period than the bank was willing to consider. A total of thirty-two concerns reported that credit had been refused or restricted for this reason. Loans were refused to six firms because the bank did not wish to make loans on plant and equipment, or real estate. The collateral offered by six concerns was deemed unacceptable or inadequate, and the same number reported that they were refused credit accommodation for the reason that collateral was not offered.

Of the reasons based upon the condition of the concern applying for credit, unsatisfactory current earnings ranked first, with eighteen reported cases, and unsatisfactory financial statements second, with sixteen. Other reasons mentioned five or more times were: (1) unstable market conditions in the industry of the applicant, by nine concerns; (2) unsatisfactory ratio of current assets to current liabilities, by eight concerns; and (3) excessive inventories, by five concerns.

In the Cleveland Federal Reserve district a larger percentage of credit difficulties was attributable to banking policies than elsewhere. The figure for this district was 62%. In the Chicago and New York districts, from which more than one-half of all refusals and restrictions were reported, relatively large percentages of the totals were accounted for by the condition of the concerns applying for credit. Legal limitations and requirements of examiners accounted for 27% of the refusals and restrictions reported from the Philadelphia district, as compared with 12% for all districts combined.

Credit Standing of Concerns Reporting Credit Refusal or Restriction

Trade credits are a common source of working capital resources. In the granting of trade credits, standard credit ratings determined by an impartial agency are frequently employed. While these ratings do not constitute the basis of trade credit lines, they are extensively used as checks and guides in the appraisal of credit risks. The standard credit ratings published in Dun and Bradstreet's "Reference Book" were used for the purpose of obtaining an impartial and objective view of the general credit standing in their respective trades of the concerns reporting credit refusal or restriction.

The ratings used in this analysis were published in September, 1938. They were based on the condition or situation of the several concerns during the summer of 1938. Except for those cases in which credit was refused or restricted during the summer of 1938, the rating used is not necessarily the same as that reported at the time the refusal or restriction occurred. One other limitation should be noted. The withdrawal of a line of bank credit may be a factor in a change in rating, particularly when considerable reliance is placed on bank credit as a source of working capital.

TABLE 33: CONCERNS REPORTING CREDIT REFUSAL OR RESTRICTION, CLASSIFIED BY CREDIT RATING AND FEDERAL RESERVE DISTRICT

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Rating Based on Dun and Bradstreet's Reference Book	Total	Federal Reserve District					
		Boston	New York	Philadelphia	Cleveland	Chicago	All Other
Number							
Total	154	17	27	13	25	31	41
High	26	1	2	5	7	8	3
Good	23	..	5	1	3	5	9
Fair	22	3	2	1	4	5	7
Limited	1	..	..	..	1	..	..
Not rated	82	13	18	6	10	13	22
Percentage Distribution							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
High	16.9	5.9	7.4	38.5	28.0	25.8	7.3
Good	14.9	..	18.5	7.7	12.0	16.1	22.0
Fair	14.3	17.6	7.4	7.7	16.0	16.1	17.1
Limited	0.6	..	..	..	4.0	..	..
Not rated	53.2	76.5	66.7	46.2	40.0	41.9	53.7

Concerns Reporting Credit Refusal or Restriction, Classified by Credit Rating and Federal Reserve District

The outstanding fact disclosed by Table 33 is that 82 of the 154 concerns had no credit rating. The rating service reports that the absence of any rating signifies circumstances which preclude forming a definite decision as to the credit standing of the concerns named. Although many of them are doubtless questionable risks, it should not be inferred that all the concerns that are not rated are decidedly inferior as credit risks. While their circumstances may be such that they do not appear to be entitled to their previous ratings, the circumstances may be temporary in character. A marked reduction in the rating would therefore be unjustified.

Of the seventy-two concerns reporting credit refusal or restriction that were rated, twenty-six or slightly more than one-third were rated High and twenty-three or a little less than one-third were rated Good. Of the remaining twenty-three concerns, twenty-two were rated Fair and one Limited. In the Philadelphia Federal Reserve district, six of the seven concerns for which ratings were reported stood High or Good, while in the Chicago district thirteen out of eighteen rated firms, and in the Cleveland district ten out of fifteen rated firms, were rated either High or Good.

Concerns Reporting Credit Refusal or Restriction, Classified by Credit Rating and Industry

Classification by credit rating and industry is shown in Table 34, and Table 35 shows a percentage distribution of the concerns in each industry according to their credit ratings. In six of the groups in which three or more refusals or restrictions occurred, two-thirds or more of the firms reporting credit refusal or restriction were not rated. They are: (1) liquors and beverages; (2) stone, clay and glass; (3) textiles; (4) food; (5) leather and (6) rubber. With a few exceptions the concerns in these groups that were not rated are classed as small or very small in the classifications according to the amount of capital and number of employees.

In groups where three or more refusals or restrictions were reported, chemicals, paint and varnish showed the largest proportion of concerns rated High or Good. Three out of eight of these firms were rated High and two were rated Good. In the metal products and machine manufacturing group, for which the largest number of refusals or restrictions was

Table 34: Concerns Reporting Credit Refusal or Restriction, Classified by Credit Rating and Industry

Source: The Conference Board, 1938 Bank Credit Survey

Industrial Group[1]	Total	Credit Rating in Dun and Bradstreet's Reference Book				
		High	Good	Fair	Limited	Not Rated
Total	154	26	23	22	1	82
Metal products and machine manufacturing	48	10	7	7	1	23
Paper and pulp	8	1	3	..	..	4
Textiles	11	1	1	1	..	8
Food	6	1	1	..	..	4
Clothing	1	1	..	..	..	..
Chemicals, paint and varnish	8	3	2	..	..	3
Lumber, millwork and furniture	23	4	4	6	..	9
Leather	3	..	..	1	..	2
Stone, clay and glass	14	2	..	1	..	11
Rubber	3	..	..	1	..	2
Liquors and beverages	3	..	..	..	..	3
Miscellaneous manufacturing	15	2	1	4	..	8
Extractive industries	4	..	2	1	..	1
Trade	3	1	1	..	..	1
Service	1	..	1	..	..	..
Unclassifiable	3	..	..	..	..	3

[1] Two groups, tobacco and printing, for which no credit refusals or restrictions were reported are not shown in this table.

Table 35: Percentage Distribution of Concerns Reporting Credit Refusal or Restriction, Classified by Credit Rating and Industry

Source: The Conference Board, 1938 Bank Credit Survey

Industrial Group	Credit Rating in Dun and Bradstreet's Reference Book				
	High	Good	Fair	Limited	Not Rated
Total	16.9	14.9	14.3	0.6	53.2
Metal products and machine manufacturing	20.8	14.6	14.6	2.1	47.9
Paper and pulp	12.5	37.5	..	..	50.0
Textiles	9.1	9.1	9.1	..	72.7
Food	16.7	16.7	..	..	66.7
Clothing	100.0	..	..	..	..
Chemicals, paint and varnish	37.5	25.0	..	..	37.5
Lumber, millwork and furniture	17.4	17.4	26.1	..	39.1
Leather	..	..	33.3	..	66.7
Stone, clay and glass	14.3	..	7.1	..	78.6
Rubber	..	..	33.3	..	66.7
Liquors and beverages	..	..	..	..	100.0
Miscellaneous manufacturing	13.3	6.7	26.7	..	53.3
Extractive industries	..	50.0	25.0	..	25.0
Trade	33.3	33.3	..	..	33.3
Service	..	100.0	..	..	..
Unclassifiable	..	..	..	..	100.0

reported, ten out of forty-eight concerns were rated High, seven Good, seven Fair, one Limited, and twenty-three were not rated.

Concerns Reporting Credit Refusal or Restriction, Classified by Credit Rating and Size

Tables 36 and 37 classify the concerns according to credit rating and size. Distribution on the basis of size reveals that the unrated concerns are for the most part small. On the basis of the amount of capital employed, sixty-six, or 80%, of the unrated concerns were small and very small companies.

Table 36: Concerns Reporting Credit Refusal or Restriction, Classified by Credit Rating and Capital Employed

Source: The Conference Board, 1938 Bank Credit Survey

Capitalization	Total	Credit Rating in Dun and Bradstreet's Reference Book				
		High	Good	Fair	Limited	Not Rated
Number						
Total	154	26	23	22	1	82
Very Small $50,000 and under	47	4	7	12	1	23
Small $50,001–$500,000	78	17	9	9	..	43
Medium $500,001–$1,000,000	11	2	5	1	..	3
Large Over $1,000,000	14	3	2	..	..	9
Unclassifiable	4	..	..	..	..	4
Percentage Distribution						
Total	100.0	100.0	100.0	100.0	100.0	100.0
Very Small $50,000 and under	30.5	15.4	30.4	54.5	100.0	28.0
Small $50,001–$500,000	50.6	65.4	39.1	40.9	..	52.4
Medium $500,001–$1,000,000	7.1	7.7	21.7	4.5	..	3.7
Large Over $1,000,000	9.1	11.5	8.7	..	..	11.0
Unclassifiable	2.6	..	..	..	..	4.9

TABLE 37: CONCERNS REPORTING CREDIT REFUSAL OR RESTRICTION, CLASSIFIED BY CREDIT RATING AND NUMBER OF EMPLOYEES

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Number of Employees	Total	Credit Rating in Dun and Bradstreet's Reference Book				
		High	Good	Fair	Limited	Not Rated
			Number			
Total	154	26	23	22	1	82
Very Small						
20 and under	29	2	4	2	1	20
21–50	26	6	..	7	..	13
51–100	22	3	3	3	..	13
Small						
101–250	21	4	6	3	..	8
Medium						
251–500	7	2	2	1	..	2
Large						
501–1,000	4	..	2	..	..	2
Very Large						
Over 1,000	2	1	..	..	..	1
Unclassifiable	43	8	6	6	..	23
			Percentage Distribution			
Total	100.0	100.0	100.0	100.0	100.0	100.0
Very Small						
20 and under	18.8	7.7	17.4	9.1	100.0	24.4
21–50	16.9	23.1	..	31.8	..	15.9
51–100	14.3	11.5	13.0	13.6	..	15.9
Small						
101–250	13.6	15.4	26.1	13.6	..	9.8
Medium						
251–500	4.5	7.7	8.7	4.5	..	2.4
Large						
501–1,000	2.6	..	8.7	..	..	2.4
Very Large						
Over 1,000	1.3	3.8	..	..	..	1.2
Unclassifiable	27.9	30.8	26.1	27.3	..	28.0

When the number of employees is used as a criterion of size, it is found that forty-six, or considerably more than one-half of the unrated concerns had one hundred or fewer employees.

It is significant that the percentage of concerns accounted for by the very small firms increases as the rating is reduced. For example, only 15% of the concerns with capital of $50,000 or less were rated High, 30% were rated Good, and 55% were

rated Fair. This tendency is observable only when the capital employed is used as the basis for the classification according to size. Other things being equal, a much higher degree of correlation between capital employed and the ability to obtain credit accommodation is to be expected than between number of employees and credit power.

Despite the tendency to which reference has just been made, the data do not afford convincing proof that the size of the concern was the most important factor leading to credit refusal or restriction. In general, size was probably more important than either the nature of the industry in which the concern is engaged or its geographical location. The stated reasons for refusals or restrictions, which have been analyzed, included a variety of reasons that do not bear any relation to size. Further analysis is necessary before a final appraisal of the relative importance of various contributing factors can be made. It is particularly desirable to determine, in so far as possible, whether the need of the concern was primarily for bank credit in its short-term or seasonal employments, for intermediate credits, or for additional equity capital.

WERE BANK CREDIT NEEDS INVOLVED?

If the requirements of strict commercial banking theory are to be met, bank credit should be advanced to industrial concerns primarily for financing transactions that are self-liquidating in character. According to this view, bank credit should never be regarded as a permanent or semi-permanent part of the working capital of a business. The test most frequently applied in determining whether a loan is a commercial loan in the strict sense is that repayment is or will be made as a result of completed business transactions rather than from earnings. In practice, however, bank credit has been made available for a variety of purposes, often for relatively long periods of time, and theoretical requirements have never been fully observed.

If the view that industrial and commercial loans by banks should be confined to short-term transactions is accepted, then a large number of the refusals or restrictions reported did not actually involve refusal or restriction of bank credit. A careful examination of the returns from the 154 concerns reporting bank credit refusal or restriction indicates that fifty-eight, or more than one-third of the total, probably required credit for an intermediate period of from one to five years. Funds were needed to replenish or build up working capital without reference to any given business transactions as sources of funds for repayment. In twelve of the fifty-eight cases it is probable that the problem could have been met most satisfactorily by a combination of intermediate credit and new equity capital. The earnings records of these concerns appeared to be sufficiently stable to justify loans to be repaid in instalments over a period of not more than five years, but additional equity capital seemed essential for a balanced financial structure.

The concerns that probably required credit for an intermediate period are classified in Table 38 by industry, by amount of capital, and according to the reasons for refusal or restriction. It is noteworthy that forty-seven of the fifty-five concerns that could be classified according to the amount of capital employed were either small or very small concerns with capital of $500,000 or less. Of the seventy reasons for credit refusal or restriction that were reported by the fifty-eight concerns included in the table, thirty-nine were based on the policy of the bank, twenty-four on the condition of the concern and seven on legal limitations and requirements of examiners.

Additional equity capital was probably required by twenty-nine concerns. This figure includes the twelve concerns which appeared able to solve their financial problems by a combination of equity capital and intermediate credit. The remaining seventeen concerns either had not been able to

show a satisfactory record of earnings in recent years or were operating on so small a margin of equity capital that additional capital seemed to be the only logical solution. The twenty-nine concerns are classified by industry, by amount of capital employed, and according to the reason for credit refusal or restriction in Table 39.

From the above analysis it appears that seventy-five concerns or almost one-half of those reporting credit refusal or restriction probably did not require bank credit in its short-term uses. There is doubtless a considerable margin of error in this figure, because the judgment of the compiler plays an important part in these classifications. A related factor is

TABLE 38: CASES OF CREDIT REFUSAL OR RESTRICTION TO CONCERNS PROBABLY REQUIRING INTERMEDIATE OR TERM CREDIT, CLASSIFIED BY INDUSTRY, BY AMOUNT OF CAPITAL EMPLOYED, AND BY REASON FOR CREDIT REFUSAL OR RESTRICTION

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Industry	Total	Classification by Amount of Capital					Reason for Refusal or Restriction[1]		
		Very Small	Small	Medium	Large	Unclassifiable	Legal Limitation and Requirements of Examiners	Policy of the Bank	Condition of Concern Applying for Credit
Total	58	12	35	2	6	3	7	39	24
Metal working and machine manufacturing	17	5	9	..	2	1	1	13	7
Paper and pulp	3	..	3	..	..	..	1	1	2
Textiles	6	1	2	1	2	..	1	4	4
Food	2	..	2	..	..	..	..	2	..
Chemicals, paint and varnish	1	..	1	..	..	..	..	1	1
Lumber and millwork	9	2	6	..	1	..	1	8	..
Leather	2	1	1	..	..	..	..	..	2
Stone, clay and glass	2	..	1	..	1	..	..	1	2
Rubber	1	..	1	..	..	..	..	1	..
Liquors and beverages	3	..	3	..	..	..	..	3	..
Miscellaneous manufacturing	7	2	5	..	..	..	1	3	5
Extractive industries	2	..	1	1	..	..	1	1	..
Service	1	1	..	..	..	..	1	..	1
Unclassifiable	2	..	..	..	..	2	..	1	..

[1] The total number of cases, 70, exceeds the total number of returns tabulated, 58, because 12 cases warranted a double classification.

that detailed information in regard to financial structure was not requested. The classifications are based primarily on information furnished voluntarily by the executives that replied to the questionnaire.

TABLE 39: CASES OF CREDIT REFUSAL OR RESTRICTION TO CONCERNS PROBABLY REQUIRING EQUITY CAPITAL, CLASSIFIED BY INDUSTRY, BY AMOUNT OF CAPITAL EMPLOYED, AND BY REASON FOR CREDIT REFUSAL OR RESTRICTION

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

Industry	Total	Classification by Amount of Capital				Reason for Refusal or Restriction[1]		
		Very Small	Small	Medium	Large	Legal Limitation and Requirements of Examiners	Policy of the Bank	Condition of Concern Applying for Credit
Total	29	9	14	2	4	4	19	13
Metal working and machine manufacturing	9	3	5	..	1	2	5	4
Paper and pulp	5	..	3	2	..	..	3	2
Textiles	4	1	2	..	1	1	3	1
Clothing	1	1	..	..	..	..	1	1
Chemicals, paint and varnish	1	..	1	..	..	..	1	1
Lumber, millwork and furniture	4	2	..	..	2	..	2	2
Stone, clay and glass	4	2	2	..	..	1	3	2
Extractive industries	1	..	1	..	..	..	1	..

[1] The total number of cases, 36, exceeds the total number of returns tabulated, 29, because 7 cases warranted a double classification.

THE ROLE OF THE BANKS

There was a complete absence of uniformity among the opinions of executives of industrial concerns in regard to the proper role of banks in the financing of industry. A number of executives stated or implied that they did not believe that the banks should make loans to industry to run for a period of years, repayment to be made gradually out of earnings. At the other extreme, a few who plainly required equity capital were critical of the banks that had refused their requests for loans. Several of the executives who took the position that the banks were justified in refusing intermediate and long-term loans were definitely interested in loans of these types, but were of the opinion that the refusal represented a sound course on the part of the banks. The majority of the executives of concerns reporting credit refusal or restriction who expressed an opinion believed that intermediate loans to high-grade concerns represent a safe and profitable medium for the employment of banking funds.

When only the replies received from those concerns that reported no bank credit experience or no bank credit difficulty are considered, the comment in regard to the banking situation offered most frequently was that all deserving borrowers are being taken care of under existing credit facilities. Of the 1,601 concerns in these two categories, the executives of 326, or slightly more than 20%, made this observation. The importance of these figures is enhanced when it is considered that the information was not furnished in reply to a direct question. In any event, a large number of industrial executives are of the opinion that the banks have been meeting the credit requirements of industry.

It is only fair to observe that the absence of any unanimity of opinion as to the proper role of the banks in the financing of industry is not a phenomenon that is confined to industrial executives. One economist writing in 1933 reached the conclusion that the essential element in banking reconstruction was the elimination of the power of the banking system to create long-term credit.[1] One of the principal theses developed by this writer was that all investment credits extended by commercial banks represent unstabilizing and unbalancing influences. If this extreme point of view were accepted as a basis for banking policy, all intermediate and long-term loans to industry by commercial banks would be automatically eliminated. At the other extreme are those who, in discussing industrial and commercial loans, do not deem it neces-

[1] O. K. Burrell, "Essential Elements in Banking Reconstruction," *Harvard Business Review*, October, 1933, p. 12 ff.

sary to differentiate between short-term, intermediate, and long-term loans.

Analysis of the conditions under which banks might consider adding intermediate or long-term loans to their portfolios is beyond the scope of this study. It seems appropriate to point out, however, that these loans are more nearly comparable to investments than to short-term, self-liquidating loans. Their principal characteristics are the absence of both liquidity and ready marketability.

The problems incident to these loans have recently been analyzed in another study,[1] in which it was concluded that the making of term loans offers a significant avenue for expansion of the earning assets of American banks. The authors were careful to observe that the removal of obstacles that formerly existed to the making of these loans "should not blind a bank to the serious dangers involved in adding unduly to holdings of non-liquid and non-marketable assets, as well as to the added risks involved in term loans, such as an adverse turn in the business cycle during their life or management and technical changes." Further, "the volume of such loans any one bank can make will depend upon the nature of its deposit liabilities; the volume of its holdings of other non-liquid and non-marketable assets, such as real estate loans and bonds subject to substantial declines under adverse conditions; the quality of such loans available to it; and the ratio of capital resources to its deposits."

The Attitude of Industry Toward the Banks

An examination was made of the comments offered by industrial executives for the purpose of determining the attitude of industry toward the banks. The replies from 785 concerns indicated a favorable attitude. The replies from 802 concerns did not include any comments that could be

[1] "Term Loans by Commercial Banks," by the Institute of International Finance of New York University, published by Association of Reserve City Bankers, Chicago, 1938.

construed as either favorable or critical. It is probable that most of these concerns were satisfied with their banking facilities, or had no complaints that were deemed of sufficient importance to include in their replies. This inference is suggested by the fact that a request for suggestions as to how the credit situation of industry might be improved was included in the questionnaire. A specific opportunity was thereby given concerns that were not satisfied with available credit facilities to express their dissatisfaction. It would appear, therefore, that 1,587 concerns, or slightly over 90% of all concerns reporting, either enjoyed relations with their banks that were so satisfactory as to elicit favorable comments or had no specific basis for dissatisfaction.

The replies of the remaining 168 concerns, comprising 9.6% of all concerns reporting, included comments that indicated a critical attitude toward the banks. Some of the more frequent complaints are listed below. The order in which they are listed, however, has no significance.

Complaints Against Banks

1. The lending policies of the banks are too conservative.
2. The banks have not met the requirements of small industries.
3. There is a general lack of knowledge of the conditions of production and distribution in various lines of industry, and hence a lack of familiarity with credit requirements.
4. An excessive amount of collateral is required by the banks.
5. The banks require too high a ratio of current assets to current liabilities.
6. The banks are unwilling or unable to participate in long-term loans.
7. Interest charges are excessive.
8. The banks are not willing to extend small personal loans, particularly those involving distribution credits.

9. The banks are not willing to grant unsecured or character loans.

10. The banks have called loans made for emergency purposes at times when the borrower was financially embarrassed.

11. The banks are unwilling to make loans to new enterprises.

12. The banks are unwilling to make loans to textile concerns.

13. The banks are unwilling to make loans to concerns in the liquor industry.

14. Banking facilities are inadequate in a few locations that are remote from large population centers.[1]

[1] Replies to the fifth question included in the survey are not analyzed in detail in this study. This question was a request for suggestions for the improvement of the credit situation of industry. Changes in governmental policies were suggested most frequently. The extension of term loans by banks and more liberal extension of distribution credits were emphasized by a number of concerns, several of which suggested that regional credit pools should be established by the banks for the purpose of making intermediate and long-term loans to industry.

CHAPTER IV

THE INDUSTRIAL ADVANCE PROGRAMS OF THE GOVERNMENT

During the period covered by the survey, the credit facilities normally available to industrial and commercial borrowers were supplemented by advances made available through the Reconstruction Finance Corporation and the Federal Reserve banks. Two questions were asked for the purpose of ascertaining the extent to which the concerns replying to the questionnaire had solicited assistance from these agencies and their opinion as to the necessity for the continuance of the industrial advance programs. Before considering these questions and the replies received, it is desirable to consider briefly the development of these programs, with particular reference to the types of loans that may be made and the restrictions that are imposed. Data for the amount of loans authorized, the amounts disbursed and repaid, and loans outstanding on selected dates will also be presented.

Loans by the Reconstruction Finance Corporation

The industrial advance program of the Reconstruction Finance Corporation dates from June 19, 1934, when a new section was added to the Reconstruction Finance Corporation Act.[1] Prior to this time, loans to industry could be made through mortgage loan companies under the so-called N.R.A. program. The latter plan, which was developed in October, 1933, encouraged industrial concerns in a community to form cooperative groups for the purpose of soliciting loans from the Corporation. Loans were made to the local mortgage

[1] Section 5d.

loan companies for not more than three years at an interest rate of 4%, and it was stipulated that the funds could not be reloaned at more than 6%. Total disbursements on account of loans to business enterprises through mortgage loan companies amounted to $5.7 million to June 30, 1938, and on this date only $1.4 million remained outstanding.[1]

The Act of June 19, 1934 authorized the Corporation to make loans to any industrial or commercial business established prior to January 1, 1934, provided that credit at prevailing bank rates for the character of loans applied for is not otherwise available at banks. It was also provided that such loans could be made directly, or in cooperation with banks or other lending institutions, or by the purchase of participations. Loans had to be adequately secured and were to have a maturity of not more than five years. Other requirements were that loans to any one borrower could not exceed $500,000, that the borrower must be solvent, and that the loans could be made only when deemed to offer reasonable assurance of continued or increased employment of labor.[2]

It was expressly provided that the aggregate amount of loans to industry and business outstanding at any one time could not exceed $300 million. This provision is a reflection of the view, then widely held, that there was a large demand for credit accommodation that was not being met by the banks and other privately-owned financial institutions. The authority to make such loans was granted only for the period ending January 31, 1935, or on such earlier date as the President might fix by proclamation.[3]

The effective period for authorizing direct loans to industrial and commercial borrowers under Section 5d of the Reconstruction Finance Act was extended to January 31, 1937,

[1] Quarterly Report of the Reconstruction Finance Corporation for the period ended June 30, 1938.

[2] Session Laws, 73rd Congress, Second Session, Ch. 653, Section 5.

[3] *Idem.*

by an act approved on January 31, 1935.[1] An important amendment provided that any loans made must mature not later than January 31, 1945. The limitation of not more than $500,000 to any one borrower was eliminated. The statute, as amended, was extended to June 30, 1939 by an act approved January 26, 1937.[2]

The statute relating to loans to industrial and commercial borrowers was completely rewritten in an act approved on April 13, 1938, which extended the power of the Corporation to make this type of loan to June 30, 1939.[3] In its revised form the restrictions in regard to maturity and maximum total loans outstanding were removed. The Corporation was specifically authorized to purchase the securities and obligations of business enterprises. At the time of the revision, the Chairman stated that purchase of stock would not be permitted under the official interpretation of the Act.

Amount of Loans Made

Disbursements and repayments on account of loans[4] to industrial and commercial borrowers are shown by quarterly periods in Table 40. The amount outstanding at the end of each quarter of the 4-year period ended June 30, 1938 is also shown. Disbursements on account of these loans exceeded $10 million only in the quarters ended September 30, 1935 and March 31, 1936. Total disbursements under Section 5d for the 4-year period amounted to $106 million, and repayments were $30 million. Of the total of $76 million outstanding on June 30, 1938, $70.8 million was on account of loans and $5.6 million on account of purchases of participations.

The marked increases in authorizations and disbursements in the second quarter of 1938 resulted in part from the liberal-

[1] Session Laws, 74th Congress, First Session, Chapter 2, Section 10.

[2] Session Laws, 75th Congress, First Session, Chapter 6, Section 1.

[3] Session Laws, 75th Congress, Third Session, Chapter 140.

[4] Including purchases of participations in loans.

'ABLE 40: INDUSTRIAL ADVANCES[1] BY THE RECONSTRUCTION FINANCE CORPORATION, JULY, 1934 TO JUNE, 1938

Source: Quarterly Reports of the Reconstruction Finance Corporation

Thousands of Dollars

Quarter Ended	Authorizations	Disbursements	Repayments	Net Increase (+) Decrease (−) in Amount Outstanding	Amount Outstanding at End of Quarter
ıne 30, 1934	925	..	..	..	..
eptember 30, 1934	11,425	1,916	..	+ 1,916	1,916
ecember 31, 1934	16,193	4,827	117	+ 4,710	6,626
Iarch 31, 1935	14,672	6,274	162	+ 6,112	12,738
ıne 30, 1935	22,148	9,516	594	+ 8,922	21,661
eptember 30 ,1935	23,552	11,226	663	+10,563	32,225
ecember 31, 1935	12,664	8,659	1,059	+ 7,600	39,825
Iarch 31, 1936	12,257	10,003	1,620	+ 8,383	48,209
ıne 30, 1936	9,984	6,148	1,845	+ 4,303	52,511
eptember 30, 1936	12,215	7,105	2,036	+ 5,069	57,580
ecember 30, 1936	7,938	9,038	3,255	+ 5,783	63,363
Iarch 31, 1937	7,700	3,879	3,867	+ 12	63,375
ıne 30, 1937	4,585	9,422	2,331	+ 7,091	70,467
eptember 30, 1937	4,530	5,082	2,533	+ 2,549	73,015
ecember 31, 1937	2,870	4,883	3,350	+ 1,533	74,548
Iarch 31, 1938	4,537	1,411	3,369	− 1,958	72,590
ıne 30, 1938	35,127	6,780	2,997	+ 3,783	76,372

[1] Under Section 5d of the Reconstruction Finance Corporation Act. Loans through banks and ortgage loan companies and loans to the fishing industry under Section 5 are excluded.

zation of the statute in April. Disbursements in the third uarter of 1938 exceeded those for any previous quarterly eriod, amounting to only a little less than $20 million. Disursements by months in the last half of 1938 were as follows:

July	$5,650,000
August	5,380,000
September	8,961,000
October	10,858,000
November	7,699,000
December	5,723,000

Officials of the Reconstruction Finance Corporation state hat in this period numerous small loans ranging as low as 500 were made.

Classification of Loans by Industries

Disbursements of the Corporation under the industrial advance program are classified according to industry in Table 41. Manufacturing concerns accounted for 85% of total disbursements and 61% of the number of applications approved. Trade companies accounted for 5% of disbursements and 14% of the number of applications. All other concerns, including a number of fruit growers, accounted for 10% of disbursements and 25% of the number of applications.

TABLE 41: NUMBER OF BORROWERS AND DISBURSEMENTS ON ACCOUNT OF INDUSTRIAL ADVANCES[1] BY THE RECONSTRUCTION FINANCE CORPORATION, CLASSIFIED BY INDUSTRY, FEBRUARY 2, 1932, TO JUNE 30, 1938

Source: Quarterly Report of the Reconstruction Finance Corporation

Industry	Number of Borrowers[2]		Amount Disbursed	
	Number	Percentage Distribution	Thousands of Dollars	Percentage Distribution
Total	3,868	100.0	112,703	100.0
Manufacturing	2,363	61.1	95,960	85.1
Food and kindred products	414	10.7	6,816	6.0
Textiles and their products	355	9.2	23,863	21.2
Lumber and timber products	425	11.0	16,035	14.2
Paper and allied products	70	1.8	7,697	6.8
Printing and allied products	125	3.2	1,157	1.0
Chemicals and allied products	95	2.5	2,521	2.2
Rubber products	21	0.5	942	0.8
Leather and its manufactures	62	1.6	2,094	1.9
Stone, clay and glass products	215	5.6	8,960	8.0
Iron, steel and their products (excluding machinery)	199	5.1	10,641	9.4
Nonferrous metals and their products	114	2.9	3,945	3.5
Machinery (excluding transportation equipment)	204	5.3	7,182	6.4
Transportation equipment[3]	64	1.7	4,107	3.6
Trade	536	13.9	5,733	5.1
Wholesale	207	5.4	1,897	1.7
Retail	329	8.5	3,836	3.4
All other	969[a]	25.1	11,011	9.8

[1] Includes loans through banks and mortgage loan companies and loans to the fishing industry under Section 5 of the Reconstruction Finance Corporation Act.
[2] Number of borrowers represents the number of applicants to whom loans have been authorized or commitments made.
[3] Automobile accessories, etc.
[a] Includes 612 fruit growers located in the state of Washington.

Of the manufacturing groups, textiles ranked first and lumber and timber second in the amount of money received from the Corporation. The textile group accounted for 21% of all disbursements and the lumber and timber group for 14%.

Size of Loans

Data concerning the size of the industrial advances are available only on the basis of amounts authorized. Loans for $10,000 or less accounted for 46% of the total number of loans authorized to June 30, 1938, but for only 3.2% of the total amount authorized. Loans greater than $10,000 but not over $100,000 represented 43% of the number of authorizations and 30% of the amount authorized. Loans of more than $500,000 also accounted for 30% of the amount authorized, but for only 1% of the total number of loans.[1]

Loans by Federal Reserve Banks

According to the theory of central banking that was accepted at the time the Federal Reserve System was established, the lending operations of the Federal Reserve banks should be restricted to banking institutions. In recent years there have been significant departures from the principles that were originally accepted. As a result, industrial and commercial borrowers can now obtain loans directly from the Federal Reserve banks, provided certain conditions can be met.

Direct loans to individuals, partnerships and corporations were first authorized on July 21, 1932.[2] These loans could be made only when approved by at least five members of the Federal Reserve Board and only in cases where the applicant had been unable to secure adequate credit accommodation from other banks. Direct loans to individuals and

[1] Quarterly Report of the Reconstruction Finance Corporation, for the period ended June 30, 1938, Table 9.

[2] Emergency Relief and Construction Act of 1932, Section 210.

business concerns, when secured by direct federal obligations, were authorized by the Emergency Banking Act approved on March 9, 1933.[1] The maturity could not exceed ninety days, and the loans were made subject to such limitations and restrictions as the Federal Reserve Board might establish.[2]

The Act of June 19, 1934 authorized direct loans by the Federal Reserve banks for industrial and commercial purposes within their respective districts, provided the business is unable to obtain financial assistance on a reasonable basis from the customary sources.[3] Two important restrictions were imposed: (1) The loans could be made only for working-capital purposes; and (2) no loan or commitment with a maturity of more than five years could be accepted.

The Federal Reserve banks were also authorized to discount for, or purchase from, banks and other financing institutions in their respective districts obligations having maturities not exceeding five years, provided the obligations had been incurred for the purpose of obtaining working capital for an industrial or commercial business. Loans to banks and financing institutions secured by such obligations were also authorized. In addition, the Federal Reserve banks were authorized to enter into commitments with banks and financing institutions to discount or purchase, or to make loans on the security of, qualified paper within a stipulated period. Each bank or financing institution is required to obligate itself for 20% of any loss which might be sustained by the Federal Reserve bank on industrial advances acquired. In lieu of this obligation, the bank or financing institution may advance 20% of the loan from its own funds. When this is done the entire loan must be considered as one advance.

[1] Section 403.

[2] For a good résumé of all emergency loan legislation affecting the Federal Reserve banks prior to 1936, see James C. Dolley, "The Industrial Advance Program of the Federal Reserve System," *Quarterly Journal of Economics*, February, 1936, p. 233 ff.

[3] Session Laws, 73rd Congress, Second Session, Chapter 653, Section 1. This section amended the Federal Reserve Act by adding Section 13b.

Because of the opinion that there would be a very large demand for loans, the aggregate loans, advances and commitments on account of industrial advances of the twelve banks combined were limited to a maximum of about $278 million at any one time. The statutory limitation which results in this figure provided that industrial advances could not exceed the combined surplus of the Federal Reserve banks on July 1, 1934, plus $139 million to be paid to the banks in the repurchase by the Treasury of stock in the Federal Deposit Insurance Corporation.[1]

Amount of Loans and Commitments

From June 19, 1934 to October 19, 1938, 9,283 applications for industrial advances were received. The total amount requested was $396 million. Of the applications received, the Industrial Advisory Committees for the several Federal Reserve districts recommended the approval of 2,909, or 31% of the number of applications. They amounted to $180 million, or 45% of the aggregate amount for which applications were received. In the same period the Federal Reserve banks approved 2,628 applications, amounting to $173 million, or 28% of the number of applications and 44% of the aggregate amount for which application was made.[2]

The industrial advances outstanding and obligations assumed on account of commitments are shown in Table 42 as of selected dates. Both advances and commitments outstanding reached a peak at the end of 1935. The trend in advances outstanding in recent months has been downward, while commitments and participations by financing institutions have shown an upward trend.[3]

[1] *Idem.*

[2] *Federal Reserve Bulletin*, November, 1938, p. 985.

[3] The marked difference between the sum of the three items in Table 42 and total applications approved is attributable primarily to repayments, withdrawals by applicants, and the expiration of commitments, which amounted to $123 million to Oct. 19, 1938. On that date, applications approved but not completed amounted to $7.9 million.

TABLE 42: INDUSTRIAL ADVANCES, COMMITMENTS AND FINANCING INSTITUTION PARTICIPATIONS UNDER SECTION 13B OF THE FEDERAL RESERVE ACT, OUTSTANDING ON SELECTED DATES

Source: *Federal Reserve Bulletin*

Thousands of Dollars

Date	Advances Outstanding	Commitments Outstanding	Financing Institution Participations Outstanding
December 26, 1934	13,589	8,225	1,296
March 27, 1935	20,785	15,732	2,472
June 26, 1935	27,518	20,579	4,533
September 25, 1935	30,132	26,892	7,060
December 31, 1935	32,493	27,649	8,778
March 25, 1936	30,947	25,421	7,550
June 24, 1936	30,487	24,454	7,599
September 30, 1936	28,885	23,307	7,276
December 30, 1936	25,533	20,959	7,208
March 31, 1937	23,054	18,611	6,767
June 30, 1937	23,014	16,331	7,275
September 29, 1937	21,395	14,880	7,304
December 29, 1937	20,200	12,780	7,238
March 30, 1938	19,366	13,110	7,825
June 29, 1938	18,439	13,649	8,426
September 28, 1938	17,562	13,597	9,032

Loans and Commitments by Industries

Advances and commitments by the Federal Reserve banks from June 19, 1934 to December 29, 1937 are classified according to industry in Table 43. A total of $77 million was advanced to 1,484 borrowers in this period. Commitments numbered 943 and amounted to a little less than $74 million. Manufacturing concerns accounted for 54% of the number of advances and about 77% of the amount of advances. The comparable proportions for commitments were 59% and 67.5%, respectively.

Size of Loans

Data relating to the size of loans are available only on the basis of advances and commitments approved. From June, 1934 to the end of 1937, loans of $10,000 or less accounted for 37% of the number of advances and commitments approved,

TABLE 43: INDUSTRIAL ADVANCES AND COMMITMENTS BY FEDERAL RESERVE BANKS, CLASSIFIED BY INDUSTRY, JUNE 19, 1934 TO DECEMBER 29, 1937

Source: Annual Report of the Federal Reserve Board. Computed by THE CONFERENCE BOARD

Industry	Applications Received		Advances		Commitments	
	Number	Thousands of Dollars	Number	Thousands of Dollars	Number	Thousands of Dollars
Total	8,677	362,292	1,484	77,130	943	73,855
Manufacturing	3,981	237,909	805	59,225	557	49,886
Food products	489	14,325	108	3,053	44	1,909
Textiles	248	21,994	51	5,575	35	3,756
Lumber and builders' supplies	378	19,161	72	4,640	71	5,910
Paper products	115	8,972	27	3,257	19	1,789
Chemicals and allied products	139	3,503	22	763	13	264
Autos, trucks and accessories	117	26,115	23	9,392	28	10,689
Liquors, wines and beer	222	21,482	24	1,515	28	3,743
Machinery and machine tools	326	19,296	82	5,164	40	3,111
Metals	317	25,589	73	5,634	42	3,785
Stone, clay and glass products	152	6,876	34	808	19	2,020
Wearing apparel, shoes, etc.	414	10,715	77	3,040	56	2,164
Wood products	140	4,420	29	470	19	840
Electrical goods	80	5,170	15	811	16	1,151
Furniture, office and household equipment	296	14,083	59	2,922	47	2,959
Hides and leather	69	2,325	7	331	4	206
All other	479	33,883	102	11,850	76	5,590
Trade, wholesale and retail	3,149	66,105	446	8,319	270	13,015
All other	1,547	59,278	233	9,586	116	10,954

Percentage Distribution

Industry	Applications Received: Number	Applications Received: Thousands of Dollars	Advances: Number	Advances: Thousands of Dollars	Commitments: Number	Commitments: Thousands of Dollars
Total	100.0	100.0	100.0	100.0	100.0	100.0
Manufacturing	45.9	65.7	54.2	76.8	59.1	67.5
Food products	5.6	4.0	7.3	4.0	4.7	2.6
Textiles	2.9	6.1	3.4	7.2	3.7	5.1
Lumber and builders' supplies	4.4	5.3	4.9	6.0	7.5	8.0
Paper products	1.3	2.5	1.8	4.2	2.0	2.4
Chemicals and allied products	1.6	1.0	1.5	1.0	1.4	0.4
Autos, trucks and accessories	1.3	7.2	1.5	12.2	3.0	14.5
Liquors, wines and beer	2.6	5.9	1.6	2.0	3.0	5.1
Machinery and machine tools	3.8	5.3	5.5	6.7	4.2	4.2
Metals	3.7	7.1	4.9	7.3	4.5	5.1
Stone, clay and glass products	1.8	1.9	2.3	1.0	2.0	2.7
Wearing apparel, shoes, etc.	4.8	3.0	5.2	3.9	5.9	2.9
Wood products	1.6	1.2	2.0	0.6	2.0	1.1
Electrical goods	0.9	1.4	1.0	1.1	1.7	1.6
Furniture, office and household equipment	3.4	3.9	4.0	3.8	5.0	4.0
Hides and leather	0.8	0.6	0.5	0.4	0.4	0.3
All other	5.5	9.4	6.9	15.4	8.1	7.6
Trade, wholesale and retail	36.3	18.2	30.1	10.8	28.6	17.6
All other	17.8	16.4	15.7	12.4	12.3	14.8

and for 3% of the total amount. Loans of over $10,000 but not more than $100,000 accounted for 51% of the number of advances and commitments and 33% of the amount. Only forty loans in excess of $400,000 were approved to the end of 1937, but they represented an aggregate amount of $45 million, or 30% of the total for advances and commitments approved.[1]

Maturity and Rate of Interest

The industrial advances outstanding are classified according to maturity in the weekly reports of the condition of the Federal Reserve banks.[2] Prior to 1937, all advances with maturities in excess of six months were included under a single heading. At the end of 1935, when advances outstanding reached their peak, advances with a maturity in excess of six months amounted to $27.5 million, or 85% of the total. On January 6, 1937, the date of the first report in which a breakdown of maturities in excess of six months was presented, advances maturing in six months to one year amounted to $4.3 million, maturities of one year to two years were $5.9 million, and maturities of two years to five years amounted to $10 million. These amounts were equivalent to 18%, 24% and 41%, respectively, of all industrial advances outstanding. On September 28, 1938, advances maturing in six months to one year accounted for 22% of total advances, maturities of one year to two years for 33%, and maturities of two years to five years for 16% of total advances.[3]

The rates charged on advances made directly to industrial and commercial borrowers ranged from 3½% to 6% on

[1] Computed from data in the "Annual Report of the Board of Governors of the Federal Reserve System, 1937," p. 61.

[2] The maturity distribution in the weekly report of condition is based on the period that will expire between the date of the report and the maturity of the obligation.

[3] The percentages in this paragraph are based on total advances distributed according to maturity, which differ from total advances outstanding by the amount of advances more than three months past due which are included under "All Other Assets."

October 31, 1938, as is shown in Table 44. The rates on advances to financing institutions were generally lower than for direct advances. Rates on commitments ranged from ½% to 2%.

TABLE 44: FEDERAL RESERVE BANK RATES ON INDUSTRIAL ADVANCES IN EFFECT OCTOBER 31, 1938

Source: *Federal Reserve Bulletin*

Per Cent

Federal Reserve Bank	Advances Direct to Industrial or Commercial Organizations	Advances to Financing Institutions: On Portion for Which Institution is Obligated	Advances to Financing Institutions: On Remaining Portion	Commitments to Make Advances
Boston	3½–6	3	3½	½–1
New York	4–6	3	4–5	1–2
Philadelphia	4–6	2½	[2]	½–2
Cleveland	4½–6	3½	4	1
Richmond	6	4–6	4–6	1–2
Atlanta	5–6	5	5	½
Chicago	5–6	2½[1]	5–6	1–2
St. Louis	4–5½	3½	4	½
Minneapolis	6	4½–5	4½–5	1
Kansas City	4–6	4	4	½–2
Dallas	5–6	4	5–6	1
San Francisco	5–6	3–4	4–5	½–2

[1] Authorized rate 1% above prevailing discount rate.
[2] Same as to borrower but not less than 4%.

EXPERIENCE OF CONCERNS REPORTING

Two questions were asked for the purpose of ascertaining the extent to which the concerns replying to the questionnaire had solicited assistance from the Reconstruction Finance Corporation and the Federal Reserve banks. The first question was: Have you applied for credit to any government lending agency, such as the Reconstruction Finance Corporation or the Federal Reserve banks, at any time since 1932? If the reply was in the affirmative, the concern was asked to answer the following specific questions: (a) Did your request follow refusal by a commercial bank? (b) Was your request granted in whole or in part? (c) Was your request considered at least as promptly as requests made of commercial banks? (d) Were the credit standards applied appreciably less rigid

than those of commercial banks in your community? The second question was: Regardless of any experience with government lending agencies, do you feel that they are now necessary in order that the credit needs of industry may be met?

Of the 1,755 concerns that replied to the questionnaire, 159 had applied for accommodation to the Reconstruction Finance Corporation or the Federal Reserve banks. The distribution of these concerns according to their bank credit

TABLE 45: DISTRIBUTION OF CONCERNS REPORTING, CLASSIFIED ACCORDING TO WHETHER OR NOT THEY APPLIED FOR ACCOMMODATION UNDER THE INDUSTRIAL ADVANCE PROGRAMS

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

	Total	Concerns Reporting: No Experience	Concerns Reporting: No Difficulty	Concerns Reporting: Refusal or Restriction
Total number of concerns reporting	1,755	448	1,153	154
Number of concerns not applying	1,556	429	1,059	68
Number of concerns applying	159	6	70	83
Unclassifiable	40	13	24	3
Percentage Distribution				
Total number of concerns reporting	100.0	100.0	100.0	100.0
Number of concerns not applying	88.7	95.8	91.8	44.2
Number of concerns applying	9.1	1.3	6.1	53.9
Unclassifiable	2.3	2.9	2.1	1.9

status appears in Table 45. A total of 83 of the 159 concerns reported refusal or restriction of bank credit. These 83 concerns represented 54% of all refusals or restrictions that were reported. Only 70, or 6%, of the 1,153 concerns reporting no difficulty in obtaining bank credit had filed applications under the industrial advance programs at the time of the survey. The comparable figures for concerns reporting no bank credit experience were 6 out of 448, or 1.3%.

It may seem unusual that seventy-six of the concerns that applied to the Reconstruction Finance Corporation or the Federal Reserve banks reported either no experience or no difficulty in obtaining bank credit. Most of these concerns did not apply to commercial banks for the accommodation desired because they recognized that the banks were not interested in the type of loan they desired. In many of these cases mortgages on industrial properties were offered as security. A few executives stated that they did not regard this type of security as a sound basis for loans by commercial banks.

TABLE 46: DISPOSITION OF APPLICATIONS UNDER THE INDUSTRIAL ADVANCE PROGRAMS, MADE BY CONCERNS REPORTING

Source: THE CONFERENCE BOARD, 1938 Bank Credit Survey

	Total	Concerns Reporting		
		No Experience	No Difficulty	Refusal or Restriction
Total number of applications	160[a]	6	70	84
Applications granted in full	64	3	41	20
Applications granted in part	19	1	6	12
Applications refused	59	1	18	40
Applications cancelled by applicant	8	..	4	4
Applications pending	10	1	1	8
Percentage Distribution				
Total number of applications	100.0	100.0	100.0	100.0
Applications granted in full	40.0	50.0	58.6	23.8
Applications granted in part	11.9	16.7	8.6	14.3
Applications refused	36.9	16.7	25.7	47.6
Applications cancelled by applicant	5.0	..	5.7	4.8
Applications pending	6.3	16.7	1.4	9.5

[a] The comparable figure in Table 45 is 159. One concern was refused credit by a Federal Reserve bank. An application was later filed with the Reconstruction Finance Corporation. A decision on this application was pending at the time of the survey.

Disposition of Applications for Loans

The disposition of applications under the industrial advance programs is shown in Table 46. The most interesting fact is that less than one-fourth of the concerns reporting bank credit refusal or restriction that applied for loans to the two agencies making industrial advances received the full amounts requested. Applications granted in full or in part accounted for 38% of the applications made by concerns reporting bank credit refusal or restriction. Of the applications by concerns reporting no bank credit difficulty, 59% were approved entire and slightly more than two-thirds wholly or in part. For all groups combined, 40% of the applications were approved in full and 12% in part.

Of the applications which had been filed up to the time of the survey, complete refusals were reported by 48% of the concerns that had experienced bank credit refusal or restriction, by 26% of the concerns that had not had any bank credit difficulty and by 17% of those reporting no bank credit experience. For the three groups combined, the ratio was 37%.

Only 104 of the concerns whose applications had been granted or refused at the time of the survey stated which of the two agencies had granted or refused the loan. The Reconstruction Finance Corporation granted thirty-three applications in full or in part, and refused forty-one requests for accommodation. The Federal Reserve banks granted twenty applications and refused ten.

Did the Application Follow Refusal by a Commercial Bank?

Answers to this question were furnished by 140 concerns, of which seventy-nine, or 56%, stated that application to the Reconstruction Finance Corporation or to the Federal Reserve bank followed refusal by a commercial bank, and sixty-one, or 44%, replied in the negative. In thirty-seven cases where the request had been refused by a bank the application was granted wholly or in part, but under similar circumstances refusals were reported by forty-two concerns. A much larger proportion of approvals was reported when application did not follow refusal by a bank. For this group forty-four applications were approved by one of the two agencies and only seventeen were refused.

Credit Standards and Promptness in Handling Applications

A total of 115 concerns replied to the question as to whether the credit standards applied by the Reconstruction Finance Corporation and the Federal Reserve banks were appreciably less rigid than those of commercial banks in the community. No less than 107, or 93%, of these concerns stated that the credit standards were as rigid as, or more rigid than, those of commercial banks. A substantial number of executives were of the opinion that excessive caution was exercised, especially by the Reconstruction Finance Corporation.

In considering the question of credit standards, it should be remembered that the average loan made by the Reconstruction Finance Corporation to industrial concerns differed in important particulars from ordinary bank loans to these concerns. Appraisals and audits by the Reconstruction Finance Corporation were necessitated in part by the type of loan, and in part by the absence of any previous credit experience. Commercial bank loans to industry are principally on a line of credit basis, the principal bases for which are satisfactory financial statements and records of earnings.

A question in regard to promptness in handling applications was answered by 109 concerns: Fifty-two stated that their requests were considered at least as promptly as requests at commercial banks and fifty-seven replied that their requests were considered less promptly.

The Need for the Lending Agencies

A total of 1,224 concerns replied to the question whether it was believed that the lending programs of government agencies[1] were necessary to meet the credit needs of industry.

[1] Including the industrial advance program of the Federal Reserve System which, strictly speaking, is not a government agency. This program, however, was instituted by the Federal Government.

Only 337, or 27.5%, stated that they believed government lending agencies were necessary.

There was a marked difference between the replies received from concerns reporting bank credit refusal or restriction and those reporting no experience or no difficulty. A total of 117 concerns that reported bank credit refusal or restriction replied to the question. Of these, eighty-five, or 73%, regarded the programs of the lending agencies as necessary. The comparable ratios for the groups reporting no bank credit experience and no bank credit difficulty were 26% and 22%, respectively.

Criticisms of the Industrial Advance Program of the Reconstruction Finance Corporation[1]

Numerous criticisms of the policies and procedure of the Reconstruction Finance Corporation were made in the questionnaire returns. In considering these criticisms, it is well to remember that the Corporation has generally followed a conservative policy in interpreting and applying the section of the statute that provides for loans to industrial and commercial businesses. This is freely admitted by officials of the Corporation.

The criticisms made most frequently were:

1. Applications for loans are refused without offering specific reasons.

2. The expenses incident to compliance with the requirements of the Corporation are excessive.

3. The total cost of the loan, including interest, expenses in connection with the application, and amortization, is excessive.

[1] Only a few criticisms of the industrial advance program of the Federal Reserve banks were noted in the replies. Several borrowers thought they were extremely conservative. Ignorance of local industrial conditions was charged by a borrower whose application was restricted.

4. The collateral requirements are excessive or too burdensome.

5. Applications for loans are not considered with reasonable promptness.

6. No consideration is given to the character of the applicant.

7. There is an almost complete absence of personal contact between lender and borrower, comparable to that found in relations with banks.

8. The Corporation has not made it possible for small businesses to use its facilities extensively.

9. Terms of the loans are at times in conflict with other federal policies such as the undistributed profits tax.

CHAPTER V

FACILITIES FOR FINANCING SMALL ENTERPRISE

THE SIGNIFICANCE of the problem of bank credit availability to industrial and commercial borrowers cannot be appraised solely on the basis of the overall figure of 8.8% for refusals and restrictions, or any similar figure. It was shown in Chapter II that refusals and restrictions of bank credit are confined primarily to small and very small concerns. In its most important aspects, the problem is one that relates to companies with a capital of $500,000 or less.

In discussions of bank credit availability to industry, it is frequently assumed that the bank credit problem is a separate and independent problem in the field of finance. Legislation is proposed on the theory that the financial difficulties of industry involve solely, or at least principally, the relationships between the banks and actual or potential borrowers from the banks. There is the inference that, if the banks can be induced to lend more freely, the financial problems of industry will be solved.

In its proper perspective, bank credit availability is merely one phase of a broader problem that involves the financing of small enterprise. The purpose of this chapter is to consider the several elements of this problem and various proposals that have as their objective the improvement of credit and related financing facilities for small businesses.

Elements of the Problem

The financial problems of small enterprise in the recent period were to a considerable extent an outgrowth of the extreme credit liquidation and deflation in the period that ended in 1933. Because of operating losses incurred, and epreciation and revaluation of assets, many small industrial oncerns entered the period of revival in a weakened financial ondition. The surplus account of the average concern was eatly reduced and capital impairment was by no means inequent. In 1933, many small companies had financial ructures that are best described as unbalanced, because of ne effects of the depression on their surplus and capital ccounts.

Rehabilitation of the financial structure of the small enterrises that had been affected most seriously required addiional equity capital or loan funds for relatively long periods. n numerous cases additional equity capital was essential for he restoration of a proper balance. Risk capital in small mounts was generally not available. The small concern isually did not have access to the capital markets, and never on a basis comparable to that available to the large, wellinanced concern. In addition, the individual capitalist who n earlier periods occasionally risked $50,000 or less in a small nterprise with which he was familiar seemed to have disppeared. The most widely used sources of additional equity apital for small business in earlier periods, such as retained earnings and investments by owners, were also relatively navailable in the early years of revival.

The enactment of the undistributed profits tax in 1936 cted as a deterrent to the normal improvement of the equity capital position of small enterprises. Many small concerns earned profits in 1934 and 1935, but 1936 was a year of very good earnings in industry. This was the first of the two years to which the tax in the extreme form found in the Revenue Act of 1936 applied. The effect of the tax on the small corporation struggling for financial rehabilitation was unfortunate. The tax at the high graduated rate schedule of from 7% to 27% was actually paid by a substantial number of small concerns, so urgent was their need for additional permanent working capital.

Under the conditions that obtained, a change in the character of industrial demand for bank credit accommodation was inevitable. An increasing proportion of requests was for funds on a term basis for the purpose of providing semipermanent additions to working capital and of financing necessary additions to plant and equipment. In the early part of the period of revival many of the banks were not in a position to consider increasing their non-liquid assets.

Prior to 1938 the attitude of the examining authorities acted as a deterrent to the development of intermediate and long-term loans to industry as a recognized part of the banking business. These loans were generally classed by examiners as slow or worse. The status of these loans has been greatly improved as a result of a revision of examination procedure put into effect in the summer of 1938, in which the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and a number of state regulatory authorities have concurred. Under current practice, prospects for earnings and repayment are given first consideration in classifying loans with relatively long maturities. For all practical purposes, banks subject to the jurisdiction of these examining authorities are now free to adopt policies with respect to intermediate and term loans that fit their particular circumstances.

Another element of the problem has to do with fiscal and related policies. Throughout the five-year period beginning in 1933, the economy was dependent on federal spending to an unprecedented extent. Much of this spending exerted a stimulating effect on business, since it involved the expenditure of funds in excess of revenue receipts. It was difficult, if not impossible, to forecast either the general business situation or the trend for a particular business, if the artificial support afforded by these expenditures should be withdrawn. This was an important consideration in those cases where credit was desired for intermediate or long periods. When a request was received for a loan to be amortized out of earnings over a period of years, there was no sound basis for forecasting earnings under a more orthodox fiscal policy. The behavior of a business during preceding business cycles was not an adequate criterion.

The dearth of venture capital in the recent period was to some extent a consequence of fiscal policy. A speculative fiscal policy having as its objective the stimulation of business activity to a higher level is not conducive to the assumption of business risks. This observation applies to forward commitments of almost every kind, but it is especially applicable to the employment of additional capital in undertakings that involve greater than average risks.

Another aspect of the problem is that federal surtax rates were increased to the unusually high maximum of 75%. Income taxation that provides for a maximum combined rate of 79%, together with a high level of average effective rates on all large incomes, acts as a deterrent to the investment of capital in equities by those most able to assume the risks involved. The high surtax rates have been justified in part on the ground of fiscal requirements. In a lesser degree they are a reflection of the consumer-purchasing-power approach to our economic problems and the belief that there is a strong tendency toward oversaving.

From the standpoint of small enterprise, the most serious fiscal development in the period ending in 1938 was the adoption of the undistributed profits tax, to which reference has been made. The advocates of this tax assumed that there was a degree of uniformity among business enterprises that did not exist. In particular, the fact that developing industries which are too small to obtain access to the central capital markets rely upon earnings for a large part of their capital requirements seems to have been overlooked entirely.

Throughout the period from 1933 to 1938 an easy-money policy was followed by the Federal Government. The Treas-

ury favored an easy-money policy in order that the huge financial operations incident to deficit financing could be carried through on a low-cost basis. In addition, this policy seemed to be justified on the ground that low money rates facilitate recovery. From the standpoint of the banks, extremely low money rates were undesirable for the reason that earnings were affected adversely. Because of their low earning power, banks generally were not in a position to allocate substantial amounts to reserves and surplus. Unsatisfactory earnings in turn affected the decisions of bankers in regard to the assumption of risks. With operating income so low that adequate reserves could not be established from income, there was a tendency on the part of some bankers to follow a conservative course in the case of any loan or investment opportunity that carried more than a minimum of risk.

Proposed Improvements in Financing Facilities

In the past few years various plans and suggestions have been offered, which have as their objective the improvement of the credit and other financing facilities available to business enterprise. The underlying assumption in these proposals is that there is a legitimate demand for credit and investment funds, principally by small businesses, that is not being met under existing facilities. It is usually assumed that the financial problem of small industry is primarily a credit problem.

Regional Banks for Industry

The most common proposal is that an independent system of banks should be established for the purpose of supplementing the financing facilities now available to business and industry. Loans would ordinarily be restricted to those with maturities of not less than one year, but if short-term credit was not otherwise available, it is probable that the banks would also grant this type of credit. Loans for both fixed and working-capital purposes would be authorized.

A bill[1] providing for the establishment of a minimum of five and a maximum of twelve regional industrial banks has been introduced in the United States Senate. Its provisions are as follows. Each of the banks would have authority to make loans upon such terms and conditions, with or without collateral, and at such rates of interest as its board of directors should determine. Purchases of preferred stock, common stock, or bonds of any business enterprise would be authorized. Stocks and bonds of public agencies and the bonds of governmental bodies could also be purchased, presumably in order that surplus funds of the banks might be employed profitably. In addition, the board of directors of each bank would be empowered to take such other steps as might be deemed necessary to furnish needed credit and capital facilities.

The regional banks would be granted authority to rediscount the loan paper offered by national and state banks. They would be permitted to dispose of any assets acquired in the course of their operations, subject only to such terms and conditions as their governing authorities might prescribe.

Each regional bank would begin business with a capital stock of $100 million subscribed by the Secretary of the Treasury for the United States Government. The capital stock of each bank could later be increased to a maximum of $1 billion. The public would be given the right to purchase capital stock of the banks. Additional funds would be obtained through the sale of debentures, which would be insured through a fund established in the Treasury of the United States. National banks would be given the right to purchase the debentures.

The system of regional banks would be placed under the supervision of a Board of Governors, to be composed of one

[1] S 1203, introduced by Senator Pepper of Florida on Feb. 6, 1939.

member from each region, appointed by the President and confirmed by the Senate. Each regional bank would be governed by a board of seven members, four of whom would be appointed by the President and three elected by the bank's customers and holders of the bank's securities.

If a system of regional industrial banks should be established, the industrial advance programs of the Federal Reserve banks and the Reconstruction Finance Corporation would doubtless be terminated as soon as decisions had been reached on applications under consideration at the time the legislation authorizing the banks became effective. Logically, the activities of these agencies would be restricted to liquidating outstanding loans. It is inconceivable that the regional banks would attempt to operate on a basis whereby they would supplement the facilities now available through both the commercial banking system and the industrial advance programs.

The principal difference between the financing facilities that would be provided by the proposed system of regional banks and those now available is that the regional banks would be authorized to furnish equity capital. This would be the one outstanding advantage, as compared with the present system. Insofar as loans are concerned, the industrial advance programs would appear to be the practical equivalent of a system of intermediate credit banks.

There is no means of forecasting the volume of funds that might prudently be invested in the equity issues of business enterprises. The volume of lending operations under the industrial advance programs suggests that the volume of loans, including purchases of debt obligations, that could be made would be relatively small. Under the Federal Reserve program, applications involving a total of $175 million were approved between June, 1934 and the end of 1938. Advances outstanding at the end of 1938 amounted to $17,250,000, and commitments accounted for a little more than $14 million.[1] Loans to business enterprise by the Reconstruction Finance Corporation to the end of 1938 amounted to $150 million, of which $110 million was outstanding. It should be noted that many of the loans under these programs were made prior to the change in procedure in classifying loans adopted in the summer of 1938, to which reference was made in the preceding section. If the change had been made effective at an earlier date, it is probable that the actual advances under the two programs would have been smaller.

The record under the industrial advance programs for the last half of 1938 affords a better indication of the effective demand for funds on a loan basis that might be expected by the regional banks. In this period the Federal Reserve banks approved applications amounting to $13.9 million, including applications for commitments, while loans to business enterprises by the Reconstruction Finance Corporation amounted to $44.2 million.

The effective demand for loans in the last half of 1938, together with the amounts outstanding, suggests that the volume of loans available would be decidedly small, unless the credit standards of the regional banks were much less exacting than those of the Federal Reserve banks and the Reconstruction Finance Corporation. This assumes, of course, that the regional banks would not attempt to compete with commercial banks and would confine their activities to supplementing the facilities already available.

Whether the proposed banks could obtain a volume of business that would enable them to cover expenses and losses would depend upon such factors as the number of banks established, the availability of the physical facilities necessary for their operation at a reasonable cost, and their ability to

[1] Agreements to discount for, or purchase obligations from, financing institutions and to make loans or advances to them on the security of obligations received on account of industrial advances.

keep losses at a minimum. There is no reason to believe that, if the minimum objective was to cover expenses and losses, it would be possible to expand the volume of loans much beyond that reached under the industrial advance programs. Credit standards could be made much more liberal than those of the two agencies now making industrial advances only if it was anticipated that any impairment of capital that might follow unprofitable operations would be covered by a governmental subsidy. The right to purchase preferred and common stock would tend to increase the volume of operations, but this would probably be the most difficult part of the business to operate at a profit.

Experience under the industrial advance programs suggests that any system of banks designed to supplement the facilities available to industrial and commercial borrowers through privately-owned institutions might find it difficult to operate on a profitable basis. Earnings and expenses under these programs have not been released. The Federal Reserve bank of New York in its *Monthly Review* for August, 1938, stated, however, that in general, "the experience of this bank with this type of loan indicates that the income received, even at rates as high as 6 per cent, is not adequate to cover expenses and losses." Comparable information for the system as a whole is not available, but a substantial proportion of total advances is past-due. It is unofficially reported that the operations of the Reconstruction Finance Corporation in this field will show some losses, and that the net result on all industrial loans is more likely to be a loss than a profit. On the basis of current indications, it would appear that the regional banks could break even on a comparable volume of loans only if they were more successful in appraising applications and minimizing losses.

The Pepper bill does not restrict the securities of business enterprises that may be purchased to new offerings. It is not probable that, if this or a similar bill should be approved, the regional banks would be permitted to purchase large blocks of securities on the exchanges. The banks should not be authorized to make any purchases of a strictly speculative nature. In addition, any legislation of this type should definitely limit the business of the banks to supplementing and coordinating the financing facilities available through privately-owned institutions. As the bill is drawn, this proposed addition to our financial mechanism would give broad powers to boards of directors dominated by presidential appointees. It would represent perhaps the most definite step ever taken toward complete government control of the banking and financial system.

Industrial Finance Corporations

Separate corporations to be financed by the banks have been suggested as a means of improving the financing facilities available to business enterprise, especially the small concern. Under this plan the banks would invest in the stock of an industrial finance corporation, which in turn would be authorized to make loans to industrial and commercial businesses and purchase their securities. The investment of any one bank would be limited to a certain percentage of its capital and surplus. Securities eligible for purchase would include both preferred stock and common stock.

This plan would have the advantage of spreading the risks involved in financing a particular business without the mediation of a government agency. In common with the regional bank proposal, it would provide a means of advancing funds to industrial concerns on a basis that would result in a better balance in their financial structures. There are many small concerns with reasonably good prospects that require additional equity capital. In many cases, additional funds on a loan basis would result in further distortion of a financial structure that is already unbalanced because of a high ratio of borrowed funds to total capital employed. The mere provision of additional funds should not be considered the sole objective of any plan designed to improve the financing facilities available to business enterprises. The attainment of a proper balance between borrowed funds and equity capital should be regarded as a complementary objective.

Credit Insurance for Business Loans

Another method of improving the credit facilities available to industry would involve insurance by a federal agency of loans to business by national and state commercial banks. The assumption underlying credit insurance proposals is that the banks will lend more freely to industry, if the risk of loss is covered by insurance.

Bills providing for the insurance of business loans by the Reconstruction Finance Corporation have been introduced in both houses of Congress during the present session. The provisions of the House bill will be outlined for the purpose of illustrating this type of proposal.[1] If this bill should become law, the Reconstruction Finance Corporation would be authorized to insure national and state commercial banks against losses which they may sustain on loans made to any industrial and commercial business for the purpose of enabling it to increase its production, extend its operations, or modernize its plant and equipment. Only loans made from July 1, 1939 to June 30, 1941 would be acceptable for insurance. To be acceptable for insurance, a loan would have to meet five specific requirements:

1. The amount of the loan must not exceed $200,000.
2. Principal and interest must be payable in periodic payments over a period of not more than seven years.
3. The rate of interest, exclusive of the insurance premium

[1] H. R. 4280, introduced by Representative Allen of Pennsylvania on February 17, 1939.

and any service charge, may not exceed 4% on the amount of principal outstanding.

4. The conditions of the loan may not provide for a service charge of more than 1% of the original amount.

5. The loan must be secured by a first mortgage upon real estate, or by a chattel mortgage upon personal property, or by debentures which can be amortized in ten years, determined by the Corporation to have a value of at least 125% of the principal of the loan.

The Reconstruction Finance Corporation would be authorized to fix a premium charge for the insurance of loans, which in no case could be less than ½ of 1%, or more than 1% per annum of the original amount of the loan. The insurance premium would be collected by the insured bank and remitted to the Corporation. A bank holding an insured obligation would be authorized to sell it to, or discount or rediscount it with, any other bank. Insured obligations would also be made eligible for discount and rediscount at the Federal Reserve banks by both member and non-menber banks.

The most significant feature of this bill is that only loans secured to the extent of 125% or more of the original amount of the loan would be acceptable for insurance. A question arises as to whether many loans secured by mortgages or other satisfactory collateral with a margin of 25% are to be found among the loans that existing lending institutions regard as marginal. Stated differently, are the banks and the agencies making industrial advances now refusing well-secured loans on which the risk of loss is so small that it can be covered by an annual insurance premium of 1% or less? Although only scattered information is available, it is entirely probable that the loss ratio on all intermediate and term advances to industry made under the industrial advance programs in the recent period will be in excess of 1% of the average amount outstanding during each year.

A comparable bill was introduced by Senator Mead. On May 8 a revised bill was introduced in the Senate by the same sponsor. Under the provisions of this bill, banks could be insured by the Reconstruction Finance Corporation only in respect to losses in excess of 10% of the principal amount of business loans. The minimum premium charge would be ¼ of 1%; the maximum, 1%. Insurance would be restricted to loans for periods of from one to ten years, and the insured indebtedness of any borrower would be limited to not more than $1 million. Insurance would not be restricted to secured loans, as provided by the Allen bill, and there is no limitation as to the period during which loans must be made.

Insurance of loans to business and industry would lead to some additional lending by commercial banks, especially by those banks that for various reasons have adopted a conservative policy in regard to loans to be amortized over a period of years. There is little reason to believe, however, that it would result in a large increase in industrial and commercial loans. The credit standards necessary in order to keep losses within income from premiums would make it impossible to grant loans to concerns with unsatisfactory earnings records, as well as to those whose future prospects could be rated no better than fair. The acceptability of real-estate mortgage security as a basis for insurance, as provided by the Allen bill, would not in itself induce additional lending. With some exceptions, the value of an industrial plant as security for a loan is a going-concern value directly related to the operations of a particular industry.

In considering the proposal for insurance of business loans, it should be remembered that deposits in practically all commercial banks in the United States are now insured with the Federal Deposit Insurance Corporation. Deposits are insured up to a maximum of $5,000 per depositor. This is the practical equivalent of insuring the assets of a bank to an aggregate amount equal to the deposits covered by insurance.

For banks with few depositors' balances of more than $5,000, insurance of both assets and deposits would appear to be inconsistent. If adopted, the proposed plan of insurance would further reduce the sphere of action in which bankers may make decisions and assume complete responsibility for them. Because of the powers granted to the corporation administering the insurance system, it could only be construed as another step towards the complete socialization of the banking system.

SUMMARY AND CONCLUSIONS

Recent Banking Developments

THE banking and financial statistics for 1933 to 1938 do not disclose any underlying reasons for the existence of unjustifiable refusals or restrictions of bank credit. After the adjustments necessitated by the banking holiday had been completed, the number of banking offices remained relatively stable. Bank suspensions were at a minimum, and the confidence of depositors was enhanced by the establishment of a national system of deposit insurance.

Loans and investments of member banks of the Federal Reserve System showed an upward trend through 1936. Purchases of United States Government securities were the principal reason for this rise. The upward movement in loans continued through the first half of 1937, and the trend in commercial loans was not reversed until the early part of 1938, or about a half year after the beginning of the business recession. The increase of $2 billion in commercial loans in 1936 and 1937 suggests that the credit needs of industry and trade were given consideration in the formulation of loan and investment policies.

Probably the most significant fact disclosed by the analysis of member bank statistics relates to the early part of 1937, when it was decided to increase reserve requirements to the full extent permitted by law. At that time there was a marked reduction in investments in United States Government securities. By the end of June commercial loans of member banks were over $600 million larger than at the beginning of the year, while total loans showed an increase of over $900 million in the same period. The actions of member banks at that time strongly suggest that the demand for business loans is an important factor in the formulation of policies with respect to the investment portfolio.

Federal policies during most of the period were directed toward easy money. The only possible exception relates to the period when reserve requirements were increased. The banking legislation enacted included provisions designed to liberalize the conditions under which the resources and facilities of the Federal Reserve System could be made available to the banks and to business. Rates charged customers reached unusually low levels and short-term open-market rates dropped to minor fractions of 1% per annum. Because of the extremely low yields obtainable on short-term open-market purchases, one would logically expect that the banks would have availed themselves of every opportunity to add sound commercial loans to their portfolios.

During the period from 1933 through 1938 there was a close relationship between banking developments and federal fiscal policy. The level of deposits was affected by the methods employed in financing the federal deficit. The easy-money policy, which was dictated in a large measure by the requirements of Treasury finance, had an adverse effect on bank earnings. Changes in federal taxation, especially the adoption of the undistributed profits tax and the higher level of surtaxes, tended to retard the resumption of normal flows of capital and were a factor in accounting for a change in the character of industrial demand for bank credit accommodation.

Under the conditions that prevailed, it is difficult to imagine the emergence of a serious bank credit problem, involving numerous refusals of credit accommodation to deserving borrowers. There are two other factors, however, that should be mentioned. As the attitudes of bankers are involved in these factors, statistical measurement is impossible.

The first is that restriction may have resulted from more conservative loan and investment policies instituted as a

consequence of the crisis early in 1933 and the unusual conditions under which the banking business was conducted immediately thereafter. It is probable that the events of that period influenced the average banker toward conservatism. If this was the case, it was not necessarily undesirable, so long as the ultimate result was not arbitrary action in dealing with requests for credit accommodation.

The second factor relates to the decline of the commercial loan and the large increases in investments, especially United States Government securities. In the immediate postwar period the ratio of commercial loans to total loans and investments decreased quite rapidly, and the downward trend in the ratio continued until 1936. During the decade ending in 1930, the most important reason for the decline was the reduced degree of dependence of industry and trade on the banks for meeting their requirements. Changes in methods of financing then in evidence meant that banks were compelled to seek other outlets for banking funds. As business was becoming more and more independent of the banks, it was inevitable that the banks should become less dependent upon commercial loans.

Deficit financing by the Federal Government through the banks accentuated the decline in relative importance of the commercial loan from 1931 to 1936. There is no indication, however, that the availability of United States Government securities meant a change in attitude towards commercial loans. The marked increases in this type of loan in 1936 and 1937 could hardly be construed as evidence of apathy or indifference. On the contrary, there is reason to believe that the banks strongly desired to increase their loans to industry and trade in order that a better balance in loan and investment portfolios might be obtained.

The Bank Credit Problem

No bank credit problems had been experienced in recent years by 91.2% of the 1,755 concerns replying to the questionnaire. The remainder, or 8.8%, reported bank credit refusals or restrictions. Concerns without any bank credit experience accounted for 25.5% of all concerns reporting, while 65.7% reported that they had not encountered any difficulty in obtaining adequate bank credit for their legitimate business requirements. The fact that more than one-fourth of all concerns reporting had not had any credit experience is mainly a reflection of corporate policy. The large number of concerns reporting no credit difficulty is indicative of high standards of financial management.

A substantial number of concerns reported that the banks voluntarily offered them funds in excess of current requirements, or suggested that they accept a line of credit even though none had been requested. This active solicitation suggests that the banks desire to avail themselves of every opportunity to increase their industrial and commercial loans.

The New York Federal Reserve district ranked first in the percentage of concerns reporting no credit experience with 32.5%, while for the Kansas City district only 8.9% stated that they had not had any credit experience. The proportion of concerns reporting no bank credit difficulty ranged from a maximum of almost 78% for the Kansas City and San Francisco Federal Reserve districts to a minimum of approximately 59% for the New York and Richmond districts. The Kansas City district ranked first in the proportion of concerns reporting bank credit refusal or restriction with 13.3%, followed by the Philadelphia district with 11.2% and the Richmond district with 11%. At the other extreme, the ratio for the Dallas district was only 6.7%.

Among concerns with capital of more than $1 million, 97.8% reported either no experience or no difficulty in obtaining bank credit. These large concerns accounted for 41.7% of the companies reporting no credit experience, for 37.3% of those reporting no credit difficulty, and for 2.2% of all credit refusals or restrictions. Concerns with capital of over $1 million represented 36% of the total number of returns.

Credit refusals and restrictions were found principally in the two groups classed as small and very small, or among concerns with capital of $500,000 or less. These two groups accounted for 81.2% of all credit refusals or restrictions, although they constituted only 51.9% of the number of concerns reporting. Of the concerns with capital of $50,000 and less, 21.7% reported bank credit refusal or restriction, while for those with capital of $50,000 to $500,000, the ratio was 11%.

The Basis of Bank Credit Refusal or Restriction

Considered as a whole, the replies do not permit a satisfactory generalization as to what proportion of credit refusals and restrictions was warranted. A careful analysis of the replies indicates a substantial number of cases in which the record of earnings and current financial condition of the applicant fully justified the decision of the bank. There are other cases in which the decision of the bank seemed to be unjustifiable, judging from the record of the concern in meeting its obligations both before and after the refusal or restriction. The unbalanced financial structures of many companies, attributable in part to the depression and in part to the relative unavailability of capital to small concerns, have been a factor in refusals or restrictions, particularly in cases where credit was desired for comparatively long periods.

Credit refusals were reported by eighty-nine concerns, or 5.1% of all concerns reporting. Credit restrictions were reported by sixty-five concerns, or 3.7% of all concerns reporting. These include cases in which a part of the request was granted and those in which concerns obtained all the short-term credit required but had been denied loans to be amortized over a period of years. Of 112 concerns that furnished information in regard to the year or years in which the credit refusal or restriction occurred, sixty-five reported refusals or restrictions in 1938.

In 87% of the reported cases bank credit was needed for working-capital purposes. Most of the concerns reporting credit refusal or restriction had requested accommodation on the basis of the general credit of the firm. Only a small percentage of the loan paper offered originated in specific transactions. Credit refusal or restriction was based on the policy of the bank in more than one-half of the reported cases. The financial condition of the concern was the reported basis for one-third of the refusals and restrictions.

Of the 154 concerns reporting credit refusal or restriction, eighty-two were not rated in the late summer of 1938 by a rating service widely used in the granting of trade credits. Four-fifths of the unrated companies had capital of less than $500,000. Of the seventy-two concerns that were assigned definite ratings, twenty-six were rated High and twenty-three were rated Good.

More than one-third of the concerns reporting credit refusal or restriction appear to have required credit for an intermediate period, or for one year to five years. For some of these concerns a combination of intermediate credit and new equity capital seemed to represent the most logical solution of the problem. A total of twenty-nine concerns probably required additional equity capital. An analysis of the 1,755 replies leads to the conclusion that there is no uniformity among the opinions of industrial executives in regard to the proper role of banks in the financing of industry. The majority of the executives of companies reporting credit refusal or restriction, who expressed an opinion, believed that loans for intermediate periods to high-grade concerns represent a safe and profitable medium for the employment of banking funds.

The comment offered most frequently by the executives of concerns reporting no bank credit experience or no bank credit difficulty was that the requirements of all deserving borrowers are being met under existing credit facilities.

The Industrial Advance Programs of the Government

The industrial advance programs of the Reconstruction Finance Corporation and the Federal Reserve banks were instituted on the assumption that there was a large unfilled demand for credit which was not being met by the banks and other financing institutions. Total disbursements on account of industrial advances by the Reconstruction Finance Corporation amounted to $113 million to June 30, 1938. On the same date, loans outstanding were slightly more than $76 million.[1] Advances by the Federal Reserve banks amounted to $77 million to December 31, 1937, and commitments executed amounted to $74 million. Advances outstanding at the end of June, 1938, amounted to a little more than $18 million. Combined advances of the Reconstruction Finance Corporation and the Federal Reserve banks outstanding at the end of June, 1938, amounted to $95 million. This figure is equivalent to less than 1.5% of the loans by member banks classed as industrial and commercial on June 30, 1938.

Accommodation was sought from the Reconstruction Finance Corporation or the Federal Reserve banks by 159 of the 1,755 concerns that replied to the questionnaire. A total of eighty-three reported refusal or restriction of bank credit. Less than one-fourth of these eighty-three concerns received the full amounts requested under the industrial advance programs, and 38% reported that their applications were granted fully or in part. For the entire group of 159 concerns, 40% of the applications were fully approved and 52% in full or in part.

[1] Exclusive of loans through banks and mortgage companies and loans to the fishing industry under Section 5 of the Reconstruction Finance Corporation Act.

A total of 140 concerns replied to a question as to whether the application followed refusal by a commercial bank. Of these, seventy-nine concerns, or 56%, replied in the affirmative and sixty-one, or 44%, in the negative. Only thirty-seven of the seventy-nine, or 47% of the concerns that had previously applied to commercial banks, reported that their applications to these agencies were approved fully or in part. The comparable proportion for the concerns that had not previously applied for the loan to commercial banks was 72%. More than 90% of the concerns which answered a question concerning credit standards under the industrial advance programs believed that the credit standards applied by the two agencies were either as rigid as, or more rigid than, those of commercial banks. More than one-half of the concerns that replied to a question in regard to promptness in handling applications stated that their applications were considered less promptly than at commercial banks.

A total of 1,224 concerns replied to a question as to whether or not lending programs under government auspices, such as these industrial advance programs, are necessary to meet the credit needs of industry. Of these, 337 companies, or 27.5%, stated that they believed the credit facilities available through these agencies are necessary.

Facilities for Financing Small Enterprise

Bank credit availability is one phase of a broader problem that relates to the financing of small enterprise. This problem is largely an outgrowth of the extreme credit liquidation and deflation in the period from 1929 to 1933. Rehabilitation of the financial structures of many small concerns required additional equity capital or loan funds for relatively long periods. The undistributed profits tax acted as a deterrent to the improvement of the equity capital position through the retention of earnings. In the early part of the period of revival many banks were not in a position to consider requests for intermediate and long-term loans. The attitude of the banks toward these loans was affected by the adverse classification of such loans by the examining authorities.

The financial problems of industry were aggravated to some extent by federal fiscal policies. Since 1933, the economy has been dependent on federal spending to an unprecedented extent. Because of the artificial support afforded by expenditures in excess of revenue receipts, it was virtually impossible to forecast business trends and earnings over more than a short period. The willingness of capital to assume venturesome risks was also affected by fiscal policy. The high level of surtaxes and the undistributed profits tax, combined with a fiscal policy that is best described as speculative, tended to retard the resumption of normal flows of capital and credit. The easy-money policy of the Federal Government had an adverse effect on bank earnings, which in turn affected the ability of the banks to allocate substantial amounts to reserves and surplus and the attitudes of bankers in regard to risk-taking.

Various proposals have been made for the improvement of the financing facilities available to business enterprises, especially small concerns. A separate system of from five to twelve regional industrial banks has been suggested for the purpose of supplementing the facilities now available through privately-owned institutions. The banks would be owned by the United States Government. They would be authorized to make loans to, and purchase the securities of, any business enterprise and to rediscount loan paper offered by national and state banks. Under another plan, industrial finance corporations would be established by the banks, which would be authorized to invest in the stock of such corporations up to a certain percentage of their capital and surplus. Under both the proposed systems, purchases of equity issues of industrial concerns would be permitted. If the minimum objective was to cover expenses and losses, the volume of loans that could be made would probably not be much larger than that under the industrial advance programs.

Insurance of loans to business by national and state commercial banks has been proposed as a method of making credit more freely available. Bills recently introduced in Congress would provide for insurance of loans meeting specified requirements by the Reconstruction Finance Corporation, which would be authorized to charge a small annual premium. Banks insured with the Federal Deposit Insurance Corporation account for about 97% of all deposits in commercial banks. Insurance of deposits and assets through separate federal agencies would appear to be inconsistent. Insurance of deposits is the practical equivalent of insurance of assets up to a total equal to deposits covered by insurance.