The Clearing Banks and the Finance of British Industry, 1930-1959

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This thesis has two goals. First, it refines our understanding of the role that the clearing banks in Britain played as providers of credit to industrial borrowers in the period between the Macmillan Committee of 1930 and the Radcliffe Committee of 1959. It then analyzes the banking system as a component of the monetary and credit structure in the economy. The conclusion reached is that industrial lending was a significantly more important aspect of banking business than has hitherto been appreciated, but that the banks themselves should be considered as one of a number of institutions operating within a fairly unitary credit market.

Chapter 1 sets out the way in which the bank-industry relationship has been perceived in previous work and notes that this perception rests largely on the concept of a debilitating separation between the two sectors. This is true of Marxist writers, who have viewed the hegemonic position achieved by bankers and financiers within the policy-making process as the explanation of British economic decline in the twentieth century. They assert that episodes such as the return to gold in 1925 and the defense of sterling in the 1950s confirmed the international role of the City of London and directed attention away from financing of domestic industry [1]. Alternatively, those who could be described as members of the historicist school have argued that the liquidity crisis of 1878 (largely caused by overextension of industrial credits) resulted in the banks' withdrawal from industrial lending and ensuing concentration on expansion in other spheres of business. The postwar boom of 1919/20, however, encouraged massive lending, and the downturn of the 1920s left many banks seriously overexposed to staple industries such as cotton or steel. The historicist school argues that the banks' chosen policy response was one of extrication rather than of rationalization and industrial reorganization, which their position as creditors may have warranted [4]. This last observation has resulted in many unfavorable comparisons with the universal banking system as it developed on continental Europe. The major defining characteristics of this system were the mixture of commercial and investment banking in the same institution and very close ties between banks and large-scale industry.

Chapter 2 questions the assumption of a separation between the two sides of the credit transaction. Empirical analysis of the operation of industrial accounts held by Lloyds Bank and Midland Bank in the 1930s

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reveals the credit nexus as a much closer, more supportive, and longer term relationship than has previously been appreciated. Bank credit was granted on pragmatic considerations of creditworthiness, security offered, prospects of the firm, and longevity of the relationship. Given these considerations, overdrafts operated as an important safety net in the market by their general availability and easy accessibility. Regularly and easily renewed, these overdrafts represented the banks' *de facto* long-term commitment to their industrial customers. More importantly, perhaps, both sides well understood this aspect of the loan, which greatly reduced any uncertainty that may have attached itself to the process of borrowing on short-term credits, repayable on demand.

The relationship between bank lending and industrial output in the 1930s has received considerable attention from both contemporaries and historians. Chapter 3's presentation of a new series of data on lending by the Midland Bank allows a more exact comparison between these two economic indicators. A number of conclusions emerge. The first arises from the data itself. That the Midland Bank felt moved to analyse in considerable detail what it felt to be a harmful drop-off in its industrial business is indicative both of the high priority given to this type of lending and of the nature of bank support for its customers. The most important conclusion in this section relates to the homogeneity of the capital and credit market. The failure of bank advances to respond to recovery in the economy after 1932/33 was a function of the demand for, not the supply of, loans. Many companies, encouraged by the differential between the price of bank advances and the income from the assets that would normally be used to secure those loans, were able to finance their recovery by realizing these assets. The demand for credit was satisfied by means other than bank advances, indicating a fundamental ambivalence about the provenance of funds on the part of borrowers. This conclusion is supported by the observation that once the decision to borrow had been made, availability of funds was a more important criterion than the price to be paid for credit. Bank loans, internal liquidity, and proceeds from the realization of assets were essentially interchangeable from the firm's point of view and would be used equally as working or investment capital depending on current needs and availability.

Chapter 4 analyzes the impact of monetary policy in the 1950s on the banking system. The fundamental problem that the authorities faced in this decade was one of demand management--how to achieve high industrial growth rates in a shortage economy without promoting inflation. Throughout the period from 1947 to 1958, control over bank lending was seen as one solution to this problem.

Successive governments established a set of prioritites that identified those sectors to which bank lending was approved and disapproved. Export, import saving, manufacturing, and defense industries belonged to the former category, whereas retail and distribution, services, inventory investment, and personal borrowing were assigned to the latter. The government used persuasion and voluntarism, emphasized with greater or lesser strength depending on the inflationary or balance of payments position, rather then statutory requirements in an attempt to control the level of bank lending. The

banks were asked to refuse applications for loans from those in the non-approved sectors and to grant those from the priority sectors. Analysis of the pattern of bank lending throughout this decade reveals some interesting results. It is clear that the banks, both in terms of overall magnitude of lending and of the directions in which that lending was channeled, conformed to the government requests. However, it is equally clear that, with the possible exception of the second half of 1955, the lending restrictions had little impact on the levels of current domestic demand in the economy or on the ability of most firms to maintain an overdraft with their banker. Analysis of the evidence to the Radcliffe Committee on the Working of the Monetary System in 1959 indicated that the greatest impact of the credit restrictions was an introduction of uncertainty into the bank-customer relationship. Unsure of the future and long-term availability of bank finance, firms maintained operations from internal sources of funds or from current overdrafts but shelved future investment plans. Encouraged by the indisposition of the banking system, other financial institutions started to offer credit-provision services in this period. Rather than affecting the levels of demand in the economy, the particular policy chosen by the authorities restricted the banks' ability both to compete with each other and to exploit new forms of business in competition with building societies, hire-purchase companies, etc. This had a significant negative impact on the banking system itself.

Chapter 5 focuses on the question of gaps in the credit market. The report of the Radcliffe Committee stressed that the "Macmillan Gap" was still a feature of the British credit market thirty years after it had first been identified by the (Macmillan) Committee on Finance and Industry. That is, small and medium sized firms seeking to raise small amounts of capital--up to £200,000--over the long term continued to experience significant difficulties. This "gap" was seen as an indictment of the excessively risk-averse credit allocation policies of the banking system. Its existence encouraged the formation of many institutions, both private and public, that sought to provide funds for this market. The record of a number of these institutions is analyzed in this chapter. The one characteristic which they shared was an inability to discover significant numbers of creditworthy loan applicants. This conclusion emerges: the provision of venture capital in small amounts over the long term was not a function that the market could fulfil in Britain. The manifest failure of institutions specifically designed to fill this gap in credit and capital provision should also exonerate the banking system. The existence of a significant fringe of unsatisfied borrowers should be interpreted as evidence of the efficiency of the capital and credit market in identifying those projects considered too risky to invest depositors' funds. The longevity of the Macmillan Gap, therefore, provides some empirical evidence of the existence of credit rationing within the banking system. This should not, however, be seen as a criticism of that system.

The evidence that is contained in this thesis constitutes a significant reappraisal of the nature of the bank-industry relationship in Britain and the position of the banking system within the monetary and credit flows in the economy. The final section casts a brief look at some recent research on the universal banking systems of continental Europe. This work has suggested

that just as the negative aspects of the British banking structure have been overstated, so the advantages and positive influence on economic growth of the universal system may also have been exaggerated [2,3]. This thesis, then, asks some serious questions of those who would seek to explain Britain's relatively poor economic performance in the twentieth century by reference to its banking system.

References

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