Selective Credit Controls

The Experience and Recent Interest

by Arnold Dill

Ask a typical economist how monetary policy works and chances are he will tell you how the Federal Reserve affects the total supply of money and bank credit, the general level of interest rates, or both. When asked about the allocation of this credit among borrowers, our typical economist will probably say that it is the financial markets that allocate credit to those who are willing and able to pay market interest rates.

However, he will also tell you that the financial markets do not allocate this credit uniformly and that the impact of monetary restraint or ease on different sectors of the economy is not equal. In particular, corporate borrowing in recent years seemed relatively immune to monetary restraint, whereas credit flows into housing and, to a lesser extent, into small businesses and municipalities, were highly susceptible to restraint. It has been argued that credit might be rationed in a more socially desirable way if general controls on the supply of money and bank credit were supplemented with selective controls.

In evaluating this suggestion, we should keep in mind that the U. S. does have considerable experience with selective credit controls, particularly during wartime when extensive controls were used in an effort to restrain the growth of credit to the private sector. This was to conserve financial resources for the war effort and to reduce inflationary pressures. During peacetime when there have been restraints on the use of general monetary policies or when their use might have had undesirable effects, selective credit controls have also been employed. Peacetime controls have tried to limit the expansion of specialized types of credit—namely, stock market credit and foreign lending—without affecting the expansion of other types.

The first part of this article reviews U. S. experience with selective credit controls. Later, the current interest in these controls is discussed in light of past experience.

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The Experience

World War I. This chronicle of U. S. experience with selective controls begins with the Capital Issues Committee (CIC) of the Federal Reserve Board. The CIC, given formal status in April 1918 by the War Finance Corporation Act, consisted of three FRB members and an advisory group of commercial and investment bankers. Subcommittees functioned in each Federal Reserve District.

The purpose of the CIC was to prevent a diversion of capital into industries not essential to the war effort (and away from Liberty Loans and defense-related industries). This was accomplished by screening prospective issues of stocks and bonds in excess of $100,000 and by approving only those in the national interest. The CIC was keenly aware of a flourishing traffic in fraudulent securities; such securities were not essential to the war effort and, therefore, not approved. Although the CIC had no enforcement powers, its disapproval hindered the marketability of an issue.

By December 31, 1918, when it stopped active operation because of a return to a peacetime economy, the CIC had screened applications involving nearly $4 billion in securities, about $1 billion of which were not approved. What success the CIC had can be attributed to several factors. First, investment bankers saw the CIC as an expedient to a desirable end—namely, the financing of the war effort. Second, the CIC was pervasive, screening **all** applications by corporations (except railroads) or state or local governments wanting to issue securities in excess of $100,000. This means there were few legitimate loopholes for evading the CIC, although some borrowers may have been able to substitute short-term borrowing for security issues. Moreover, the administration of the CIC was aided by two factors: (1) the clearer distinction between essential and nonessential borrowing that exists during wartime and (2) an institutional setting conducive to controls—namely, the investment banking industry, which is more organized and geographically concentrated than other areas of finance, such as consumer and real estate finance.

The CIC had little success in controlling the issuing of fraudulent securities, many of which were exchanged for Liberty Bonds of naive investors. When the CIC terminated activities, Charles S. Hamlin, then Chairman, warned the public about worthless securities and urged Congress to enact laws outlawing these existing abuses. Carter Glass, then Secretary of the Treasury, shared this concern, but meaningful legislation was not forthcoming for many years, largely because public opinion would not permit it. In retrospect, CIC activities probably should have been continued, with emphasis on screening out fraudulent and doubtful security issues.

Excerpts from Letter of Capital Issues Committee to Federal Reserve Banks January 1918

"In order to win the war, it is imperative at this time that goods, credit, and savings be placed at the disposal of the Government in the largest possible measure. . . ."

"The committee will not pass upon the intrinsic merit of securities to be offered for sale; it will only examine into two questions:

(1) Whether the offer is timely with respect to the financial operations to be undertaken by the Government from time to time, and

(2) Whether the objects for which the funds are to be raised by the offer of securities are compatible with the public interest as above described."

Stock Market—1929. Another security market problem—the use of credit in purchasing stock—prompted the next attempt to selectively control

Excerpt from Letter of Federal Reserve Board to Federal Reserve Banks February 2, 1929

"The Federal reserve act does not, in the opinion of the Federal Reserve Board, contemplate the use of the resources of the Federal reserve banks for the creation or extension of speculative credit. A member bank is not within its reasonable claims for rediscount facilities at its Federal reserve bank when it borrows either for the purpose of making speculative loans or for the purpose of maintaining speculative loans.

"The board has no disposition to assume authority to interfere with the loan practices of member banks so long as they do not involve the Federal reserve banks. It has, however, a grave responsibility whenever there is evidence that member banks are maintaining speculative security loans with the aid of Federal reserve credit. When such is the case the Federal reserve bank becomes either a contributing or a sustaining factor in the current volume of speculative security credit. This is not in harmony with the intent of the Federal reserve act nor is it conducive to the wholesome operation of the banking and credit system of the country."

credit. The dilemma facing monetary authorities in the late 1920's was how to limit stock market credit without causing undesirable declines in "legitimate" business and agricultural loans as well. Finally, in February 1929, the Federal Reserve Board advised member banks that they were not within their reasonable claims for rediscount facilities when they borrowed for the purpose of making or maintaining speculative loans.

This move was ineffectual, since it applied only to member banks borrowing from the Federal Reserve—not to other member banks, nonmember banks, or other sources of stock market credit. Actually, in the first three quarters of 1929, foreign banking agencies, corporations, and individuals increased their loans for purchasing securities by nearly $3 billion.

The "crash" in October 1929 gave impetus to overdue regulation of security markets. In the years that followed, major sources of stock market credit were subjected to selective control.[1] The effectiveness of selective controls of stock market credit has been enhanced by their broad coverage of sources of stock market credit and sympathy for the regulations among the financial community and the general public.

World War II. The regulation of consumer instalment credit was first authorized by an executive order of the President in August 1941. By limiting instalment credit, it was hoped that consumers would reduce their demands for scarce goods and buy savings bonds instead. This would relieve inflationary pressures and ease the shift of resources from production of consumer durables to production of defense-related goods.

The drafters of the regulation—members of the staff of the Board of Governors, consultants, and representatives of the Office of Price Administration—had to decide the form, scope, and terms of the regulation. Controls took the form of Regulation W of the Board of Governors. Minimum down payments and maximum repayment periods were stipulated for purchases of durable goods in 47 categories ranging from air conditioners to water pumps. Original down payment requirements, which could be in the form of a trade-in, ranged from 10 percent for furniture and pianos to 33 percent for autos; the standard repayment period was 18 months. These terms, originally set near those prevailing at the time, were tightened and coverage was broadened in March and May of 1942.

The regulation was primarily aimed at instalment sales contracts on durable goods. But it also covered single payment loans, which were required to be paid within 90 days, and charge account balances, which were required to be paid by the tenth day of the second month after the purchase.

The implementation of the regulation was formidable, since nearly 200,000 granters of instalment credit had to be registered and informed of their responsibilities. A staff had to be assembled to investigate compliance with the regulation, but actual detection of violation was difficult to verify. Evasion did not require a great deal of ingenuity. For example, down payment requirements could sometimes be evaded by overstating both the price of an article and the value of a trade-in, in effect increasing the amount of the instalment credit extended to purchase the article. Also, durable goods were sometimes sold in component parts to avoid the regulation. Disciplinary action consisted of letters of admonition and "disciplinary conferences" and, eventually, criminal proceedings. However, during the six years the regulation was in effect, there were only six suspensions of licenses, by consent, and only one court case.

There was a high level of compliance with Regulation W during the war largely because of the scarcity of consumer durable goods, the liquid state of consumers that reduced the need for instalment credit, public sympathy with the war effort, and the rationing program of the Office of Price Administration. Compliance, however, began to deteriorate in early 1946, nearly one year before any official relaxation of the regulation.

1947-48. By the time Regulation W was suspended in November 1947, rapid increases in consumer instalment credit and bank loans were fanning inflationary fears. This revived interest in various selective controls, especially since traditional monetary curbs were largely nullified by the Federal Reserve's price support of marketable U. S. Government bonds. In November 1947, the same month that consumer credit controls were suspended, Federal and state bank supervisors sent a letter to commercial banks urging them to: (1) voluntarily curtail all loans for "speculation" in real estate, commodities, or securities; (2) guard against an overextension of consumer credit; and (3) confine credit extension to financing that would help "production" rather than merely

[1] *Regulations G, T, and U, prescribed in accordance with the Securities Exchange Act of 1934, limit the amount of credit to purchase and carry margin stocks that may be extended on securities as collateral by prescribing a maximum loan value, which is a specified percentage of the market value of the collateral at the time the credit is extended; margin requirements are the difference between the market value (100 percent) and the maximum loan value. The term, "margin stocks," is defined in the corresponding regulation.*

Regulation G and special margin requirements for bonds convertible into stocks were adopted by the Board of Governors effective March 11, 1968.

Minimum Downpayments and Maximum Maturities Under Regulation Governing Consumer Instalment Credit Sept. 1, 1941-Nov. 1, 1947

Type of credit	Sept. 1, 1941-Mar. 22, 1942		Mar. 23, 1942-May 5, 1942		May 6, 1942-Nov. 30, 1946		Dec. 1, 1946-Nov. 1, 1947	
	Down-payment (per-cent)	Maxi-mum maturity (months)	Down-payment (per-cent)	Maxi-mum maturity (months)	Down-payment (per-cent)	Maxi-mum maturity (months)	Down-payment (per-cent)	Maxi-mum maturity (months)
1. Air conditioners, room units	20	18	33⅓	15	33⅓	12	33⅓	15
2. Air conditioning systems, home	15	18	33⅓	15	33⅓	12	.....	.....
3. Aircraft (including gliders)	33⅓	18	33⅓	15	33⅓	12	.....	.....
4. Attic ventilating fans	15	18	33⅓	15	33⅓	12	.....	.....
. . .								
45. Water pumps	15	18	20	18	33⅓	12	.....	.....
46. Wearing apparel and furs	.....	.....	.....	.....	33⅓	12	.....	.....
47. Yard goods	.....	.....	.....	.....	33⅓	12	.....	.....

increase consumer demand. Nine months later, in August 1948, a special session of Congress authorized an imposition of consumer credit controls, and Regulation W was reinstated effective September 1948 .

In retrospect, these controls were ill-timed because contractionary forces were already slowing economic activity when they were imposed. This is especially true of the consumer credit curbs, which went into effect one month prior to a period that the National Bureau of Economic Research later designated as an economic contraction.

In addition, the inflationary fears that prompted the controls may have been exaggerated. Part of the increases in published price indexes after the termination of wartime price controls in 1946 reflected an understatement of real price increases in the 1942-46 period that occurred through the elimination of discounts, poorer service, and the deterioration of quality. Also, the rapid increases in bank loans after 1945 reflected a shift in credit demands from the Government to private industry rather than an inflationary expansion of bank credit.

The growth of business loans slowed shortly after the November 1947 letter of bank supervisory agencies, a fact that can be attributed to a weakening of credit demands and, perhaps, to other restrictive measures as well as the 1947 letter.[2] In addition, some business credit demands may have been shifted from banks to stock and

Excerpts from Statement of Bank Credit Policy Issued by Bank Supervisors, 1947

"Our country is experiencing a boom of dangerous proportions. The volume of bank credit has been greatly inflated in response to the needs for financing the war effort."

". . . a further growth of outstanding bank credit tends to add to the already excessive demand and to make for still higher prices."

"Under existing conditions, however, the banks should curtail all loans either to individuals or businesses for speculation in real estate, commodities, or securities. They should guard against the overextension of consumer credit and should not relax the terms of instalment financing. As far as possible, extension of bank credit under existing conditions should be confined to financing that will help production rather than merely increase consumer demand."

[2] *Other restrictive measures included a reduction in member bank reserves in the first half of 1948, increases in reserve requirements in February, June, and September 1948, and increases in the discount rate in January and August 1948.*

bond markets, where new corporate issues jumped from $4.8 billion in 1947 to $6.2 billion in 1948.

At least the 1947 letter had an important advantage over the Federal Reserve Board's 1929 letter regarding stock market credit—it pertained to all commercial banks and not just to member banks borrowing from the Federal Reserve. However, the policy was hindered by the vague distinction between "speculative" and "productive" loans.

In the case of consumer instalment credit, growth slowed about the time that Regulation W was reimposed, but largely because the demand for the regulated items was already weakening. The Regulation was relaxed only six months later—in March 1949—and then terminated in June 1949. This was too short a period for serious enforcement attempts.

Korean War. Interest in selective controls renewed in mid-1950, when the demands of the military buildup reinforced a cyclical upswing in economic activity. Prices increased rapidly. Selective controls were used in an effort to limit demands of consumers and business, especially because the Federal Reserve's support of U. S. Government bond prices limited the use of general monetary controls.

On August 4, 1950, national and state bank supervisors urged lenders to decline to make business and consumer loans that might be used for speculative purposes or that might otherwise interfere with defense requirements. This action evidently had little impact on the allocation or expansion of bank credit.[3] On November 17, 1950, the Federal Reserve Board sent a letter to member banks calling "the attention of every member bank to the loan policy announcement of August 4, 1950. . . ." This letter was backed up by sharp increases in reserve requirements in January and early February 1951 and by the end of Federal Reserve support of Government bond prices (the Treasury-Federal Reserve Accord) in March. This stymied bank credit growth in the first half of 1951.

After being authorized by the Defense Production Act of 1950, consumer instalment credit controls—again in the form of Regulation W—were reissued in September 1950. The administration and especially the enforcement of Regulation W, however, proved a difficult task, and the original Regulation was amended five times during 1951.[4] Nevertheless, Regulation W was evidently partly responsible for slowing consumer instalment credit growth in late 1950 and 1951. Inventories of consumer durables began to build in the second quarter of 1951, a fact the Board of Governors attributed to a heavy volume of consumer buying in the late 1940's and 1950, as well as to the restrictions of Regulation W.

A month after Regulation W was reissued, Federal Reserve Regulation X (pertaining to real estate credit) was issued along with companion regulations by the Federal Housing Administration and the Veterans Administration. These regulations, which stipulated maximum loan values and maturities for credit extended for purchasing new one- or two-family houses, proved ineffective because of the large volume of building underway, a heavy volume of financing commitments outstanding, and the exclusion of credit granted on existing property. Mortgage debt continued to rise rapidly after the regulation. Administrative difficulties associated with the regulation are evidenced by the fact that the regulation was amended no less than ten times during 1951.

Finally, the National Voluntary Credit Restraint Committee (VCRC) was organized by the Federal Reserve in March 1951. Its purpose was to encourage financial institutions to channel their lendable funds into loans that increased "essential production" and away from loans that served only to effect transfers of ownerships, to permit speculative purchases of property or commodities, or to contribute to the production of "nonessential" items.[5] It was hoped this would facilitate the

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[3] *A survey of changes in business loans at selected member banks in leading cities indicated that commodity dealers, manufacturers of food, liquor, and tobacco, sales finance companies, and wholesale and retail trade received the largest increases in bank credit between July 1 and October 31, 1950. These industries were not closely associated with the defense effort.*

[4] *The Federal Reserve Banks had to build and train enforcement staffs, which were difficult to recruit because of uncertainty about the length of the Regulation. Staffs were too small to thoroughly implement the Regulation, which is borne out by the fact that only two-fifths of the 180,000 registered granters of instalment credit were contacted and examined from September 18, 1950 to December 31, 1951. Criminal proceedings were often drawn out and punitive action was not sufficient to deter offenders. Actually, there were only two suspensions of licenses to engage in instalment credit operations during the first 15 months the regulation was in effect. Also, there was a tendency to disassemble some goods into component parts, since items below $50 were exempt from regulations.*

[5] *Sections of the VCRC's "Statement of Principles," are reminiscent of the "real bills doctrine" that said if banks lend only to finance inventories an increase in*

Excerpts from Board of Governors' Program for Voluntary Credit Restraint, 1951

"It shall be the purpose of financing institutions to extend credit in such a way as to help maintain and increase the strength of the domestic economy through the restraint of inflationary tendencies and at the same time to help finance the defense program and the essential needs of agriculture, industry and commerce."

"Any increase in lending at a more rapid rate than production can be increased exerts an inflationary influence. Under present conditions of very high employment of labor, materials and equipment, the extension of loans to finance increased output will have an initial inflationary effect; but loans which ultimately result in a commensurate increase in production of an essential nature are not inflationary in the long run whatever their temporary effect may be. It is most important, however, that loans for nonessential purposes be curtailed in order to release some of the nation's resources for expansion in more vital areas of production."

"Cooperation with this program of credit restraint makes it increasingly necessary for financing institutions to screen loan applications on the basis of their purpose, in addition to the usual tests of credit worthiness. The criterion for sound lending in a period of inflationary danger boils down to the following: Does it commensurately increase or maintain production, processing and distribution of essential goods and services?"

Items from Digest of Opinions Rendered by Regional Voluntary Restraint Committees on Typical Cases, November 1951

Business of borrower and purpose of loan	*Opinion*
Delicatessen ..... To build a new store building to serve a newly developed residential area.	Favorable
Retail farm tractor and implement dealer ..... To erect sales and service building in order to retain franchise.	Unfavorable
Retail ladies' ready-to-wear ..... To modernize store, add new front and increase floor capacity to maintain competitive position.	Unfavorable
Dentist ..... To purchase furnishings and equipment necessary to operate a dental office. Borrower recently graduated from dental school.	Favorable
Farmer ..... To clear 50 additional acres of land for pasturage.	Favorable
Farmer ..... To purchase farm land for lease as an investment.	Unfavorable

transfer of real resources to the defense effort and that it would reduce inflationary pressures.

The VCRC consisted of four representatives each from the banking, insurance, and investment banking industries, and two each from the mutual savings banks and savings and loan associations. Subcommittees in all Federal Reserve Districts advised lending institutions in determining the appropriateness of specific loans. Three bulletins were issued by the VCRC, setting guidelines for credit extended to finance inventories, plant and equipment expansion, and state and local governments. A digest of decisions on typical cases was also issued to serve as a guide for regional committees.

After the organization of the VCRC in March 1951, the allocation of bank and nonbank credit conformed more closely with the desires of bank regulators—namely, credit expanding to defense-related industries and contracting for others. To some extent, of course, this allocation of credit reflected shifts in credit demands toward defense-related firms, but in the judgment of the Board of Governors, the program was a success.

In appraising the role of VCRC, the Board of Governors concluded that such a program should be undertaken only when several conditions are present; namely, that a rapid inflation exists, that speculative fever is growing, that a rapid expansion of private credit is occurring, that vigorous use of general credit restraints is used, and that selective credit regulations are being used in those specific areas where experience shows such regulations can be effective. The Board concluded:

In the absence of these conditions, it is likely to be difficult to arouse widespread interest among

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production, money and goods would rise simultaneously and there would be no pressure on prices. However, banks could lend larger and larger sums of money to finance a given quantity of goods during inflation.

the financial community and to enlist the real measure of general acceptance and support without which a voluntary effort will not achieve substantial success. These basic conditions were present in the months following the outbreak of the Korean War and doubtless contributed to the achievements of the Voluntary Credit Restraint Program.[6]

Balance of Payments—1960's. Since the expiration of Korean War controls in 1952, selective controls on domestic credit, other than on stock market loans, have not been used. However, in an effort to reduce large and persistent deficits in the U. S. balance of payments during recent years, selective controls have been imposed on foreign lending and investment by U. S. residents. It was thought that the degree of general monetary and fiscal restraint required to eliminate the deficits would have severely reduced real economic growth and would have increased unemployment substantially. Consequently, selective controls were imposed in an effort to stem directly the dollar drain from certain elements of the balance of payments, while gaining time to make more fundamental adjustments.

The Interest Equalization Tax (July 1963) made investment in foreign securities less attractive by reducing after-tax yields on these securities. The Voluntary Foreign Credit Restraint Program (February 1965) asked banks and other financial institutions to keep their holdings of foreign loans and investments within ceilings, expressed as a percent of outstanding levels. The Voluntary Cooperation Program (March 1965) asked businesses to help reduce capital outflows by returning more foreign earnings to the U. S., repatriating short-term funds held abroad to earn higher interest, holding direct investment expenditures in developed countries to target levels, and making greater use of funds borrowed abroad. The Voluntary Cooperative Program became mandatory after January 1, 1968, and the other programs have been extended and expanded as balance of payments problems have continued.

The 1966 "Crunch." Still another attempt to control selectively the allocation of member bank credit occurred during the very tight money market conditions in 1966. The problem facing monetary authorities was to slow business loan growth at large banks without further curtailing credit flows into mortgages and municipal securities. More intense general monetary restraint, it was feared, would have aggravated stresses in the money and capital markets and would have increased the drain of funds from mortgage-oriented thrift institutions.

In a September 1966 letter, the Board of Governors told member banks that "the national economic interest would be better served by a slower rate of expansion of bank loans to business within the context of moderate overall money and credit growth." The Board specifically disapproved the practice of financing increases in business loans by liquidating other bank assets (municipal securities in particular) and by curtailing mortgage lending. The Board concluded: "Accordingly, this objective (the moderation of business loan growth) will be kept in mind by the Federal Reserve Banks in their extensions of credit to member banks through the discount window."

The problem with that approach, as previously mentioned concerning the Board's 1929 letter regarding loans to purchase stock, was that it applied only to a certain class of banks—member banks borrowing from the Federal Reserve—and not to other bank and nonbank sources of business credit. Business loan growth at major banks actually halted about the time the letter was issued. Even more so than the September letter, however, this seemed to be the result of a weakening in loan demand—which stopped business loan growth at all classes of banks—and another restrictive move—the runoff of CD's at large banks.

The Lessons Learned

At best, most U. S. selective credit controls have been somewhat successful. But experience has also revealed that selective controls have some serious administrative and enforcement difficulties, which, together with a general distaste for direct economic controls, partly explains why they have not been relied on more heavily.

Administrative costs have been one of the most obvious drawbacks. Congress had to authorize the controls and designate an administering authority. Then staffs were needed to write, implement, and enforce the regulations. Those affected by the controls had to be informed of their responsibilities; this sometimes included collecting additional data and submitting reports. Compliance had to be checked and, in the case of compulsory controls, disciplinary actions taken against offenders. In addition, experience indicated a recurring need to amend these regulations in order to plug loopholes and to adjust the effects of the controls. All of these proceedings involved considerable "red tape" and public and private expense.

The administrative task and expense was less when controls were relatively simple, such as in

[6] *Monetary Policy and the Management of the Public Debt, Joint Committee on the Economic Report, Part I, 82nd Congress, 2nd Session, 1952, p. 440.*

the case of the Capital Issues Committee, where security issues in excess of $100,000 were screened. In general, the more complex the controls and the greater the number of borrowers and lenders in the market subjected to them, the more unwieldy the administration.

Perhaps the greatest shortcoming of selective controls has been the difficulty of enforcing them. Inadequate or ununiform accounting methods and drawn out criminal proceedings interfered with enforcement. Even more important, the substitutability of various sources and types of credit made it easy to evade the controls. For example, businesses that were denied Capital Issue Committee approval for a prospective security issue were, in some cases, able to turn to alternative credit sources, such as banks or life insurance companies. When denied additional loans to purchase stocks, speculators sometimes indirectly financed their portfolios by financing durable goods or mortgaging real estate holdings. In other words, it was not always possible to determine if loan proceeds were actually used for that stated purpose.

Because of the substitutability of various sources of credit, experience has shown that, to be effective, controls must be pervasive—that is, applied to all sources of a given type of credit. For example, in 1929, it did little good for the Federal Reserve Board to attempt to limit stock market loans at member banks without also trying to limit these loans from other sources.

Given the enforcement difficulties of selective controls, public support has usually been necessary in order to achieve satisfactory compliance. Part of the generally high level of compliance with controls during wartime can be attributed to public acceptance of the need for Government interference in economic decisions during a national emergency. Conversely, deterioration in compliance with instalment credit regulations after World War II and near the end of the Korean War was related, in part, to a growing dissatisfaction with controls.

Recent Interest

In the past year, the allocation of credit flows and conditions in financial markets were nearly the reverse of those that led to Congressional authorization of standby credit controls in December 1969. Monetary policy has eased and interest rates have dropped; thrift institutions have been swamped with funds; and credit flows to mortgage markets have expanded sharply. Credit flows to state and local governments have also markedly increased, while flows to businesses have declined slightly. Yet, the very institutional arrangements that helped produce these reversals could again dry up mortgage credit if market interest rates turn upward rapidly once more. Should this happen, interest in using selective controls for influencing the allocation of credit could again mount.

For now, it is only conjecture as to what types of controls might be suggested. However, one selective control proposal that has been receiving considerable attention is the extension of reserve requirements to member bank assets. By setting different reserve requirements against various types of assets, it is argued, effective rates of return on various assets can be altered and, in turn, bank lending behavior and the allocation of credit influenced. If one type of bank loan—for instance, loans to businesses—was considered inflationary, reserve requirements applied to increases in these loans would be set relatively high, whereas requirements for favored assets—perhaps residential mortgages or municipal securities—would be set at a lower rate. In this way, banks would be encouraged to invest in mortgages and municipal securities and discouraged from increasing their business loans.

Remembering that selective controls must be pervasive to be effective, asset reserve requirements, or some equivalent, would also have to be applied to nonmember banks and other sources of business and mortgage credit. Otherwise, if member bank business loans were cut back because of a penalty reserve requirement, it is likely that corporations would turn to nonmember banks and to the nonbank sector of the money and capital markets. In the case of home mortgage credit, banks do not supply a large enough portion of this credit—only about 15 percent in the 1960-70 period—to be able to significantly counter the slowdown in mortgage lending during tight money.

The asset reserve requirement scheme raises some difficult technical and philosophical questions; some of the more obvious include:

(1) Who shall determine the relative asset reserve requirements on whose social priorities?
(2) How can asset reserve requirements, or some equivalent, be extended to nonmember banks and the nonbank sector of the money and capital markets?
(3) When, and by how much, should relative asset reserve requirements be changed to have the desired effect of credit allocation?
(4) How would asset reserve requirements affect the relationship between reserves and the money supply?

Even if satisfactory answers to these questions can be found, there is still a fundamental objection to the use of asset reserve requirements, or any other selective control mechanism, to reduce gyrations in home mortgage financing. Such

controls fail to get at the source of the problem—which is not bank portfolio behavior—but the inability of mortgage-oriented thrift institutions to compete effectively for savings flows when market interest rates are rising rapidly.[7] The long-run solution to this problem is not selective controls but, rather, improving the functioning of the financial markets that causes the problem in the first place. This may involve making changes in institutional arrangements such as the diversification of existing mortgage-oriented intermediaries, the development of new ones, and changes in the mortgage instrument and in the mediums for investing in mortgages.■

[7] *During periods of tight money, the supply of home mortgage credit was more seriously curtailed than other areas of credit, basically because interest rates on competing instruments have eclipsed rates paid by mortgage-oriented thrift institutions, the chief suppliers of home mortgage credit. Funds were then shifted from these institutions to intermediaries not specializing in home mortgages or into money and capital market instruments.*

Bank Announcements

MARCH 20, 1971
BARNETT BANK OF AUBURNDALE
Auburndale, Florida

Opened for business as a nonmember. Officers: Andrew P. Ireland, chairman; Alton F. Ridley, president; A. G. Hancock, Jr., executive vice president; John P. Derham, Jr., senior vice president; E. R. Komlodi, comptroller; Gilbert K. Grass, vice president and cashier; June D. Williams, assistant vice president; and Richard T. Furry, auditor. Capital, $250,000; surplus and other capital funds, $250,000.

APRIL 1, 1971
LAUDERDALE LAKES NATIONAL BANK
Lauderdale Lakes, Florida

Opened for business. Officers: A. W. Saarinen, president; William E. Nevling, executive vice president; and James Overdorff, cashier. Capital, $500,000; surplus and other capital funds, $250,000.

APRIL 12, 1971
MIDWAY NATIONAL BANK
Miami, Florida

Opened for business as a member. Officers: Charles M. Volk, chairman and chief executive officer; Charles W. Meyers, president; and Frederick B. Brundrett, cashier. Capital, $300,000; surplus and other capital funds, $300,000.