Date March 30, 1951

To Board of Governors

From Mr. Vest

Subject Supplementary report of task force committee on mandatory credit control.

The Subcommittee on Mandatory Control of Credit, of which Mr. John D. Clark is Chairman, has made a supplementary report in response to a further request.

For the information of the Board there is attached a copy of the supplementary report dated March 29, 1951.

March 29, 1951

SUPPLEMENTAL REPORT ON MANDATORY CONTROL OF CREDIT

By Subcommittee appointed by Committee designated by the
President on February 26, 1951

The group which reported upon the mandatory control of loans by banks and other institutions has given further consideration, as requested, to the specific character of administrative action necessary in connection with such control. We have proceeded upon the hypothesis, stated in our first report, that direct control will be ordered only if milder measures are considered inadequate, and that if harsh action of this kind is required, it cannot be administered softly without destroying its effectiveness. We therefore propose minimum provisions to provide the elasticity in administration which is necessary in order to permit lending institutions to perform their essential service in the present situation. Fortunately, the direct control program does not, in the course of its operation, create any vested interests or establish business positions which in any way limit the range of amendment and modification which may be made as experience grows or when conditions change.

Plan A.

The initial executive order, which should be issued on a Friday or Saturday, would provide that no bank, savings bank, trust company, or insurance company should make a loan in an amount which would bring the total outstanding loans of the institution above the level of loans at the close of business on the day of the order.

The first qualification would be that during the next 30 days any institution might make new loans which did not lift the volume of outstanding loans more than two percent above the ceiling. At the end of the 30-day period, no new loans should be made by that institution until the liquidation of loans furnished a margin therefor within the ceiling. A renewal loan in the same amount would not be a new loan.

The second qualification would be that notwithstanding the ceiling any institution might make any loan in an amount authorized by the Federal Reserve Bank of the district upon the certificate of the Federal Reserve Bank that the loan was essential in the defense program or for the purpose of desirable expansion of the productive capacity of the economy.[1/]

We do not propose that the criteria of permissible excess loans be elaborated in the original order. Experience will quickly show whether the broad standard proposed either leads to too great leniency in authorizing excess loans, or works too harshly in restricting loans needed by the economy or in creating unfair conditions for certain institutions. That experience should be the basis for the refinement

[1/] We note again that Mr. Vest does not approve the specification of the Federal Reserve as the administrative agency.

of administrative measures and for the expansion of administrative machinery to include, perhaps, the local or regional committees established under any program of voluntary control.

Plan B.

An alternative control base, suggested for consideration by the Treasury, would afford considerable leeway for the institutions with relatively low loan volumes. The executive order would limit the loans of a commercial bank to 25 percent of its combined deposits and capital funds, and would limit the loans of other institutions in accordance with Plan A. A survey by the Treasury indicates that roughly half the banks have loans above the limit, and half the banks have loans below the limit.

If this plan were adopted, the two qualifications of the executive order under Plan A would be appropriate to it. It would also be necessary to establish rules to bring about a fairly rapid contraction of the volume of outstanding loans of the banks with loans above the limit, or the increase in loans made by other banks would permit the expansion of credit which the program is designed to bring to a sharp halt. This aspect of the plan might require considerable administration, but at the outset the general provision authorizing excess loans upon certification by the Federal Reserve Bank would furnish enough elasticity to justify the inclusion in the executive order of a provision prohibiting any new loan by a bank with loans above the limit.

The argument for Plan B is that it has inherent elasticity in its base and it does not place at a disadvantage the bank which has held down its loans in this inflationary period. It has to meet the objection that the banker under restraint might find his customers shifting to a competitive bank which was able to expand its loans.

There is no clear basis for weighing the respective advantages and disadvantages of the two plans. Since no mandatory control plan would be proposed, we assume, unless the situation were considered serious enough to require prompt action which would be immediately effective, we recommend Plan A for that purpose. The immediate objective of halting the expansion of bank loans having been attained by that action, the modification of the program in accordance with Plan B could be considered.

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