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Statement of Sherman J. Maisel,
Member, Board of Governors of the Federal Reserve System
before the
Committee on Banking and Currency
of the House of Representatives
on
H. R. 14026 and related bills
May 25, 1966

1. This is a proper period for the use of monetary restraint. Failure to do so without taking alternative actions might speed up inflation and aggravate a sticky balance of payments position.

   (a) The demand for goods in the economy at the moment is pressing too hard upon our physical capacity to produce and therefore is tending to generate sizable price increases.

      (1) Generally, I think we would be better off if the bulk of excess demand is removed by fiscal rather than monetary policy, since extremes in the application of monetary policy create large problems for the economy. The timing of monetary (rather than tax) restraints is less certain. Monetary restraint's differential impact on parts of the economy probably is greater than that of fiscal policy, while its final incidence on subgroups in the country is probably less certain.

      (2) On the other hand, given the decision to rely upon monetary instead of greater fiscal restraint, I believe that monetary policy should be made as effective as possible.

   (b) In the current situation, higher interest rates and tighter credit availability in the United States will aid the balance of payments. Again, I feel other steps to correct the balance of payments situation are preferable, such as the use of taxes, tariffs, and other governmental policies. Since such steps have not been taken, monetary restraint and higher interest rates are necessary to aid in the adjustment process of bringing about an equilibrium balance of payments.

2. Given a decision to adopt a policy of monetary restraint, raising the ceiling of Regulation Q, and not adopting a split rate, was a proper corollary to the rise in the discount rate last December.

   (a) I do not believe that small savers should be discriminated against in favor of large savers, corporations, or financial institutions. If Congress decides to penalize small savers, I would help to enforce such a decision, but it seems to me enforcing a lower rate of return for the savings of a selected group of citizens without considering carefully other alternatives would conflict with the best traditions of the American way of life.

   (b) I think the previous use of interest rate ceilings to halt normal competition among savings institutions turned out to be unfortunate for the country. The protected position of some institutions resulted in a good deal of waste and inefficiency. Unless there is a real danger from excessive competition, or unless the period is one in which the market is acting in a destabilizing manner, one should hesitate to impose ceilings on wages, prices, interest rates, or any other good without a clear theory as to what the ceiling is to accomplish, who is to gain by it, who is to pay for it, and whether the ceiling is the most efficient form of transferring money from one group to another.

   While we have no exact figures yet, there are indications that some small savers are responding to the appeal of higher rates by increasing their savings. This is exactly one of the developments that is desired as a result of monetary restraint. It is a major reason why the savings institutions now should have some freedom to increase rates--to stimulate, and to share in, a larger financial savings flow.

(c) I doubt that a ceiling on either negotiable CD's or on small ones would give the results some hope for. Thus far it certainly appears as if competition among institutions has aided savers. At the same time, we have no proof that it is the major cause of the April losses in some institutions. From all appearances the main competition thus far has been between the money market and all financial institutions for sophisticated money. Imposing a ceiling of 5 per cent on $10,000 CD's might simply force money into U. S. Government agency issues at 5.5 per cent or into other market instruments.

Many of the major losses of funds seem to have centered in savings institutions that knowingly risked this situation by departing from their normal scope of operations. It was a risk that I and most regulatory authorities deplored and called specifically to their attention in public statements. Some simply tried to expand by attracting larger deposits. Others went farther. To strive for increased profits, they sought money market money rather than real savings and used that money for lending on more speculative properties at higher rates. The average stability in a given institution of small savings still seems to be much greater than for larger blocks of funds. Such stability should not have been expected for larger savers. Should the small thrifty family that is not at fault be penalized before we have better proof that such action would stabilize sufficient funds to make the inequity worthwhile?

3. I should make it clear that if our survey shows that unstable conditions exist, or that a further ratcheting of interest rates without productive results appears imminent, I would vote to impose some stabilizing regulations even at some sacrifice of both fairness for the small saver and the efficiency expected from the market. But I would do so with a great deal of unwillingness, and such a decision would require a particularly careful measuring of alternatives.

I am concerned with the potentially greater instability of larger CD's. I do not, however, feel that their existence can force the Board to raise the Q ceiling, any more than their existence last December seemed to me then to lend weight to the argument for raising the discount rate. I believe that at the present, within rather broad limits, the discount rate is a price fixed by the Board and not the market. The existence of market rates against the ceiling may lead to a particular distribution of credit which differs from that which would exist without the ceiling. The question which must be answered is whether such a distribution is desirable and for how long the pressure can be maintained given the fact that money is fungible.

4. These hearings have properly called attention to the fact that even though monetary policy is applied generally, its major impacts center in certain selective markets. These costs which result from restraints must be measured each time monetary policy is used. When, as in the current period, a decision has been made to use monetary restraint in place of more pointed and vigorous fiscal and balance of payments procedures, then these particular costs will be experienced.

If in the circumstances, Congress believes that selective cushioning is needed for the areas hit hardest, clearly they should consider taking special action. I have gone on record on numerous occasions over the past 10 years to the effect that Congress has properly established the special assistance program of FNMA and the advances of the FHLBB to deal with such a problem. They represent ways of putting money directly into the house-building market when a determination has been made that such areas are suffering too much as a result of the application of general monetary policy.

If it appears that the pinch of monetary restraint is too great in particular spheres, action should be taken either to substitute other types of policy for monetary ones or aid should be given directly to the sectors where the cutbacks appear to be anti-productive from the point of view of the economy as a whole. Until evidence is available to the contrary, however, I believe the most reasonable presumption is that special ceilings on all, negotiable or small, CD's would not offer sufficient aid to the mortgage market to make worthwhile the sacrifices they would entail for savers, other institutions, and many borrowers. A Pandora's box might be opened in which decisions now made by the market as to how to distribute savings among institutions and borrowers would have to be made by law or governmental fiat. This I am certain we would all much prefer to avoid.