It is worth asking whether banks have been reducing the amount of their financing to small business borrowers who rely so heavily on them. The data we are using, are categorized only by the size of the loan, not the size of the borrower. However, it seems safe to assume that small firms tend to borrow small amounts while large borrowers tend to borrow large amounts.

From the end of October 1971 to the end of October 1981, the Canadian dollar assets of the chartered banks grew at a compound annual average rate of 18.5 per cent.[11] Over the same period of time, total loans outstanding grew by 20 per cent, while the value of outstanding business loans grew by 21.4 per cent per year. Loans in general, and business loans in particular, have thus become a more important part of the Canadian dollar assets of chartered banks.

The relative importance of various sizes of business loans in the 1970s and early 80s is positively related to loan size. From October 1973 to October 1981 the outstanding value of loans with authorizations in excess of $5 million grew by 26.3 per cent per annum. For loan authorizations between $1 million and $5 million, the annual growth rate was 17.7 per cent and for those between $200,000 and $1 million, the growth rate was 16.2 per cent. The value of loans outstanding for the smallest business loan class, less than $200,000, grew by 13.4 per cent per year, indicating that the real value net of inflation of even the smallest class of loans increased over this period.

Over the last ten years, the outstanding value of larger loans grew faster than the outstanding value of small loans. This pattern is much more pronounced in 1981. The outstanding value of loans under $200,000 fell in that year by 6.80 per cent, largely due to a 15 per cent decline during the month of October 1981. In contrast, the outstanding value of large loans (in excess of $5 million) grew by 83.17 per cent in 1981. The growth in loans outstanding for the two intermediate size classes was 15.09 per cent for loans between $200,000 and $1 million and 25.03 per cent for those between one and five million dollars.

We know that the demand for large business loans was a major factor in raising the Canadian dollar assets of chartered banks in 1981, accounting for almost 42 per cent of this asset growth. The question to be answered is then whether this growth crowded out the availability of smaller loans. The growth in the outstanding value of medium-sized loans did not fall significantly. Rather it seems that demand factors determined the allocation of the banks' business loans by size class, with the demand for the smallest of loans being greatly affected by high interest rates. The after-tax cost of interest, for any given interest rate, is higher for small business due to the lower marginal tax rate they face. As such, they are more adversely affected by high and rising interest rates than are large firms paying normal corporate rates. Therefore high interest rates tend to reduce the demand for credit from smaller firms more so than for larger firms. Moreover, as large firms become increasingly reliant on the banks, rather than their traditional sources of financing, it can be expected that this increased demand for bank credit will put upward pressure on bank interest rates. To the extent that this happened, the demand for bank loans by small firms would have been reduced even further. It is likely that the increased demand from large companies for bank financing of corporate takeovers in 1981 compounded this problem. However the general increase in interest rates in 1981 is also related to factors other than this, as discussed earlier in the report.