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Statement of Oliver S. Powell, Member,

Board of Governors of the Federal Reserve System,

and

Chairman, Voluntary Credit Restraint Committee,

before the

Subcommittee on General Credit Control and Debt Management

of the Joint Committee on the Economic Report.

March 19, 1952.

Mr. Chairman and Members of the Committee:

It is a pleasure to appear before this Committee to discuss the unique adventure in American finance known as the Voluntary Credit Restraint Program. A comprehensive statement as to this Program appears as the answer to question No. 42 addressed to the Chairman of the Board of Governors of the Federal Reserve System and printed in the answers to the Patman Committee questionnaire. This statement will, therefore, be confined to a few highlights and to more recent information now available to us as to the progress of the Program. A companion memorandum of statistics and charts has been furnished to the members of the Committee.

Beginning of Program.

The Program began in a mixed spirit of patriotic enthusiasm and skepticism. The leaders in the fields of commercial banking, insurance and investment banking who met with me to discuss the nature of the Program were at the same time anxious to do their part in the fight against inflation under the terms provided in Section 708 of the Defense Production Act of 1950 and fearful that they might overstep the bounds of anti-trust legislation. However, the latter was considered a businessman's risk and the Program was set up, approved by the Federal Reserve Board and the Attorney General after consultation with the Federal Trade Commission, and inaugurated on March 9, 1951.

Organization.

The Program is administered by a national Committee, appointed by the Federal Reserve Board, and 43 regional committees, appointed by the national Committee. Five principal types of lending institutions are represented on the national Committee (commercial banks, life insurance companies, investment bankers, savings banks and savings and loan associations) and each type has its own group of regional committees. The national Committee directs general policy within the framework of the Statement of Principles and has the task of studying the Nation's credit developments to appraise the effectiveness of the Program and of applying its principles to new problems. The national Committee keeps the Federal Reserve Board advised of its activities.

The regional committees have the sole responsibility for answering questions as to loans and security offerings. They keep minutes and send these records to the national Committee where they are filed as a public record. A regional committee, uncertain as to the right opinion on some type of case, may submit the case to the national Committee.

Educational Phase.

The Program was launched in such general terms that in the words of one critic "You could drive a truck through it anywhere." He had reference to the difficulty of interpreting such terms as "essentiality," "defense-supporting" and other terms characterizing the nature of credits by which it was hoped financial institutions would be guided in their efforts to provide credit for the defense effort and to screen carefully all other requests. The national Committee fully recognized the general language of the Program and proceeded at once to help lenders in applying the Program to specific problems. A series of bulletins was issued by the national Committee on such topics as inventory loans, plant expansion credits, municipal borrowings, real estate credit, etc. Press releases and public addresses were also used to acquaint both lender and borrower with the principles and objectives of the Program. Later when the regional committees had offered their opinions on a sufficient number of inquiries, digests of these opinions were made available to lenders as illustrations of the combined judgment of lenders.

Appraisal of Program's Value.

It is my firm conviction that the Voluntary Credit Restraint Program has achieved a large measure of success and has been an important companion and supplement of general and selective credit and fiscal controls in helping to stem the tide of inflation following the outbreak of the Korean trouble. It has given lenders in all branches of finance benchmarks or guides for loan and investment policy in this emergency period. It has informed lender, borrower and the general business public of the relation between credit and inflation. It has, doubtless, been a considerable factor in the restoration of the public's confidence in the purchasing power of the dollar which has resulted in a substantial increase in savings and a less active use of available funds.

Federal Government agencies in the lending field and in the civilian defense offices have accepted the principles of this Program and have given it excellent support. Finally, I am confident that many of the projects which have been postponed for the present will furnish a welcome backlog of spending power and business activity for the inevitable let down in business which will follow the peak of the defense effort.

Statistical evidence of the effectiveness of the Voluntary Credit Restraint Program is difficult to provide. Defense and other essential activities have been adequately financed and this has resulted in some increase in bank credit and in a tremendous volume of corporate and municipal security offerings. On the opposite side of the ledger it is impossible to measure the dollar amount of credits and security issues which have died in embryo. We hear of many cases where a prospective borrower decides after a discussion with his banker not to apply for the loan. Other proposed loans have never come out of the directors' room of the interested corporation. At the same time, there is fragmentary information in our files from annual reports and other sources that commercial banks have denied or postponed nonessential credits in large amounts--$7 million, $10 million, $27 million--at individual banks. For a variety of reasons loans at the larger banks have risen much less in 1951 than in 1950, and in the first two months of 1952 they have declined about $400 million as compared with an increase of $900 million in the first two months of 1951. While corporate and municipal security issues have been in large volume in 1951, they have been predominantly for purposes consistent with the defense effort. Finally, the record of the regional committees, which aside from municipal issues only offer opinions in doubtful cases, indicates that out of some $4 billion 300 million of credit and security offerings reviewed, $456 million were declared to be not in harmony with the Program. It is probable that in a majority of these cases the lender or other inquirer abided by the opinion of the committee.

Future Plans.

For the remainder of 1952 the Voluntary Credit Restraint Program will have an added goal which is really merely an application of the principles of the Program to a new problem. The Treasury Department has explained to the national Voluntary Credit Restraint Committee its financing problem for this calendar year and requested the cooperation of the Committee in its efforts to finance the deficit in the least inflationary way possible. It is, of course, highly unfortunate to have a deficit in times like these and every effort should be made to achieve a balanced budget by a reduction of expenditures or increased taxes or a combination of both. If this is not possible, however, the Voluntary Credit Restraint organization has pledged to the Treasury that it will do its part by continuing to urge the postponement of less essential capital flotations and other credits which might absorb investment funds which otherwise could be used for the purchase of new Treasury securities. It is highly important that the Treasury finance the deficit without resort to the inflationary process of borrowing from commercial banks. This means that a portion of the new savings and funds from existing debt repayments of individuals and corporations must be attracted into the purchase of Government securities. It will be the role of the Voluntary Credit Restraint Program to persuade lenders on the purely voluntary basis inherent in the Program to screen new financing projects more carefully than ever with this added goal in mind.

Screening State and Municipal Borrowing.

This Committee may be interested in some of the special problems and techniques developed by the Voluntary Credit Restraint organization to meet the problems which have arisen during its short existence. One technique in which I am sure the Committee will be interested is that developed for screening state and municipal borrowing proposals. At the outset it was recognized that the special characteristics of municipal borrowing practices would require a somewhat different procedure from that in private borrowing if adequate screening were to prevail. It is customary for a state or a municipality to advertise for bids on a bond issue and usually a large number of bidders will enter sealed bids on a certain day. It would be impractical for every firm which contemplated placing a sealed bid to ask the opinion of a regional voluntary credit restraint committee as to whether the proposed issue is in harmony with the Program. Accordingly, at the request of the Voluntary Credit Restraint Committee, Mr. Charles E. Wilson, Director of Defense Mobilization, sent a letter to the Governors of all States, to the Mayors of the principal cities and to other important municipal finance officers asking them voluntarily to submit proposed financing to the appropriate regional committee assigned to their area for an opinion as to whether the project was in harmony with the Program. This has worked satisfactorily and a very high percentage of state and municipal offerings has been so offered for screening. The national Voluntary Credit Restraint Committee was greatly pleased to receive last December, after seven months of operations in this manner, a resolution from the Executive Board of the Municipal Finance Officers Association, reading in part as follows:

"WHEREAS, It is recognized that one of the sources contributing to inflationary pressure is the issuance of municipal obligations for purposes which could be regarded as nonessential or postponable in character;

"BE IT RESOLVED By the Executive Board of the Municipal Finance Officers Association of the United States and Canada that we do subscribe to the principles of the Voluntary Credit Restraint Committee designed to curb borrowing by governmental units for purposes that are nonessential, postponable, or inflationary in character; and

"BE IT FURTHER RESOLVED That (1) we strongly recommend that all public finance officers of all governmental units exert their influence at all times to curb public expenditures in order to contribute a factor toward combatting the inflationary trend which has become excessive, undesirable, and not in the best interests of citizens and the national economy; (2) public finance officers are urged to continue to cooperate with the several regional investment banking committees having the duty of screening municipal applications for issuance of municipal debt obligations."

Protection Against Collusion.

The question has been asked whether there is any danger or likelihood of collusion between lenders in the operation of the Voluntary Credit Restraint Program. It would be simple to say that collusion is not to be expected in an operation which calls for the turning down of profitable business by lenders and underwriters. However, we have gone far beyond that assumption in safeguarding the Program from such an accusation. The Program itself was approved by the Federal Reserve Board and the Attorney General of the United States. Federal Reserve representatives are members of the national Committee and of all but one of the regional committees, and attend all meetings to represent the public interest. The agenda for discussion by the national Committee is prepared by its Chairman, who is a Member of the Federal Reserve Board. The Alternate Chairman of the national Committee is the General Counsel of the Federal Reserve Board. A competent official of the Federal Reserve Board reviews all opinions on individual loan applications as soon as such cases are reported to the national Committee. The national Committee keeps the Federal Reserve Board advised as to its current thinking on credit conditions and has, on occasion, recommended changes in the Program to the Federal Reserve Board and the Attorney General.

Careful minutes of all committee meetings are kept and filed in the national office. The files of the national office are open for public inspection. Representatives of the Attorney General's office and more recently a representative of the United States Department of Interior have inspected these files. Indeed, the effort to avoid collusion and to maintain the voluntary nature of the Program among lenders has been made even at the sacrifice of some efficiency in the application of the Program.

Special Concern for Small Business.

This Committee will be interested in the methods built into the organization of the Voluntary Credit Restraint Program to protect small business. First of all it should be recognized that of the 60,000 lenders who are in one way or another concerned with this Program, the great majority deal only with small business. The success of these lenders depends on the success of the small business enterprises of the Nation. In setting up the committee organization for the Voluntary Credit Restraint Program, committee members were chosen from institutions of various sizes as well as with some geographical distribution. Thus, the voice of the smaller lending institutions is heard directly in the councils of the Program. It is not stretching a point to add that the Federal Reserve representatives on the regional committees can be expected to think in terms of small as well as large business institutions. The Board of Directors of each Federal Reserve Bank has six directors elected by member banks of the District, of which two are elected by small banks, two by medium sized banks and two by large banks. Thus, the operation and policy of each Federal Reserve Bank and its officers are geared to banking and business of all sizes.

Handicaps.

Your Committee should be advised that in the eyes of the Voluntary Credit Restraint organization there is at least one Federal program which is making the success of this Program considerably more difficult.

I have reference to various parts of the Government program requiring the expenditure of Federal funds or encouraging municipalities to borrow with Federal guarantee, which the national Voluntary Credit Restraint Committee considers undesirable at this time despite the over-all merits of the programs.

I refer most particularly to the various plans for supporting the mortgage market on veterans' home loans and especially to the public housing program which is estimated to require $800 million of municipal borrowings during the current calendar year. In the latter case, it is the opinion of the national Committee that this competition for funds in the capital markets in the coming months with the certain needs of the Federal government to finance the deficit is undesirable except for essential defense housing. Furthermore, if these public housing projects are basically desirable, they will fit into the business picture much better after the peak of defense expenditures is past and some slowing down in business and employment occurs. This is one of the few types of projects which can be administered with certainty to combat swings in the business cycle.