

March 14, 1951

To: Board of Governors Subject: Task force committee
From: Mr. Vest re mandatory credit controls.

Mr. John D. Clark, as Chairman of the task force committee "to develop an administrative and substantive plan for mandatory control of expansion of private credit", held the first meeting of the committee yesterday. The other members are Messrs. Bergson of ODM, Lynch of the Treasury, and myself.

There was some discussion of the legal authority to control credit extension by banking institutions under the Emergency Banking Act of 1933 and the Trading with the Enemy Act. There seemed to be agreement that such control was technically possible under these statutes, although I pointed out the serious questions about the advisability of using these old statutes which were enacted for different purposes and the repercussions which might be expected. Mr. Clark commented that action which President Truman might take in this matter would not be as drastic as that taken by President Roosevelt in 1933.

Mr. Clark outlined a plan of credit limitation which he thought the committee might suggest for use, if it should be decided by the proper authorities that action should be taken on the basis of these statutes. It was his thought that it was not the function of the committee to discuss the advisability of any such action or to make a recommendation that any action be taken. Briefly stated, his proposal was that the President by Executive Order provide that no banking institution could extend credit over and above the amount of credit it had outstanding on the date of the order. Provision would be made for exceptions, and the plan would be administered by the Federal Reserve Board and by the Federal Reserve Banks. The Reserve Banks would decide in any particular case whether there were exceptional circumstances justifying a banking institution in breaking through its ceiling and making additional loans. The plan would apply to insurance companies and other similar institutions as well as banks.

I indicated several times that I did not feel that such a program should be put into effect under these two old statutes, unless Congressional consent were obtained or, at the very least, unless the matter was fully discussed with Congressional leaders and an opportunity was afforded for the banking institutions to comment in accordance with the Administrative Procedure Act. I also said that if such a plan were to be proposed, it should be administered by the Treasury Department rather than by the Federal Reserve.

It was understood that Mr. Clark would draft a proposed report by the committee, outlining the plan, and submit it to the members of the committee preliminary to a discussion at a further meeting at 2:00 p.m. on Thursday, March 15. A copy of the proposed report, which has now been furnished me by Mr. Clark, is attached. I note that the proposed report mentions administration of the plan by the Federal Reserve Banks but does not refer to the Federal Reserve Board. In the discussion at the meeting, however, the Board was specifically mentioned as the administering authority.

J. D. Clark
3/14/51

DRAFT REPORT ON MANDATORY CONTROL OF CREDIT

This subcommittee has been appointed to report upon the method whereby the expansion of bank credit may be halted and other credit may be restricted by exercise of emergency powers of the President, who asked for consideration of the subject in the following paragraph of his memorandum of February 26, 1951:

"Furthermore, I should like you to consider the necessity and feasibility of using the powers provided in the Emergency Banking Act of 1933 to curtail lending by member banks of the Federal Reserve System. These powers are vested in the Secretary of the Treasury subject to my approval. The Secretary could by regulation delegate the administration of this program to the 12 Federal Reserve Banks, each to act in its own Federal Reserve District under some flexible procedure. The program could be extended to institutions other than member banks, if desired, by using the powers provided by the Trading with the Enemy Act."

Our assignment is too limited to permit us to make a recommendation whether mandatory control of credit should be imposed. Rigorous action of this character should be taken only if the problem to be solved is **most** serious, and if more moderate measures which may be available are too slow, too uncertain in operation, or are otherwise inadequate.

The seriousness of the problem of expanding credit may be considered settled for the purpose of this study by the memorandum of the President. He has, however, directed that several methods of **attack** be considered, and these are being studied by other subcommittees. Their reports as well as this report must be taken into account by the major committee in reaching its own decision whether to recommend use of one or more of the milder programs, or to report to the President that mandatory control should be established either because faster action is necessary or because the more

moderate measures would not be effective enough.

Statutory Authority

The relevant statutes are section 5 of the Trading with the Enemy Act of October 6, 1917, which was amended by the Emergency Banking Act of March 9, 1933 and again on December 18, 1941; and section 4 of the Emergency Banking Act of 1933. There is appended a copy of the two sections in the 1933 statute and of the 1941 amendments.

The statutory authority upon which President Roosevelt acted in closing the banks in March, 1933 was section 5 of the Trading with the Enemy Act. A few days later the Congress confirmed his action and extended his authority in the act of March 9, 1933, which amended and re-enacted the section. He again relied upon section 5 in August, 1941, when he authorized the Federal Reserve Board to regulate consumer credit several weeks prior to the enactment of specific legislation upon the subject. Upon that occasion he was making use of the statute to curb inflation in a period of partial mobilization, which is the present problem.

We are of the opinion that these statutory provisions authorize the President, by executive order in the present emergency, to regulate and limit the issue of credit by banks and other investment institutions. The Chief Executive should weigh carefully arguments challenging the propriety of taking action of such import upon the authority of emergency statutes without securing congressional approval, but these arguments do not go to the question of statutory authority itself.

Executive Action Permitted by Statute

Several policies to restrict credit are possible under the statute, but we have confined our study to direct limitation orders since that is the only proposal which has been under discussion.

The simplest action, which is also the most rigorous, is to issue an executive order prohibiting the making of new loans which would increase the total volume of outstanding loans of the bank or other institution above the volume of loans outstanding on the day of the order. An earlier base date might be used in an attempt to roll back the total volume of credit, but this would raise difficult problems of the kind which have inhibited the rollback of prices.

A variation in the plan would be to fix the limit on loans by formula, either as a given percentage of the capital funds of the institution, or in the case of banks, as a given percentage of the **deposits**. Either formula would have some inherent elasticity. More important would be the leeway given each institution which had not already made loans up to the prescribed ceiling. This would permit an expansion of loans without specific administrative action, but if this did not work against the desired objective of halting credit expansion it would be necessary to require the banks with over-loans to liquidate. This would probably require detailed administrative attention to individual banks in order to make the process of transition tolerable.

Essential Features of Credit Control Program

The simple executive order would effectively and immediately freeze the volume of credit at the current level. It would be open to the serious

objection, however, that loan capital needed for defense and other essential new projects would be available only as outstanding loans were liquidated. Seasonal requirements of certain businesses and regions might not be met if the freeze order were imposed during the off season. The present volume of credit, which in the case of bank loans is now more than \$4 billion greater than last August when the Federal Reserve Board reported that it was too large, is certainly great enough in total to meet the requirements of defense production and of economic expansion during the next few months, but an immediate and complete restriction of credit expansion would halt the financing of a great many individual business projects which should be encouraged and expedited, not hung up until the liquidation of loans created a margin within which new loans might be made.

Our hypothesis being that the expansion of credit has already reached the point where it must be halted, there is no place for tenderness in devising and administering a control program, or for great sensitiveness about the hardships of restraint. The requirements of the national economy call for a control program sufficiently elastic to facilitate necessary loans, however, and the evil of credit expansion is not so vicious that it is necessary to frustrate or delay the plans of businessmen who have made commitments in reliance upon established lines of credit or upon their ability to complete loans already negotiated.

Administrative Procedure

Leeway for new loans which have been arranged but not completed can

be afforded by a provision in the executive order permitting a bank or other institution to increase its loans by a moderate amount, say two percent, above its ceiling for 30 days, after which time the bank would be prohibited from making new loans until liquidation of its outstanding loans brought the volume within the ceiling.

The broader problem of providing elasticity to permit loans for defense and other essential purposes and to care for seasonal requirements not permitted by the ceiling would require more extensive administrative organization and action. Starting with a simple authorization of loans exceeding the ceiling if approved by the Federal Reserve Bank of the region, regulations could be developed to establish general criteria for exemptions to be administered by local committees such as those contemplated in the discussions of voluntary credit control.

Administrative problems will spring up on every hand if an effort is made to set up a program which operates so perfectly at every point that no squeezes occur, no bank is harassed or hurt, and no borrower with a worthy project is impeded. We have made no effort to conjure up all of the difficulties and complaints which might arise, and we make no effort to outline an administrative process to meet them. If the threat to our economy arising from the expansion of bank loans is not so great that harsh action must be taken, the major committee should give no consideration to the mandatory control proposal. If the danger is great, but the committee can advise the President that it can be met by more moderate measures, the mandatory control plan should not be considered. But if

the danger is great, as the President has been advised, and if harsh measures must be used because milder restraints are too slow or too ineffective, it would not do to denature the control program with exceptions nor to load it down with administrative processes in the self-defeating effort to make a harsh program comfortable for all concerned. The moment the situation improves enough so that it is permissible to think about the difficulties of those affected by credit control rather than about the way to prevent the dangerous expansion of credit will mark the time for the repeal of mandatory control.