

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

## Office Correspondence

Date May 4, 1951To Board of Governors

Subject: \_\_\_\_\_

From Oliver S. Powell

*Voluntary Credit Restraint*

Attached is a Bulletin approved by the Voluntary Credit Restraint Committee yesterday for release in the papers of Monday, May 7. It is intended that there will be a simultaneous release of a letter referring to the Bulletin signed by Mr. Charles E. Wilson. The approximate form of Mr. Wilson's letter is also attached.

Since the Voluntary Credit Restraint Committee wishes not to issue Bulletins which meet objections from the Federal Reserve Board, I request that you read this material today. If the Board voices no objections, the release will be given to the newspapers this afternoon.

*[Signature]*

Attachments.

DRAFT

BULLETIN NUMBER 3 OF THE VOLUNTARY CREDIT RESTRAINT COMMITTEE  
RESTRICTION OF STATE AND LOCAL GOVERNMENT BORROWING

The Voluntary Credit Restraint Committee, at its meeting May 3, 1951, discussed the matter of credits to state and local governments and unanimously adopted the following statement:

In 1951 state and local debt outstanding has reached an all-time high approaching \$22 billion. Since Korea nearly \$2 billion of public securities have been sold to raise new money.

To curb inflation in 1951 every segment of the economy, public and private, must reduce expenditures wherever possible. Financing institutions participating in the Voluntary Credit Restraint Program should carefully screen loans to state and local governments as well as loans to other borrowers. Expansion programs that under normal conditions would be financed without hesitation should be critically examined. Ordinary government as well as private expenditures should be met largely out of current revenue rather than financed by new borrowing. If not urgently needed for preservation of public health and safety or for purposes directly related to defense, public works should be deferred.

Long Term Borrowing

Projects for expanding or modernizing municipally owned facilities constitute the major demand for public capital borrowing. Roads, schools, water systems, drainage and sewage projects and the like are the principal purposes. In the majority of cases local governments can borrow only on the approval of the electorate, which means that long periods intervene between first proposals and final financing. In many cases funds were authorized some time ago to finance projects that are just being put under way or which will be started shortly. Some projects which had voter approval before Korea are turning out to be under-financed at present prices and may

require additional financing if they are carried forward on the basis of original plans. Examination of these plans might eliminate nonessential features and avoid more borrowing.

It is sometimes difficult in individual cases to differentiate essential from nonessential expenditures and to sort out those programs which should be undertaken immediately from those which it would be desirable to postpone. Therefore, certain tests are suggested to financing institutions cooperating in the Voluntary Credit Restraint Program to be used in arriving at financing decisions in discussions with municipal authorities.

Soldiers' bonus issues are inflationary under today's conditions. They add to the spending power of the public through the creation of credit. It would seem desirable to postpone such issues until a time when immediate purchasing power is needed to counteract unemployment and when it might be more beneficial to the veteran.

Among the types of state and local government capital outlays for which, in the judgment of the Committee, the financing should be postponed are:

1. Replacement of any existing facilities that can continue to perform their function during the emergency period.
2. Construction of facilities of the types not recommended by the Defense Production Administration--such as recreational facilities and war memorials.
3. Acquisition of sites or rights-of-way not immediately needed.
4. Purchase of privately-owned utilities by municipalities, which involves borrowing to replace equity capital.

Short-Term Indebtedness

Lenders are urged to encourage local governments to balance operating budgets and thus to avoid any deficit borrowing.

Borrowing in anticipation of taxes or other revenues should be held to the minimum amounts and periods required for operation of state and local governments. Such borrowing should be discouraged if it exceeds reasonable expectations of revenues, since there is always the danger that deficits may thus be concealed.

Temporary borrowing for capital purposes, unless anticipating current revenues, should be judged by the standards specified above for long-term capital loans.

Advance Clearance of Large Issues

Regional committees have been established for consultation as to whether or not pending financing is consistent with the principles of the Voluntary Credit Restraint Program.

The Committee recognizes that the established procedure for origination and bidding on public issues of state and local governments differs from other types of financing. We are advised that for this reason Defense Mobilization Director Wilson has requested public bodies to submit financing of \$1,000,000 or more to these regional committees for a ruling as to conformance with the Program before negotiation of private sale or advertising for public sale.

Financing institutions are requested to cooperate in this matter by not participating in the public or private sale or purchase of such securities unless the issue involved has been cleared by the proposed issuer, or as the result of an application for a ruling by the financing institution itself. All such transactions, regardless of size, should be screened by the financing institutions in

accordance with the Statement of Principles of the Program, and may be referred to the regional committees if the financing institutions so desire.

The regional committees available to consider these transactions are the investment banking regional committees as follows:

<u>Committee</u>	<u>Chairman</u>	<u>Territory</u>
Eastern	Percy M. Stewart, Kuhn, Loeb & Co., 52 William Street, New York, New York.	The Atlantic Seaboard to and including Ohio, West Virginia, Tennessee and Alabama.
Mid-Western	D. Dean McCormick, McCormick & Co., 231 S. LaSalle St., Chicago 4, Illinois.	Michigan, Indiana, Kentucky, Mississippi, Missouri, Kansas, Nebraska, the Dakotas, Minnesota, Iowa and Colorado.
Southwestern	John H. Rauscher, Rauscher, Pierce & Co., Mercantile Bank Bldg., Dallas 1, Texas.	Texas, Louisiana, Arkansas, Oklahoma and New Mexico.
Western	Frank F. Walker, Dean Witter & Co., 45 Montgomery St., San Francisco, Calif.	The West Coast states along with Arizona, Utah, Wyoming, Montana, Idaho and Nevada.

TO ALL GOVERNORS OF STATES, MAYORS OF MAJOR CITIES AND FINANCIAL OFFICIALS  
OF PRINCIPAL COUNTIES AND OTHER POLITICAL SUBDIVISIONS:

Control of inflation is vital to national defense. The national defense outlay will grow monthly to a peak in 1952 or later. It will take a steadily increasing share of our country's production and absorb a growing portion of its manpower during this period. Thus, to avoid a runaway rise in prices, it is vital that all practicable steps be taken to reduce demand for goods and labor at this time.

I am writing to you as the leader of a great municipality to enlist your support and the understanding and cooperation of your constituents in this objective which is second only to adequate defense to the future well-being of our people.

Borrowing--bank loans, insurance loans and bond issues--adds dollars of buying power to today's income. In effect, they mortgage future buying power to spend today. Regardless of the soundness of the borrower's credit, it should be used sparingly if at all at this time. You and the citizens of your communities will agree that this rule applies to State and municipal borrowing as well as to private borrowing.

On behalf of our government I ask you to postpone borrowing, no matter how worthy the purpose, if the project is postponable. While many municipal projects are urgent, others might be set back to a time when they would contribute to maintaining a high level of employment in a period of slack business. Soldiers' bonus payments, many war memorials, and municipal recreational projects are but a few important examples of postponable projects which will serve the nation better at a future time.

Your Federal Government has set up machinery for voluntary screening of loans as to desirability in this defense period. Under the Defense Production Act of 1950, the Board of Governors of the Federal Reserve System has appointed a Voluntary Credit Restraint Committee. I am attaching a bulletin from that Committee with the urgent request that you read it and conduct your constituency's financing in accord with its spirit.

Regional committees have been chosen from the leading investment bankers of the nation. They are at your service to advise as to the current desirability of your financing. Their names appear in the attached bulletin.

It is my earnest request that, during the defense emergency, every State and municipal borrowing of \$1 million or over receive the approval of one of these committees before being consummated either by a single lender or by public sale. Unprecedented as this request may be, your cooperation will be a major contribution to the future welfare of our country. No one could have a higher aim.

Chas. E. Wilson