VCR-196

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THE VOLUNTARY CREDIT RESTRAINT PROGRAM

An Address by Oliver S. Powell, Member,

Board of Governors of the Federal Reserve System,

Before the National Credit Conference
of the American Bankers Association,

LaSalle Hotel, Chicago, Illinois.

Wednesday morning, December 5, 1951.

THE VOLUNTARY CREDIT RESTRAINT PROGRAM

It is my thought that this Conference would like to have a report of the stewardship of the national committeemen in directing the Voluntary Credit Restraint Program and any pertinent suggestions for the future development and performance of the Program. It is only a few months--less than a year--since the Voluntary Credit Restraint Program was first announced. In those beginning days who would have thought that voluntary credit restraint would have become a watchword among lenders? Who would have thought that a Program of turning down non-essential loans would have become so popular that groups of lenders not officially recognized in the Program have been clamoring for an active part in the organization? Who would have predicted that the voluntary credit restraint principles would become the model for Government lending agencies or that the Program would play a large part in the thinking of Government as to inflation control for 1952?

Yet, all of this and more has happened. Certainly the developments have confounded the skeptics. You may recall that even some bankers last spring feared that this was a mousetrap play which would lead them to assume an unperformable task after which Government would step in with iron-clad limitations on loans. Far from this development, the Program is now considered one of the big three in the credit tools of inflation control: general credit restraints, selective credit restraints, and voluntary credit restraints. The praise for this achievement should go to those men of courage and vision who designed the original Program, to the diligent and devoted private citizens who have guided it through the past months and to the patriotic financiers and their customers who have adopted the principles in their own lines of business.

While acclaiming the success of the Voluntary Credit Restraint Program, we must not be led into the delusion that this Program is all powerful. It is a necessary Program, but it is only one of many angles to the fight against inflation. The price level has been steady since the end of March, defense production has been growing rapidly, unemployment is at a low point, but we cannot assume that our Program is wholly responsible for this development. We must not forget that the public had over-bought in the fall and winter of 1950-51 and that retail merchandise stocks had been built up to unwieldy totals. The gradual reduction in stocks of merchandise in the hands of retailers has been one of the great restraints on inflation during recent months. Department store stocks seasonally adjusted have been declining since the end of April, but it was not until the end of October that the total fell below the rising level in the fall of 1950.

Consumers also have been a major factor in the control of inflation. For the past six months or more, they have been saving rather than spending. Perhaps they too have caught the spirit of the Voluntary Credit Restraint Program, which is really nothing more than encouragement of conservatism in spending and borrowing.

The Voluntary Credit Restraint Program finds one of its principal expressions in the lending operations of commercial banks. In the survey of bank lending operations prepared for this Conference by the Credit Policy Commission of the American Bankers Association, you will find the history of bank loans in 1951 as compared with 1950. The contrast is striking. Total business loans have risen only half as fast as a year ago. Defense loans have been rising and essential agricultural loans have also risen sharply. Other kinds of loans have either not risen or have declined. This is selective credit control on a true voluntary basis. Essential loans have been made. I have yet to receive a complaint as to an essential loan being turned down due to the Voluntary Credit Restraint Program.

Parenthetically, much of the material in the A.B.A. report to this Conference can be directly attributed to the efforts of the voluntary credit restraint organization and to the wholehearted assistance of 200 of the largest banks. For the first time when we talk about changes in business loans of commercial banks, we know what we are talking about. We have learned much and we shall learn more as to the working of the private banking system of the United States from these illuminating weekly figures.

So much for what has happened. However, this Conference is a working session and not an occasion for mutual admiration. You are going to want to take home with you concrete suggestions for improving the Program. Performance has not been perfect--but we did not expect perfection. I well remember the first session in New York of the financial experts who had been invited to draft the Program. They faced soberly the question of less than full acceptance and conformance by all lenders. To their great credit, they decided that this was a risk, but not a barrier to success, that with 70 to 80 per cent adherence the plan would work. This margin would allow for the inevitable lapses of memory, incomplete indoctrination, differences in judgment, yes, even greed and an effort to make a profit while competitors are holding off.

I am positive that compliance has been fully as good as was hoped--

and it has been improving, as the result of fuller understanding, the growing realization that others in all branches of finance are living up to the principles and the concrete evidence that the Voluntary Credit Restraint Program is playing an important part in the restraint of inflation.

I wish to explore with you the future of the Program. It is a hackneyed trick of the public speaker to declaim that "We are at the cross roads" and yet that is exactly where we are today in my considered judgment. We can either go the road of better understanding on the part of both borrower and lender and more complete conformance in the public interest no matter what the sacrifice in short run profits, or we can have a growing number of cancerous defections. Perhaps no one of them would destroy the Program but each would surely leave a growing area of resentment and a growing sense of futility.

I choose and I am sure that American banking will choose the road leading to continued success for the Program. Private finance can and will do its part toward maintaining the soundness of the American dollar. This chapter of cooperation in the national interest started on such a high level and so conscientiously developed must be carried to a successful ending.

It will be helpful to take a square look at some of the problems and difficulties which have been met in the operation of the Program. None of them is insurmountable. Most of them can be cured through a better understanding of objectives. In fact, since this is a Voluntary Program, full information and an appeal to action in the public interest are the only methods for making the Program work. Now let me outline some of the problems and tell you what steps are being taken to solve them.

The first problem was that of defining lending standards which are appropriate in a time of strong inflationary pressures. The Statement of Principles was drawn in very general language and critics said that there were very few black or white loans and a very broad area of gray loans. As a practical matter, this problem has turned out to be more theoretical than actual. We have found that the banking judgment on borderline cases as evidenced by the opinions of the regional committees has been almost uniform and invariably conservative throughout the United States.

Realizing the nature of this problem at the outset, the National Committee immediately set about narrowing the problem by a series of bulletins on special kinds of loans which were mailed to all lenders. These bulletins were supplemented by informal memoranda to the regional committees on problems which were only occasionally met and did not seem broad enough to warrant advising all lenders. A number of these cases were submitted to the National Committee by the regional committees for an opinion. New problems continually arise and constitute the subject matter for the periodic meetings of the National Committee.

Probably the most helpful move recently made by the National Committee was to distribute a Digest of Opinions which have been rendered by the regional committees in a broad variety of cases. These digests have been mailed to all lenders and have received a good deal of newspaper and other publicity. The Digest was limited to the types of cases which seemed to have a general application. In addition to these specific aids to credit judgment, there has been a tremendous amount of publicity in the way of letters, press releases, public addresses, radio programs, etc. As a result, the combination of native good judgment on the part of lenders and broad dissemination of basic information has kept the problems of interpreting lending standards to a minimum and has reduced criticism of the Program to a negligible factor.

The second type of problem arises out of a conflict of interests. One conflict is between private short-term interests and the broad public concern. There is the occasional institution which "just had to make an exception for a good customer," but which believes that if most institutions conform to the Statement of Principles most of the time, the Program will succeed. Here the remedy is partly better information leading to a better understanding of the importance of the Program on the part of both the insistent borrower and the lender and partly a matter of courage on the part of the lender. To the extent that the borrower understands the national inflationary problem the degree of courage required on the part of the lender is reduced. In fact, one of the arts of a program of this sort is the ability of the lender to explain the inflationary problem to the borrower.

Another type of conflict arises occasionally between state and local interests and the national interest. There was the instance of the municipal university that could not wait for a more appropriate time to construct a library. There was the state whose mandate to pay a soldiers' bonus overrode the obvious fact that the payment of the bonus at this time would add to inflationary pressures and thus would be contrary to the national welfare. Fortunately such cases have been few. Public officials have given excellent support to the Voluntary Program and have shown great understanding of its objectives. A continued broadening of the informational activities on the part of lenders should minimize problems of this sort as time goes on.

Another type of problem arises from failure to pass the word down the line among the lending officers within an institution. There was the top executive officer who went fishing without telling his second in command about the Voluntary Credit Restraint Program. The result was that a loan was made which had been turned down by a competitor in accordance with the Statement of Principles of the Program. There was the state bankers association which inadvertently overlooked placing the Voluntary Credit Restraint Program on the agenda for its group meetings and thus passed up a splendid opportunity to inform practically every bank in its state about the Program. There was the institutional investor which did not tell the firm originating mortgages of the new tests which it expected to apply to home mortgages with the result that some less conservative mortgages were created in the early stages of the Program. In all of these cases, the answer is better information and a realization of the necessity for informing the men who close the loans.

Finally, there is the continuing fear that if private financial institutions do a good job in holding down unnecessary loans, some government agency will step in and make the loan. In my judgment this is more of a threat than an actuality at the present time, but there have been quite a few cases of government competition which was disliked by private lenders and that have come to the attention of the National Committee. Every one of these cases has been discussed frankly and objectively with the government agency involved. In this way we hope to keep this problem at a minimum. I should add that the heads of the government lending agencies have expressed an eagerness to be told of cases where their operations seem to conflict with the Voluntary Program.

A report of stewardship would not be complete without some comments as to the future operation of the Program. First, I would encourage you to keep up the good work. We must recognize that the Voluntary Credit Restraint Program has been operating under a general set of economic conditions favorable to its use. The Program was conceived in the stark drama of the early Korean conflict. Our greatest danger is that the Program will fail in the humdrum era following an armistice--if there should be one--and before the slackening of the defense effort makes it possible to send out a "well done" message. There is nothing spectacular about a continuation of conservatism in lending activities and yet that is the prescription for the immediate future.

My second recommendation, particularly to bankers and other lenders of short-term credit, is that you strive to obtain the maximum seasonal pay off of loans in the months ahead. It is just as important to get the money back after it has served its original essential purpose as it is to be conservative in making the loan.

My third recommendation is that the operation of the Program be strengthened in individual institutions. Spread the word among your lending officers. Apply the same lending tests to your best customers as to others. Avoid the temptation to see how close to the borderline a loan can be before it becomes absolutely black. In case of doubt, submit loan applications to your regional committee.

Finally, let us all continue actively to publicize the Program among businessmen and the public in general. Continued repetition of the basic principles is the fundamental method for increasing public knowledge of the Program and keeping it actively before them. The men in this audience are experts in telling their story to the public. Your combined efforts and ingenuity will do the job. If we can keep up the tempo and spirit of the Program during the remainder of the emergency period, we shall have the satisfaction of having written a most excellent chapter in the history of private finance in the United States.