A New Plan to Re-Open The U. S. Capital Market

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Let the RFC Provide Capital to Build Up the Investment Banking Business

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"... A CONCENTRATION of all banking resources and all banking control in one spot or in a few hands is contrary to a sound public policy."

Thirteen years ago, almost to the very day, these words formed an important part of the annual message of the Governor of New York to the state legislature. At a time when the nation was sinking deeper and deeper into economic depression, and the Republican administration in Washington was sitting helplessly by and wringing it hands, New York's Democratic governor — Franklin Delano Roosevelt—was making his first bid for the Presidency.

The annual message of 1932 was filled with confident and constructive ideas for the economic salvation of the nation. To a people who were watching their life savings vanish with the collapse of banks in the south, the west and the north as big depositors shifted their balances to the already strong banks of the east, the governor's words made uncommonly good sense. This was the language they had been waiting to hear.

Money Still Piles Up

How Governor Roosevelt went on to capture the imagination of the voters with more such words, and to be elected President four times, is now history. But the pages on which one might expect to find recorded the steps taken by the federal government to make private finance equally strong and independent in each of the twelve Federal Reserve districts, are still blank.

For the Roosevelt administration has never progressed beyond the emergency measures it adopted to expand Federal lending facilities when private finance was paralyzed by the banking panic of the early 'thirties. Meanwhile private money has continued to pile up in financial institutions in New York. Thus, since President Roosevelt first took office, deposits of New York Clearing House banks have quadrupled, from $7,000,000,000 to $28,000,000,000, while assets of the New York "Big Five" life insurance companies have almost doubled, from $11,000,000,000 to $19,000,000,000.

And the major New York investment banking houses, which count heavily in their security underwriting operations on the support of the New York banks and insurance companies, naturally have not found the increasing strength of these institutions disadvantageous, while it has been a veritable bonanza to the big Wall Street law firms that serve as the real brains of the New York financial community.

The tremendous growth of the financial resources of New York has not been accompanied by a corresponding increase in financial services to business, industry and agriculture in the various parts of the nation whose funds have gone to make up the New York total. The life insurance companies, of course, are heavily restricted in the investments they can make, and extreme caution has been the watchword with the investment and commercial bankers in making loans. The New York commercial banks, on the one hand, have elected to keep most of their funds in cash and government bonds. The New York investment banking firms, on the other hand, have been making it almost their sole business to refund from higher to lower coupons high grade issues of securities suitable for insurance company portfolios—a business that has been made possible chiefly because of the Federal government's policy of keeping money rates low.

Government in Banking

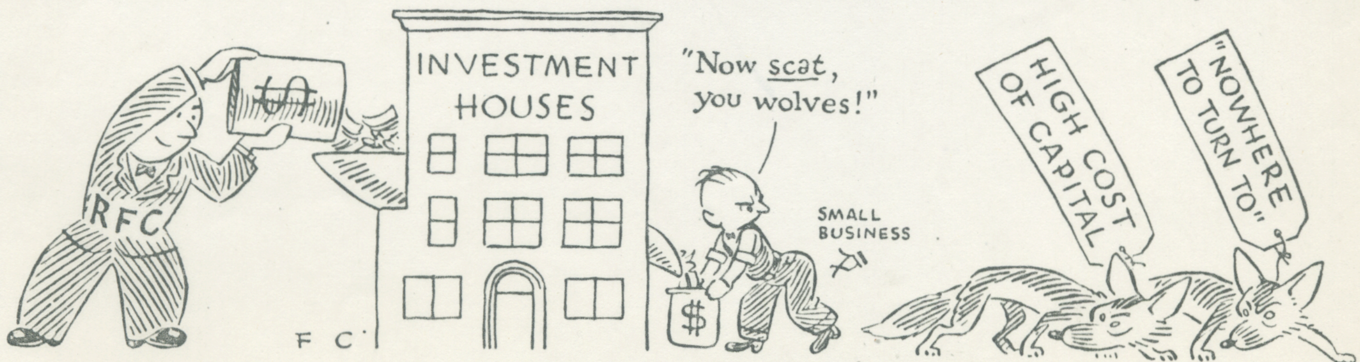
Even though the New York financial community, with a preponderance of our private banking resources in its control, has been unwilling or unable to take ordinary business risks, the fundamental financial needs of our economy have, of necessity, had to be met.

The Roosevelt administration, having failed to formulate its oft-promised program to give each region a measure of financial independence, has for 12 years followed the only other possible course, that is, to put the Federal government into the banking business on an ever larger scale until it is now compelled to advance $30 billion to American business through thirty-odd lending agencies. The true magnitude of this figure is emphasized by comparison with the mere $22,000,000,000 of loans to business and agriculture being made by all of the commercial banks and trust companies in the entire United States.

Unless we are to go on as at present until there is complete federalization of finance, action must be taken without further delay to reopen the capital markets on a broad regional basis. As I see it, this could be readily accomplished by the adoption of the following two-point program, or its equivalent:

☞ Temporary Federal subscription —possibly through the Reconstruction Finance Corporation — to preferred stock or capital notes of investment banking houses in every region, on the plan once followed with the commercial banks.

☞ Extension of liberal loans on securities to investment banking houses and joint participations in un-



Cyrus Eaton

derwritings with investment banking houses by the Federal Reserve banks in the 12 Federal Reserve districts, in the manner followed by the Bank of England with British investment banking houses.

The first step is necessary because there is not now enough capital in the investment banking business, and there has not been since the Banking Act of 1933 very properly segregated commercial from investment banking. It must be remembered that, while the scope of the commercial banks' business was thus reduced, and these institutions were at the same time supplied by the government with additional capital to carry on in the commercial field, no parallel action was ever taken to replenish the capital available for the furnishing of long-term funds to industry.

Government accommodation of investment banking houses now would at last open up the capital markets, and enable rapid and sharp curtailment of government lending. If smaller houses were included in the program, moreover, a way would be found to provide small and medium-sized business enterprises with the venture capital they cannot now obtain anywhere, not even from the government. There are any number of smaller investment banking firms around the country which, with a slight increase in capital, could handle financing in amounts of $15,000, $20,000, or $25,000 for worthy smaller enterprises in their own communities.

The urgency of the second step lies in the limited bank credit available to investment bankers in other financial centers than New York. As matters now stand, the flotation of security issues of more than a few millions of principal amount is practically impossible unless the big insurance companies indicate in advance that they will buy large blocks on the day of public offering. If investment banking houses, whether located in Texas, Ohio, Wisconsin or any other state, could count on cooperation from their Federal Reserve banks until the public distribution of a new issue was completed, the undue influence of the big insurance companies on the capital markets would be ended.

To put these two suggestions into effect, certain legislation would be necessary. A simple extension of the RFC's already vast loaning powers would probably suffice for the first point. The present capital of our investment banking business excluding inactive houses and firms whose business is largely brokerage (FINANCE's figures showing the invested capital of investment dealers at $311,000,000 included the capital of brokerage houses and firms trading in readily marketable, listed securities) has been roughly estimated at $150,000,000 or less than that in the State of Ohio, above 15 years ago. In my opinion, the RFC should be authorized to subscribe to at least an additional $450,000,000 in preferred stock and capital notes.

A Real Central Bank

On the second count, a drastic—and, it may be added, long over-due—overhauling of our Federal Reserve system would be required.

Central banking in the United States has always lagged behind our industrial and agricultural needs; even after the panic of 1893 demonstrated most emphatically that we could no longer manage without strong, regional central banks, it took 20 years, including a new panic in 1907, to produce our first feeble approximation of a central system, 12 Federal Reserve banks with initial, combined, paid-in capital of $18,000,000 and with extremely restricted lending powers, available only to member banks. The unsettled economic conditions incident to the first World War drove us to a slight expansion of the Federal Reserve banks' powers, but it was not until after the general banking collapse of the early 'thirties that we gave them power to accept as collateral on loans any and all of the assets of their member banks. More recently, the Federal Reserve banks have also been given very limited power to make loans to industry.

Our consistent policy of withholding powers until after the time of their most urgent need has prevented the Federal Reserve system from ever playing more than a relatively minor part in our economy. As now constituted, for instance, the 12 Federal Reserve banks have combined paid-in capital of only $146,000,000 and, while they are performing some very

useful routine services such as clearings and collections, their main business is largely confined to owning or loaning on government bonds.

To transform the Federal Reserve banks into real central banks for the districts they serve, their capitalization should be sharply increased and their powers broadly expanded. Their combined, paid-in capital should be raised to $1 billion, at least; where only member banks may now subscribe to the stock of their district bank, the subscription list of each of the 12 banks should be opened to individuals and corporations in the district as well as member banks, with the government to take up the unsubscribed balance in each case. In deciding what new powers the Federal Reserve banks should be given, Congress could do worse than follow Parliament's example with the Bank of England, upon which the only restriction is that it shall not oppress any of His Majesty's subjects!

The question: *Why Not a Banking System Worthy of Our People and Our Resources?* might properly be asked. With our magnificent natural resources and our intelligent and energetic people, there is no limitation save an archaic and inadequate banking system on the material progress it is within our power to make. In the past we have always waited until financial panic overtook us before making changes, and then the changes made have never been far-reaching enough to avert the next panic.

Now is the time to revise our banking system to enable it to meet the needs of every region in days of growth as well as in days of depression. And if we are insistent enough, we can see this pressing domestic problem at last solved under the national administration that originally won office on promises to provide the solution.