

# PUBLIC DEBT CEILING AND INTEREST RATE CEILING ON BONDS

---

---

## HEARINGS BEFORE THE COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

EIGHTY-SIXTH CONGRESS  
FIRST SESSION

ON

REQUEST OF THE PRESIDENT FOR AN INCREASE IN THE  
CEILING OF THE PUBLIC DEBT AND FOR REMOVAL OF  
THE INTEREST RATE CEILING ON SAVINGS BONDS AND  
NEW TREASURY BOND ISSUES

---

JUNE 10, 11, AND 12, 1959

---

Printed for the use of the Committee on Ways and Means



UNITED STATES  
GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1959

41950

## COMMITTEE ON WAYS AND MEANS

WILBUR D. MILLS, Arkansas, *Chairman*

AIME J. FORAND, Rhode Island	RICHARD M. SIMPSON, Pennsylvania
CECIL R. KING, California	NOAH M. MASON, Illinois
THOMAS J. O'BRIEN, Illinois	JOHN W. BYRNES, Wisconsin
HALE BOGGS, Louisiana	HOWARD H. BAKER, Tennessee
EUGENE J. KEOGH, New York	THOMAS B. CURTIS, Missouri
BURR P. HARRISON, Virginia	VICTOR A. KNOX, Michigan
FRANK M. KARSTEN, Missouri	JAMES B. UTT, California
A. S. HERLONG, JR., Florida	JACKSON E. BETTS, Ohio
FRANK IKARD, Texas	BRUCE ALGER, Texas
THADDEUS M. MACHROWICZ, Michigan	ALBERT H. BOSCH, New York
JAMES B. FRAZIER, JR., Tennessee	
WILLIAM J. GREEN, JR., Pennsylvania	
JOHN C. WATTS, Kentucky	
LEE METCALF, Montana	

LEO H. IRWIN, *Chief Counsel*

JOHN M. MARTIN, JR., *Assistant Chief Counsel*

THOMAS A. MARTIN, *Minority Counsel*

GERARD M. BRANNON, *Professional Staff*

# CONTENTS

	Page
Press release, dated June 8, 1959, regarding request of the President for an increase in ceiling of the public debt and removal of the interest rate ceiling on savings bonds and new Treasury bond issues.....	1

## STATEMENTS

American Woman's Council, Mrs. Cecil Norton Broy, first vice president.....	284
Anderson, Hon. Robert B., Secretary of the Treasury.....	2, 33, 67
Baird, Julian B., Under Secretary of the Treasury for Monetary Affairs.....	2
Bennett, Representative Charles E., of Florida.....	250
Broy, Mrs. Cecil Norton, first vice president, American Women's Council.....	284
Budget Bureau, Hon. Maurice H. Stans, Director.....	216
Colm, Gerhard, chief economist, National Planning Association.....	289
Federal Reserve System:	
Martin, Hon. William McChesney, Jr., Chairman, Board of Governors.....	173
Young, Ralph A., Director, Division of Research and Statistics.....	173
Hargis, Representative Denver D., of Kansas.....	271
Hemphill, Representative Robert W., of South Carolina.....	287
Johnson, Representative Byron L., of Colorado.....	274
Martin, Hon. William McChesney, Jr., Chairman, Board of Governors, Federal Reserve System.....	173
Matthews, Representative D. R. (Billy), of Florida.....	252
National Planning Association, Gerhard Colm, chief economist.....	289
Patman, Representative Wright, of Texas.....	221
Reuss, Representative Henry S., of Wisconsin.....	253
Rogers, Representative Paul G., of Florida.....	272
Stans, Hon. Maurice H., Director, Bureau of the Budget.....	216
Treasury Department:	
Anderson, Hon. Robert B., Secretary.....	2, 33, 67
Baird, Julian B., Under Secretary for Monetary Affairs.....	2
Wright, Representative James C., Jr., of Texas.....	261
Young, Ralph A., Director, Division of Research and Statistics, Federal Reserve System.....	173

## LETTERS, EXHIBITS, ETC.

American Bankers Association, Reno Odlin, chairman, savings bonds committee, telegram to Congressman Mills, dated June 10, 1959.....	315
American Farm Bureau Federation, Charles B. Shuman, president, telegram to Congressman Mills, dated June 12, 1959.....	316
Anderson, Hon. Robert B., Secretary of the Treasury:	
Chart A. Public and private debt.....	34
Chart B. Market yield trends of short- and long-term securities.....	46
Chart C. Changes in major forms of debt.....	48
Chart 1. Longer term U.S. Treasury and Government aided debt outstanding.....	5
Chart 2. Federal securities held by nonbank investors.....	7
Chart 3. E- and H-bonds—cash sales and redemptions.....	10
Chart 4. Maturity yields on E-bonds and market rates.....	11
Chart 5. Interest rates on E-bonds and savings accounts.....	12
Chart 6. Trends in individuals' savings.....	12
Chart 7. Market yields on Governments.....	17
Chart 8. Interest cost on new long-term corporate bonds.....	18
Chart 9. Interest cost on new long-term Treasury bonds.....	19
Chart 10. Long-term interest rates since 1920.....	20
Chart 11. Changes in major forms of debt.....	22

Anderson, Hon. Robert B., Secretary of the Treasury—Continued	Page
Chart 12. The Treasury cash balance problem.....	25
Chart 13. Budget expenditures—semiannual.....	26
Chart 14. Budget receipts—semiannual.....	27
Chart 15. Budget surplus or deficit—semiannual.....	28
Chart 16. Monthly range of public debt subject to limit.....	29
Estimated distribution of the interest on the public debt fiscal years 1946 and 1958.....	44
Letter to the Speaker of the House of Representatives, dated June 8, 1959, with two proposed bills enclosed.....	76
A bill to facilitate management of the public debt, and for other purposes, with a section-by-section analysis.....	78
A bill to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, with a section-by-section analysis.....	84
Long-range commitments and contingencies of the U.S. Government as of December 31, 1958.....	151
Table 1. Forecast of public debt outstanding, fiscal year 1960, based on constant operating cash balance \$3.5 billion (excluding free gold).....	32
Table 2. Actual cash balance and public debt outstanding July 1958–May 1959.....	32
Colm, Gerhard, chief economist, National Planning Association, table entitled "Sources and uses of gross saving".....	299
deLaittre, John, president, National Association of Mutual Savings Banks, letter to Congressman Mills, dated June 12, 1959, with an address by Carl G. Freese, chairman of the committee on Government securities and the public debt, National Association of Mutual Savings Banks, entitled "Federal Debt Management and the Savings Banking Industry" enclosed.....	316
Heller, Dr. Walter W., speech entitled "Why a Federal Debt Limit" filed by Representative Byron L. Johnson, of Colorado.....	274
Johnson, Representative Byron L., of Colorado, speech made by Dr. Walter W. Heller, entitled "Why a Federal Debt Limit".....	274
National Association of Mutual Savings Banks, John deLaittre, president, letter to Congressman Mills, dated June 12, 1959, with an address by Carl G. Freese, chairman of the committee on Government securities and the public debt, National Association of Mutual Savings Banks, entitled "Federal Debt Management and the Savings Banking Industry" enclosed.....	317
National Planning Association, Gerhard Colm, chief economist, table entitled "Sources and uses of gross saving".....	299
Odlin, Reno, chairman, Savings Bonds Committee, American Bankers Association, telegram to Congressman Mills, dated June 10, 1959.....	315
Patman, Representative Wright, of Texas: Article from New York Times, dated Mar. 15, 1959, entitled "U.S. Bond Study Called Overdue".....	248
Article from Washington Post and Times Herald, dated March 9, 1959, entitled "U.S. Bond Market Speculation Probed".....	249
Table 1. Gross Federal debt per capita, 1939–53.....	243
Table 2. Demand for private savings as related to gross national product 1951–58.....	243
Table 3. Rate of personal savings compared with interest rates, 1951–58.....	244
Table 4. Changes in interest rates compared with changes in rate of personal savings.....	244
Table 5. Average maturity of marketable interest-bearing public debt.....	244
Table 6. Business loans of member banks, 1955 and 1957, by size of borrower.....	245
Table 7. Change in amount of business loans of member banks, 1955–57, by business and size of borrower.....	246
Table 8. Business loans of member banks, 1955–57, by business and relative size of borrowers.....	247
President's message to Congress regarding management of the public debt, dated June 8, 1959.....	74

	Page
Shuman, Charles B., president, American Farm Bureau Federation, telegram to Congressman Mills, dated June 12, 1959.....	316
Treasury Department, Hon. Robert B. Anderson, Secretary:	34
Chart A. Public and private debt.....	46
Chart B. Market yield trends of short- and long-term securities.....	48
Chart C. Changes in major forms of debt.....	5
Chart 1. Longer term U.S. Treasury and Government aided debt outstanding.....	7
Chart 2. Federal securities held by nonbank investors.....	10
Chart 3. E- and H-bonds--cash sales and redemptions.....	11
Chart 4. Maturity yields on E-bonds and market rates.....	12
Chart 5. Interest rates on E-bonds and savings accounts.....	12
Chart 6. Trend in individual's savings.....	17
Chart 7. Market yields on Governments.....	18
Chart 8. Interest cost on new long-term corporate bonds.....	19
Chart 9. Interest cost on new long-term Treasury bonds.....	20
Chart 10. Long-term interest rates since 1920.....	22
Chart 11. Changes in major forms of debt.....	25
Chart 12. The Treasury cash balance problem.....	26
Chart 13. Budget expenditures--semiannual.....	27
Chart 14. Budget receipts--semiannual.....	28
Chart 15. Budget surplus or deficit--semiannual.....	29
Chart 16. Monthly range of public debt subject to limit.....	44
Estimated distribution of the interest on the public debt fiscal years 1946 and 1958.....	76
Letter to the Speaker of the House of Representatives, dated June 8, 1959, with two proposed bills enclosed.....	78
A bill to facilitate management of the public debt, and for other purposes, with a section-by-section analysis.....	84
A bill to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, with a section-by-section analysis.....	151
Long-range commitments and contingencies of the U.S. Government as of December 31, 1958.....	32
Table 1. Forecast of public debt outstanding, fiscal year 1960, based on constant operating cash balance \$3.5 billion (excluding free gold).....	32
Table 2. Actual cash balance and public debt outstanding July 1958-May 1959.....	32
Wright, Representative James C., Jr., of Texas, amortization table, based upon a national debt of \$280 billion, paid off at the rate of 1 percent each year, and interest at the hypothetical rate of 3½ percent on the unpaid balance.....	268



# PUBLIC DEBT CEILING AND INTEREST RATE CEILING ON BONDS

WEDNESDAY, JUNE 10, 1959

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
*Washington, D.C.*

The committee met at 10 a.m., pursuant to call, in the committee room, New House Office Building, Hon. Wilbur D. Mills (chairman) presiding.

The CHAIRMAN. The committee will please be in order.

Our public hearings this morning are for the purpose of considering the request of the President for an increase in the ceiling on the public debt and for changes with respect to the interest rate ceiling on savings bonds and new Treasury bond issues.

Without objection, the press release referring to this hearing will be printed at this point.

[Press release, for immediate release, Monday, June 8, 1959, Committee on Ways and Means, U.S. House of Representatives, 1102 New House Office Building]

CHAIRMAN WILBUR D. MILLS, DEMOCRAT, OF ARKANSAS, COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES, ANNOUNCES PUBLIC HEARINGS ON REQUEST OF THE PRESIDENT FOR AN INCREASE IN THE CEILING OF THE PUBLIC DEBT AND REMOVAL OF INTEREST RATE CEILING ON SAVINGS BONDS AND NEW TREASURY BOND ISSUES

Chairman Wilbur D. Mill, Democrat, of Arkansas, Committee on Ways and Means, House of Representatives, today announced that the Committee on Ways and Means would conduct public hearings beginning Wednesday, June 10, 1959, on the request of the President for legislation to provide for an increase in the public debt ceiling and for legislation to remove the statutory ceiling on the interest rate payable on new Treasury bond issues and on savings bonds. Chairman Mills stated that the Honorable Robert B. Anderson, Secretary of the Treasury, would be the first witness to testify before the committee to be followed by the Honorable William McChesney Martin, Jr., Chairman of the Federal Reserve System, Board of Governors; and the Honorable Maurice H. Stans, Director of the Bureau of the Budget.

At the present time, the permanent statutory ceiling on the public debt is \$283 billion. In addition, there is an additional temporary increase of \$5 billion which expires June 30, 1959. The ceiling on the interest rate which can be paid on Treasury bonds presently is  $4\frac{1}{4}$  percent and the present interest rate ceiling on savings bonds is 3.26 percent. The President has requested the Congress to raise the permanent public debt ceiling from \$283 to \$288 billion, with an additional temporary increase to \$295 billion through June 30, 1960. The President requested that the interest rate ceilings on savings bonds and Treasury bonds be removed.

Our first witness this morning is the Secretary of the Treasury, the Honorable Robert B. Anderson.

Mr. Anderson, we are always pleased to have you before the committee and you are recognized, sir, to proceed in your own way.

**STATEMENT OF HON. ROBERT B. ANDERSON, SECRETARY OF THE TREASURY, ACCOMPANIED BY JULIAN B. BAIRD, UNDER SECRETARY FOR MONETARY AFFAIRS; WILLIAM T. HEFFELFINGER, FISCAL ASSISTANT SECRETARY; ROBERT P. MAYO, ASSISTANT TO THE SECRETARY; AND CHARLES E. WALKER, ASSISTANT TO THE SECRETARY**

Secretary ANDERSON. Thank you, Mr. Chairman.

I should like to say that it is always a pleasure to appear before this committee and I come this morning rather apologetically because of the length of the statement which I have. It is broken into two parts, one of which I shall present to the committee, and the other which is added as a supplement in order not to unduly tax the committee's time.

My only justification for such a lengthy statement is the importance of the issues which are before this committee for their consideration.

I appear this morning to support policies I sincerely believe to be in the best interests of 176 million Americans. I do so in the realization that all thoughtful people share common objectives. We realize there are honest differences of opinion as to the methods by which these objectives may be attained.

Fundamentally, we Americans endeavor to achieve sustainable economic growth in terms of real goods and services. We seek a sustainable rate of growth that would promote maximum job opportunities, continuity of employment, and real earnings. We seek as well to insure that the process of saving, which underlies the growth of this or any other country, is not diminished but encouraged. We seek to protect the welfare of those individuals who now depend for their livelihood on accumulated savings, the proceeds of insurance policies, benefits of retirement systems, the aid of social security payments, and similar accumulations from a lifetime of effort.

We seek also to insure that those who plan for the education of their children, who guard against adversity, and who provide for their own economic well-being through any process of accumulated savings shall not have the rewards of their diligence and thrift diminished.

We live in a world of tensions and in a world where new nations with new freedoms are seeking to improve their standards of living and their economic well-being, where all eyes are turned toward America. A sound domestic economy is essential if we are to maintain sufficient military strength to preserve freedom and liberty for ourselves and our friends abroad. If we are to witness the growth of better conditions for our neighbors all over the world, we must adopt and staunchly support enduring sound monetary and fiscal policies, the same policies that we have strongly encouraged them to adopt in their own interests.

We must not be unmindful of the lessons to be learned from the financial history of others who have tried methods less demanding and less exacting, nor must we succumb to the belief that real wealth is created by any other means than by the physical and mental labor of human beings working with the physical resources with which each country is blessed.

Mr. Chairman, it is with this belief that we support the proposals which have been laid before you by the President. In a world of economic complexities, there is a constant interrelationship between fiscal policy, monetary policy, and the individual and collective actions of all who participate in our economic structure. We cannot isolate one and set it apart as controlling, but we can say that each, in its own sphere, is a *sine qua non* to the achievement of our total objectives.

It is because of my belief that the people of our country are willing to subscribe to the disciplines which freedom exacts from government and individuals that I have confident faith in the security and well-being of our Nation's future.

I should like now to address myself to one important element of our economic life, the management of our national debt.

The public debt rose last month to an all-time high of \$287.2 billion and is now only slightly below that figure. This represents over \$1,600 for each man, woman, and child in America. The Federal Government owes as much money as all of the corporations in the United States put together. Our debt is as large as the debts of all the individual borrowers in the country put together plus the debts of all of our State and local governments.

The U.S. Government, therefore, owes about one-third of all of the debt in the United States and is the largest single borrower. In the calendar year 1958, the Treasury issued \$69 billion of new marketable securities—\$19 billion for cash and \$50 billion in refinancing maturities, quite apart from the continuing rollover of about \$22 billion of weekly bill maturities. All of the corporations in America issued slightly under \$10 billion of new bonds and notes last year while State and municipal new security issuances amounted to \$7½ billion.

In the year ahead, the Treasury faces the refinancing of \$76 billion of short-term securities that will mature. In some ways, the volume of this short-term debt is as important a factor in our financing picture as the size of the total debt. Each time the Treasury goes to the market—either for refunding operations or for new cash borrowing needed to cover seasonal requirements or retirement of other securities—it is a significant event in all financial markets. Both the size of our borrowing requirements and the frequency of our trips to the market tend to interfere with the smooth marketing of new corporate and State and local government securities.

Another problem related to the large size of the debt maturing within 1 year is that such debt is only one step away from money. It should be realized, however, that in this country we have a large active and continuous demand for short-term debt instruments outside of the banking system inasmuch as corporations, State, and local governments, foreign accounts, and many other investors invest their short-term funds in this manner. Almost 60 percent of our under-1-year debt, therefore, is held outside of the banks—a larger percentage than in any other country we are aware of.

Even though it is preferable to have large amounts of short-term securities in the hands of nonbank investors rather than in commercial banks, we must never lose sight of the fact that a well-balanced debt structure calls for continued offerings of intermediate

and longer term securities, whenever conditions permit, if debt management is to be conducted in a manner consistent with economic growth and stability.

The quest for a balanced structure of the debt is never-ending since the passage of time brings more and more of the outstanding debt into the short-term area. The high point of our under-1-year debt was reached at the end of 1953 when the total was \$80 billion. The total is now \$76 billion, having dropped below \$60 billion for short periods in 1955 and 1956.

If the Treasury should be able to do nothing but issue under-1-year securities to replace maturing issues between now and December 1960, instead of the present \$76 billion, we would have almost \$100 billion of under-1-year debt outstanding at that time.

The Treasury does not intend this to happen. We must, therefore, continue to sell intermediate and longer term bonds whenever appropriate as we try to keep the short-term debt from growing. The only reason we have been able to keep the short-term debt from growing since December 1953 is that since then we have issued \$34 billion of 5- to 10-year bonds, \$2 billion of 10- to 20-year bonds, and \$6½ billion of over 20-year bonds.

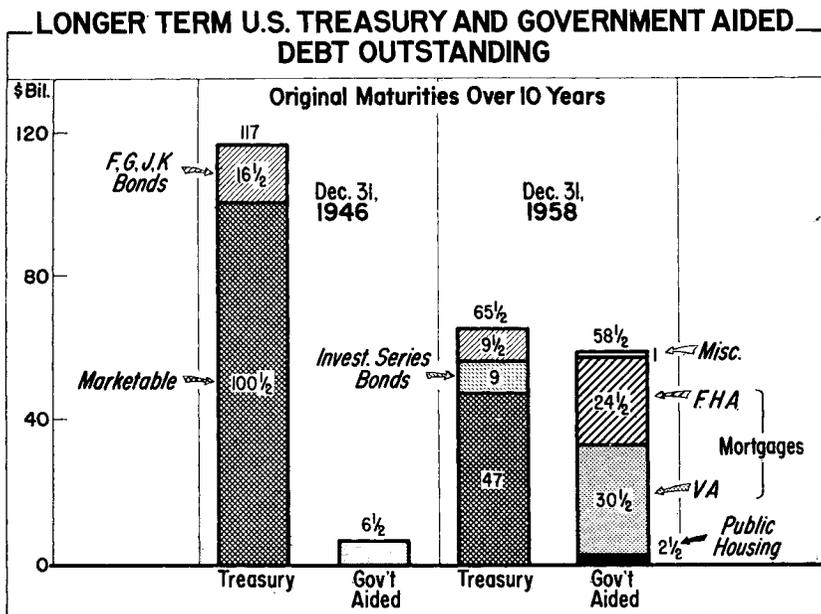
#### THE COMPETITION WHICH WE FACE

Let us look at some of the competitive phases of our problems. Federal Government programs to guarantee home mortgages for veterans and to provide FHA insurance on various types of mortgages have contributed to the unprecedented volume of homebuilding in America since World War II. But they have also fostered a marked improvement in the quality of mortgages as investments for the billions of dollars that Americans each year save out of their earnings—savings which they invest directly or of which insurance companies, savings banks, savings and loan associations, or pension funds invest in their behalf.

There are a great many other debt obligations outstanding today which our Government also aids in one way or another, including securities issued by many Federal Government agencies, even though those securities are not actually guaranteed by the U.S. Government. While the volume of long-term Government-aided obligations has been growing, the volume of long-term Treasury bonds has been declining. At the end of 1946, for example, there were \$117 billion of U.S. Treasury bonds outstanding which originally bore maturities of over 10 years. In contrast, there was \$6½ billion of what might be called long-term "Government-aided" debt outstanding. Twelve years later—December 31, 1958—the \$117 billion total of long-term Government bonds had shrunk to \$65½ billion, while the \$6½ billion Government-aided total had grown to \$58½ billion—\$55 billion of which is in FHA and VA mortgages alone.

(Chart No. 1 follows:)

CHART 1



Secretary ANDERSON. In addition, the continuation of high individual and corporate income tax rates in the postwar period has made the complete exemption from Federal income taxes which is enjoyed by State and local government securities very valuable. State and local debt outstanding has increased from \$16 billion in 1946 to \$59 billion in 1958. Tax exemption has contributed to the ability of State and local governments to sell their securities, but it has also meant that Federal securities are relatively that much less attractive.

Competition for funds available for investment has also been increased in other ways. A high corporate income tax rate has made corporations more inclined to borrow than to issue stock, since interest payments are deductible for income tax purposes but dividend payments are not. Moreover, from the standpoint of the average small saver, Federal insurance of bank deposits and savings loan shares has practically eliminated any difference in risk between private savings and Government bonds.

The problem of encouraging more long-term investors to buy and hold Treasury securities is also increased by the tendency among some investors to prefer stocks to fixed dollar obligations because of

what I believe to be a mistaken conviction that the purchasing power of the dollar will decline further. It is in this environment that the sale of enough long- and intermediate-term Treasury securities sufficient to keep the debt from getting shorter must also compete with large and growing demands for borrowing by State and local governments, by corporations for plant and equipment needs, and by homebuilders and buyers.

Many investors have also become increasingly confident in the continued growth potentials of our Nation. As this grows, the high quality of Government securities becomes relatively less important than in the past and the safest bonds in the world—U.S. Government securities—are more difficult to sell.

In recent years there has been substantial liquidation of long-term Government securities by investors who bought large amounts of such securities during World War II, based on the improvement in the relative attractiveness of other investments.

Long-term Treasury securities are held primarily by three broad classes of private investors other than commercial banks. The first group consists of savings institutions such as insurance companies, mutual savings banks, saving and loan associations, corporate pension funds, and State and local government pension funds. These investors, in the aggregate, held only \$31 billion of Government securities in December 1958, as compared with \$41½ billion 12 years ago.

When the rapid growth of institutional assets generally is taken into consideration the decline in their holdings of Government securities is even more striking. In 1946, life insurance companies had 45 percent of their assets invested in Government securities; the percentage now is 7 percent, far below the 18-percent level back in 1939.

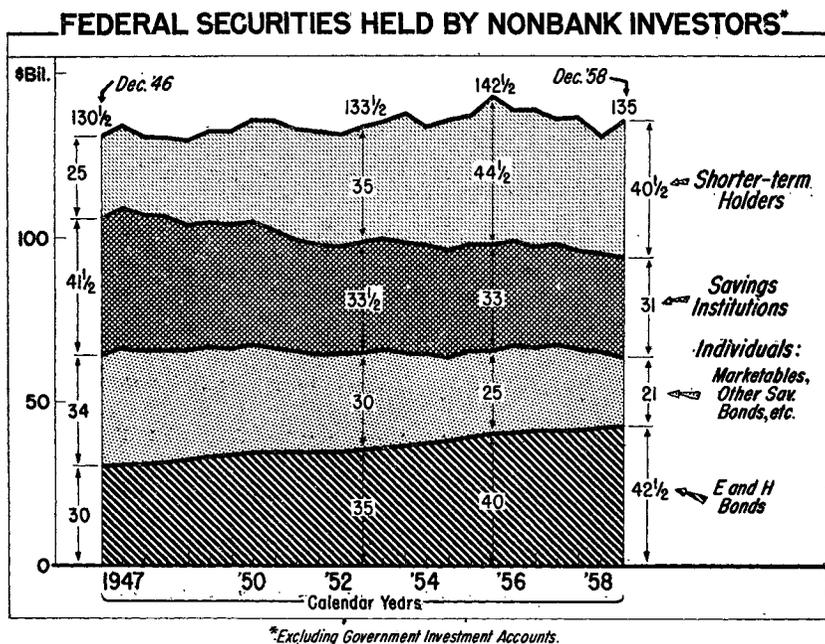
Twelve years ago mutual savings banks had 63 percent of their assets invested in Government securities; that has now been reduced to 19 percent. Savings and loan associations now have only 7 percent of their assets in Governments, although their percentage has never been much higher.

Corporate pension funds have 12 percent of their assets in Governments as against 30 percent just a few years ago. Even in State and local pension funds, where statutory requirements are much less favorable to investments outside of Government securities, the percentage invested in Governments has fallen from 54 to 35 percent in the last 6 years alone.

The second group of long-term investors includes principally personal trust accounts and individuals in the upper income brackets. Their holdings of Governments have also declined substantially in the postwar years—from \$34 billion in December 1946 to \$21 billion now. It is in this group where competition with tax-exempt State and local obligations becomes most important.

(Chart No. 2 follows:)

CHART 2



Secretary ANDERSON. By contrast, there is a third group whose holdings have been growing. This group includes the millions of small savers who buy and hold series E and H savings bonds. Through the savings bond program they have added substantially to their holdings of Government securities in the postwar period—from \$30 billion in 1946 to more than \$42½ billion now.

There is also a fourth area of long-term investment demand for Government securities apart from private investors—Federal Government investment accounts.

These accounts—social security funds, veterans' life insurance funds, civil service and railroad retirement funds, et cetera, added substantially to their holdings during the entire postwar period at an average rate of about \$21½ billion a year until last year. During the fiscal year 1959, however, trust fund expenditures are exceeding receipts, serving to complicate further the Treasury's task of keeping the short-term debt from growing.

We are just completing a fiscal year in which the largest peacetime deficit in the history of our country had to be financed. In contrast, we are looking forward to having sufficient budget receipts next year to cover our expenditures. That fact, in itself, should brighten significantly the opportunities to improve the debt structure. Budgetary soundness has a pervasive effect in improving the environment in which we operate. The confidence which grows out of proving that we can live within our means is contagious.

Our willingness and ability to act soundly in managing our debt and in conducting our fiscal affairs is important also to our friends throughout the free world who have a right to look to the United States as an example of fiscal integrity.

While the gold movements of the past 18 months have been in response to the normal functioning of gold in international exchange, the correction of prior adjustments, and the historical rebuilding of monetary reserves, they should serve as a reminder that the postwar dollar shortage has long since disappeared, although there remains a shortage of capital resources in many of the less-developed countries. These gold movements should remind us that other nations have built strong financial and industrial communities and that we must reorient our thinking in order to perform our full responsibility in the conduct of our internal and international economic affairs.

We have demonstrated the ability of a free economy to come out of an economic recession; it remains for us to demonstrate the willingness to pursue appropriate policies during a period of high and rising business activity. Under current conditions, such policies would include at least a balanced budget and sufficient flexibility for the Treasury to permit sound management of the public debt.

We would be less than frank, however, to suggest that living within our means as a National Government will automatically cure the entire problem of managing the public debt. We would also be less than frank if we suggested that the legislation which you have before you will solve all of our problems. We feel very strongly, however, that the proposed legislation can contribute significantly to a fuller realization of our goals of managing the debt in a way that is consistent with sound economic progress.

The President has already outlined his program to you, incorporating principally improvements in the savings-bond program, removing the 4 $\frac{1}{4}$ -percent ceiling on Treasury bond interest rates, and an increase in the debt limit. Proposed legislation on these three parts of the program is incorporated in sections 1 through 3 of the first of the bills we have placed before you. With your permission I should like to discuss each of these three items with you, and also to take up the second proposed bill.

Sections 4, 5, and 6 of the first proposed bill deal with three somewhat technical matters on which I am submitting a short written statement for the record. These sections would provide a 10-year statute of limitations on the liability of paying agents who in rare instances may redeem savings bonds by erroneous payments; clarify the statute which exempts U.S. obligations from State and local taxes, and authorize the issuance of bonds to the Government's various trust funds at the same prices as bonds are issued from time to time to the public. If there are any questions on these provisions, one of my associates will be glad to answer them later.

#### IMPROVEMENTS IN THE SAVINGS BOND PROGRAM

The statement on the savings-bond program which was attached to my letter to the Speaker of the House of Representatives on June 8, 1959, contains a complete description of our savings-bond plans, if the first proposed bill is enacted.

As I pointed out in that statement, the new savings bond program has three major features.

(1) All series E and H bonds sold beginning June 1, 1959, will earn interest of  $3\frac{3}{4}$  percent per annum if held to maturity—one-half percent more than at present—with lesser improved yields for shorter periods of holding.

(2) All series E and H bonds outstanding will also earn approximately one-half percent per annum more than they do now, if held to maturity, starting with their first full semiannual interest period which starts on or after June 1, 1959, with lesser improvement if redeemed earlier.

(3) All series E bonds on which an extension has already been promised and which had not yet reached first maturity before June 1, 1959, will be offered an improved extension on which  $3\frac{3}{4}$  percent will be paid if held the full additional 10 years, with lesser yields (starting at  $3\frac{1}{2}$  percent) for shorter periods of holding.

The savings-bond program is a program that every American has a right to be proud of. It puts more of the public debt in the hands of long-term investors—few people realize that the average dollar invested in these bonds stays with the Treasury approximately 7 years. It also encourages desirable habits of thrift throughout the Nation. Almost half of the current E- and H-bond sales are accounted for by purchases on payroll savings plans by some 8 million Americans throughout industry and Government. Many of these savings grow out of the convenience of the payroll plan, savings which would not be taking place in such volume if it were not for the savings program.

Corporations throughout America, large and small alike, are administering these payroll savings plans on a voluntary basis because they realize their importance and the benefits to their employees of regular habits of thrift. Similarly thousands of banks and other financial institutions across the country are selling bonds every day without compensation because this is a program they sincerely believe in.

As you know, series E and H bonds are designed particularly for small savers. We have more than  $\$42\frac{1}{2}$  billion of E- and H-bonds outstanding at the present time— $\$38$  billion in the accrual-type series E bonds issued at 75 percent of their face value with the interest reflected in successively higher redemption values each 6 months to maturity—and  $\$4\frac{1}{2}$  billion in series H bonds which pay interest currently by semiannual check to give a sliding sale of investment yields approximating E-bond yields for similar periods of holding. These are the only series of savings bonds which the Treasury has currently on sale, although approximately  $\$8\frac{1}{2}$  billion of the old series F, G, J, and K bonds (sales of which were discontinued 3 years ago) are still outstanding.

There are many reasons why so many millions of Americans buy and hold series E and H savings bonds. I have already mentioned the convenience of buying bonds on the payroll savings plan, and you are familiar with the convenience of savings bond redemption privileges throughout the country. Owners of savings bonds never need to worry about market fluctuations; their redemption values at all times are known in advance and are guaranteed by the Treasury.

Furthermore, unlike savings accounts, where rates may move either up or down from year to year, the Treasury guarantees whatever rate of interest it puts on the bond for the full term of that bond.

Americans also know that savings bonds are perfectly safe; the Treasury has replaced over a million of them which have been lost or destroyed since the program began. These are attributes of savings bonds which have not changed over the years, quite apart from the relative attractiveness of the interest rate.

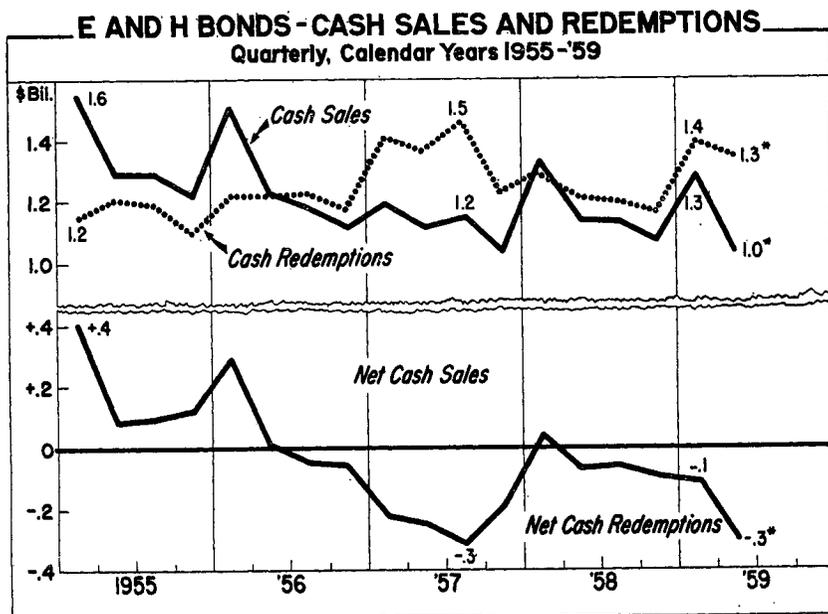
#### CURRENT SAVINGS BOND TRENDS

Sales of series E and H bonds improved slightly from 1957 to 1958 but were still behind sales for 1955 and 1956. Redemptions in 1958 declined significantly from the 1957 peak. But the 1959 record to date has not been good. Sales for the first 5 months are 6 percent behind a year ago, with a worsening trend. Similarly, 1959 redemptions through May are 9 percent above a year ago, also with a worsening trend. The amount of E- and H-bonds outstanding (including accumulated interest on E-bonds) declined by \$36 million in April and May—a greater decline than in any 2-month period since the autumn of 1950.

Furthermore, on a cash basis, the net drain on the Treasury of an excess of redemptions over sales of E- and H-bonds in the current quarter is expected to amount to approximately \$300 million—equal to the cash drain at the low point in the third quarter of 1957. This decline will undoubtedly become much more serious as time goes on unless the present terms of these bonds are improved.

(Chart No. 3 follows:)

CHART 3



\* Estimate based on April and May 1959.

Secretary ANDERSON. Furthermore, we can expect enthusiastic cooperation of financial groups and employers in sponsoring the program only when they can conscientiously recommend savings bonds to themselves, to their customers, and to their employees.

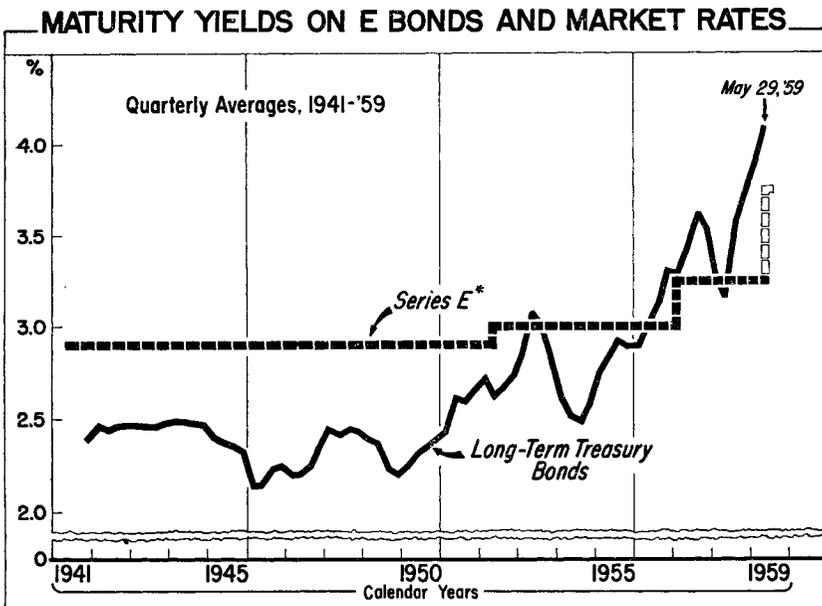
The rate of interest return on E- and H-bonds is now much less favorable in comparison with savings accounts, as well as with other types of securities—both Government and private—than in earlier years. At the end of World War II series E-bonds paid 2.90 percent for a full 10-year term of holding, as compared with 2¼ percent on long-term maturities of marketable Government securities, an average of 2⅔ percent of savings and loan shares, 1⅝ percent on mutual savings bank deposits, and less than 1 percent on commercial bank savings deposits.

At the present time the rate on E- and H-bonds held to maturity is 3¼ percent as compared with more than 4 percent on long-term Treasury marketable securities, and average rates paid of 3⅜ percent on savings and loan shares, 3¼ percent on mutual savings bank accounts, and 2¼ percent on accounts in commercial banks. Furthermore, the holder of an E-bond has to wait 3 years to get as much as 3 percent on his money, whereas the applicable rates on savings accounts apply to a far shorter period of holding.

This is the principal reason, therefore, that the growth of savings bonds in recent years has been far overshadowed by the rapid expansion of savings in mutual savings banks, commercial banks, and—particularly—savings and loan associations.

(Charts Nos. 4, 5, and 6 follow :)

CHART 4



\*Also H bonds beginning June 1952.

CHART 5

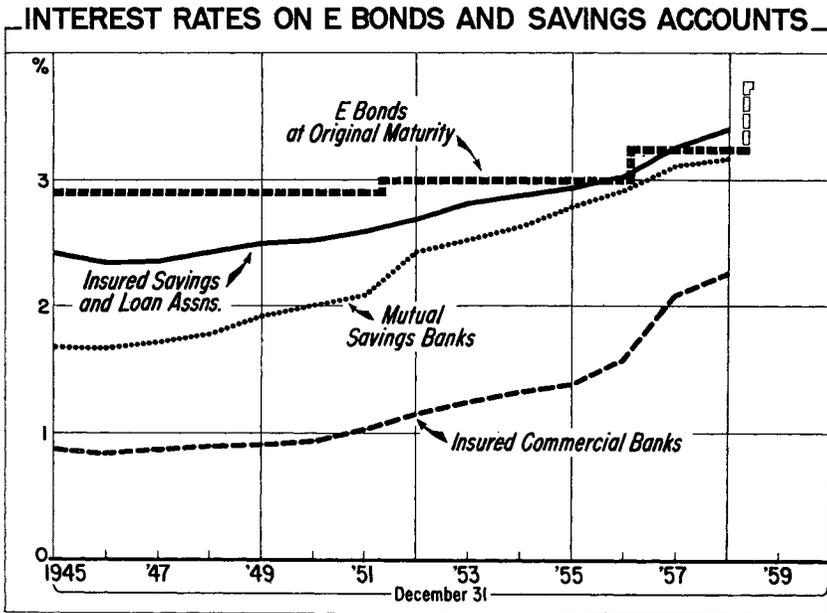
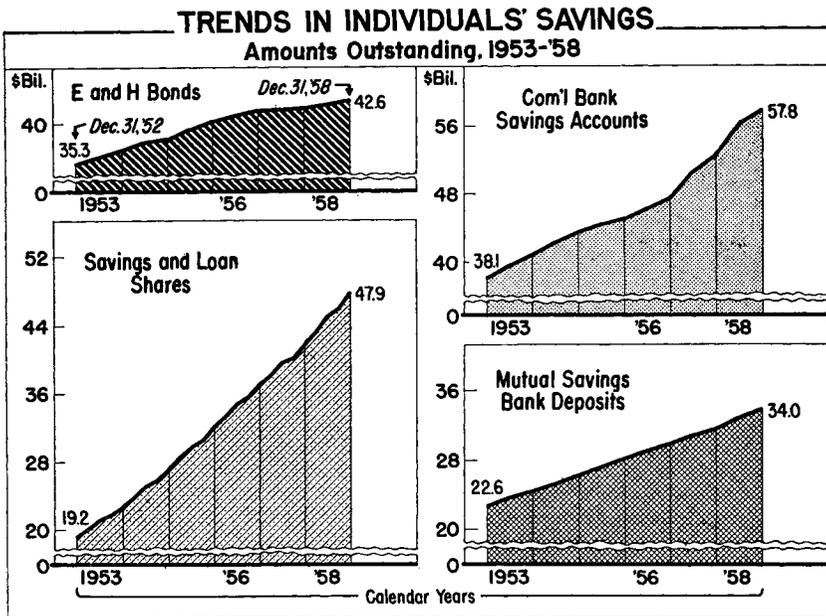


CHART 6



Secretary ANDERSON. The percentage increases during the past 6 years shown on the chart are revealing: 52 percent for commercial bank savings, 50 percent for accounts in mutual savings banks, 150 percent for savings and loan shares, and only 21 percent for E- and H-bonds.

Overall series E savings bond rates were improved from 2.90 to 3 percent in the spring of 1952, and from 3 to 4.25 percent early in 1957. In neither case did the increased rate make up for the increased return on competing savings since the preceding change.

#### SOME FEATURES OF THE NEW SAVINGS BOND PROGRAM

The Treasury's present plan attempts to correct this situation by bringing the savings bond program back approximately to the same competitive position that it held in 1952. It would, by so doing, contribute both to a greater awareness of the advantages of thrift throughout the country and to a better structure of the public debt.

Two of the three features in the new program—a higher rate on new bonds being sold and an improved extension term for bonds reaching maturity—follow the same pattern as in earlier savings bond revisions. You will note that we would like to make these changes effective as of June 1, 1959, regardless of when the legislation is approved, so that purchasers will know it is unwise to stop buying bonds on the false grounds that by waiting they could buy a better bond.

The other feature of our savings bond program is new and although it is rather completely described in the attachment to which I have been referring, I want to call it particularly to your attention. We feel quite strongly that the Government has an obligation to the millions of Americans who hold E- and H-bonds to improve the future earnings of bonds already outstanding. We plan no additional interest on holdings of savings bonds for any period in the past. But we do feel that each holder of an outstanding bond is entitled to an increase of approximately one-half percent per annum on the future earnings of his bond if he holds it to maturity just as we are planning now to pay one-half of 1 percent more to the buyers of new bonds.

Thus, present holders of E or H bonds would have little or no incentive to cash present bonds and buy new ones. Such switching operations would be costly both to the investor and to the Treasury.

The Treasury has, however, an even more important reason for taking this step—a reason which relates to the equitable treatment of all bondholders. The Treasury has something of a trusteeship function on behalf of millions of individual savers who do not follow interest rate trends closely. They buy bonds and hold bonds with understandable faith that the Government is giving them a square deal.

The new savings bond program is expected to add \$30 to \$35 million to the savings bond part of the budget cost of interest on the public debt for the fiscal year 1960. Approximately \$5 million of this increased cost is attributable to the higher rate on new bond sales and to improved extension terms. The remainder is accounted for by increased interest on outstanding E and H bonds.

In assessing the true cost of the new program, however, in terms of overall budget costs of interest on the public debt, allowance should be made for some expectation of increased sales and decreased redemptions as a result of the new program in comparison with a continued deterioration of the savings bond picture if present terms are continued.

The Treasury can borrow more economically through the proposed increase in savings bond terms at the present time than it can by borrowing through marketable securities. We believe, therefore, that the net addition to next year's budget costs for interest on the public debt because of the new savings bond program may be less than \$10 million, and could quite conceivably result in no net increase in all.

It is realized, of course, that the gross cost on savings bonds will tend to build up in later years, but the saving in comparison with alternative borrowing would very likely continue to be a sizable offset.

The inauguration of the new savings and bond program will depend on the favorable consideration by the Congress of section 3 of the first proposed bill. Section 3 will permit the Treasury to pay interest in excess of the present maximum interest rate of 3.26 percent, to pay increased interest on bonds already outstanding, and to permit future extensions of bonds for more than 10 years (the present limit) beyond their original maturity dates.

#### BACKGROUND OF THE 4½ PERCENT INTEREST RATE CEILING

I should like to consider next the 4½ percent interest rate ceiling currently applying to all new issues of Treasury bonds, which includes all new Treasury issues maturing in more than 5 years. Section 1 of the first proposed bill would repeal the present limit.

The earliest of all public debt statutes, in 1790, authorized the President to borrow money on the credit of the United States for the specific purposes of payment of the foreign debt, funding of the existing domestic debt, and assumption of the debts of the several States.

The President delegated this authority to the Secretary of the Treasury, Alexander Hamilton, and this pattern of responsibility continued in general until the early Civil War period. At that time (1861) the Congress directly authorized the Secretary of the Treasury to conduct the financing of the war through the issuance of bonds, 1-year notes, and demand notes.

Prior to World War I, however, the Secretary of the Treasury had little discretion in the actual carrying out of the public debt operations. The acts of Congress authorizing the issuance of U.S. Government obligations usually specified the terms and conditions applicable to each individual issue.

World War I brought a change in this situation. Because of the large amounts of borrowing involved and the expectation that a number of loan operations would be required, Congress departed from its previous policy of specifying the terms and conditions of the obligations to be issued. Instead, in the first and succeeding Liberty Bond Acts, Congress gave the Secretary of the Treasury broader authority to determine the terms and conditions of issue, conversion, redemption, maturities, payment, and the rate and time of payment of interest in respect to the several classes of obligations authorized to be

issued. Interest rate ceilings on Treasury bonds were still set forth in the statutes, however; the last one was the present  $4\frac{1}{4}$  percent rate ceiling.

In making these changes, Congress proceeded in several steps. In the first of the war-financing operations of World War I, authorized by the First Liberty Bond Act in April 1917, Congress departed from its policy of determining the specific terms and conditions of each Treasury issue. The Secretary of the Treasury was authorized, with the approval of the President, to issue securities to the extent of \$5 billion at a rate of interest on bonds issued under this authorization not to exceed  $3\frac{1}{2}$  percent. The bonds were to be offered at not less than par and no commissions were to be paid; other terms were left to the discretion of the Secretary.

There was an expectation that wartime rates might move higher. It was provided, therefore, that these first Liberty loan bonds could be converted into bonds bearing a higher rate than  $3\frac{1}{2}$  percent, if any subsequent series of bonds should be issued at a higher rate before the termination of the war. It may be noted that the effective return on the new bonds was actually higher than  $3\frac{1}{2}$  percent for many owners in comparison with corporate bonds or mortgages, since both principal and interest were exempt from all taxation—Federal, State, and local—except estate and inheritance taxes.

In the same act, authorization was given to the Secretary of the Treasury to issue up to \$2 billion of certificates of indebtedness, 1 year or less to maturity. The interest rate ceiling of  $3\frac{1}{2}$  percent and the tax-exemption privileges provided for the bonds applied also to the certificates.

The Second Liberty Bond Act in September 1917 in effect increased the Treasury's bond-issuing authority under both acts to \$7.5 billion and increased the interest rate ceiling on bonds to 4 percent. The conversion privilege was retained for the new bonds except that in this instance the privilege was to arise only once instead of each time new bonds were issued at a rate higher than 4 percent. In this act and thereafter, the rate of interest payable on certificates was left to the discretion of the Secretary. Tax exemption was retained under the Second Liberty Bond Act, but to a lesser degree.

By the spring of 1918, when a third Liberty loan was under consideration, the bonds of the previous loans were selling below par and industrial and other securities were yielding a return much in excess of the rate on Government bonds. The Third Liberty Bond Act (April 1918), therefore, authorized the issue of  $4\frac{1}{4}$ -percent non-convertible bonds. The tax exemption status of the new bonds was virtually unchanged from the second Liberty loan.

The  $4\frac{1}{4}$ -percent interest rate ceiling was retained for the \$7 billion of bonds issued under the Fourth Liberty Bond Act (July 1918). In order to make the rate more attractive, however, tax exemption privileges were considerably extended with respect to surtaxes, excess profits taxes, and war-profits taxes payable during the war and within a fixed time after the termination of the war.

During the early months of 1919 it became clear that new financing would again be required in the near future. A complicating element in the situation was the fact that the final session of the 65th Congress would terminate on March 4, 1919, considerably before the expected date of the new financing. Carter Glass, then Secretary of the Treas-

ury, wrote to the chairmen of both the House Committee on Ways and Means and the Senate Committee on Finance and presented a strong case for giving the Treasury greater leeway in setting the terms of new issues. He cited at length the difficulty under conditions then prevailing of fixing the terms of loans considerably in advance of the offering.

In a statement before the Ways and Means Committee on February 13, 1919, the Secretary made a number of specific requests in connection with the forthcoming Victory loan, including the request that the interest rate ceiling be removed for notes and for bonds having maturities of less than 10 years.

To withhold from the Secretary of the Treasury the power to issue bonds or notes bearing such rate of interest as may be necessary to make this refunding possible [i.e., refunding the interim certificates issued between the fourth and fifth (Victory) loans] might result in a catastrophe—

the Secretary stated. He added that :

To specify in the act the maximum amount of interest at a figure sufficient to cover all contingencies would be costly, because the maximum would surely be taken by the public as the minimum.

It may be noted that the interest rate on certificates issued in anticipation of the third Liberty loan had risen to 4½ percent a year earlier (February 1918) and had remained at that figure on subsequent issues in anticipation of the fourth and Victory loans. Certificate rates later rose to 6 percent.

Before its adjournment, Congress responded to the Secretary's appeal in March 1919 with the Victory-Liberty Loan Act. This act granted increased discretion to the Secretary of the Treasury to enable him to deal with the situation as it might develop as far as notes were concerned, but his request on bonds was not granted.

A note issue (one of the possibilities previously suggested by the Secretary) was authorized in the amount of \$7 billion—

\* \* \* containing such terms and conditions and at such rate or rates of interest as the Secretary of the Treasury may prescribe.

The notes were to run not less than 1 year nor more than 5 years from the date of issue. In April 1919, the Treasury offered \$4½ billion 4¾ percent 3-4 year gold notes, exempt from State and local taxes (except estate and inheritance) and from normal Federal income taxes, and convertible at the option of the holder into 3¾ percent 3-4 year gold notes exempt from all Federal, State, and local taxes (except estate and inheritance). The 4¼ percent interest rate ceiling on bonds was thus not involved in the final financing of World War I, but only because no bonds were authorized or issued.

#### THE 4 1/4 PERCENT CEILING IN OUR CURRENT ENVIRONMENT

Until recently, the trend of interest rates in the past 25 years has made the 4¼-percent ceiling a somewhat academic problem. Except for a short period in the early 1930's, interest rates were low all through the depression. Confidence in the future had been seriously shaken and available savings exceeded the demand for borrowed funds. In World War II, interest rates were held down artificially on Federal borrowing and the demands for borrowed funds by State and local governments, businesses and individuals were reduced to a minimum by rationing and other direct controls.

After World War II the demand for funds by non-Federal borrowers began to grow again and interest rates started to rise. This was aided by the fact that the Federal Government has not been able to reduce its debt in the postwar period as a whole. Budget surpluses in the 1920's allowed the Federal Government to reduce the public by more than one-third (from \$26 billion in 1919 to \$16 billion in 1930). As a direct result, interest rates declined during a period of general prosperity.

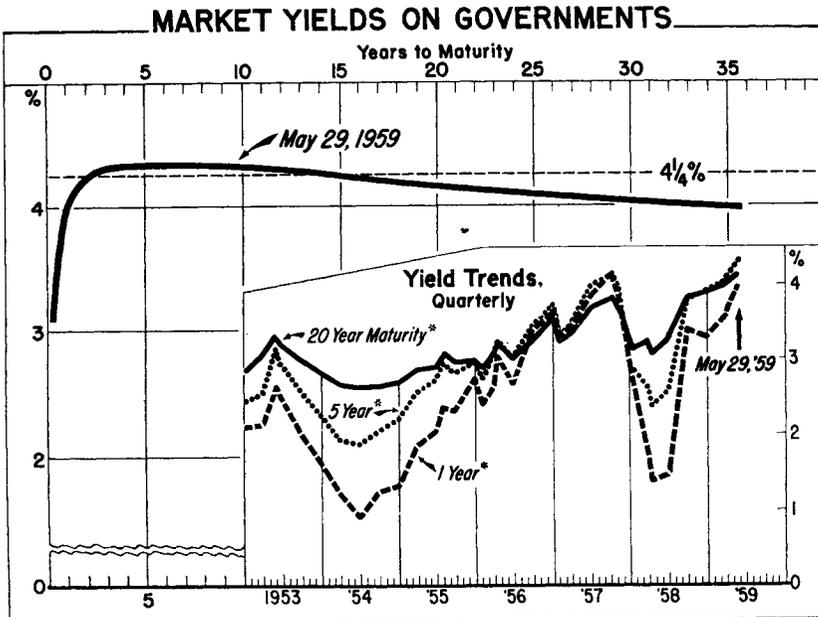
Today, current demands for funds by businesses, homebuilders, State and local governments, and other borrowers continue to push heavily against a relatively modest volume of savings, and interest rates have risen further.

At the present time it is extremely unlikely that the Treasury would be able to issue bonds in any volume at a rate of  $4\frac{1}{4}$  percent or less. This is particularly true of the intermediate term area (5-10 years), where the volume of new bonds which the Treasury can sell is usually substantially larger than the more limited market for bonds in the long-term area. By the end of May 1959, a number of bonds with more than 5 years to run were selling in the market with yields above  $4\frac{1}{4}$  percent.

Chart 7 on the market pattern of rates on outstanding bonds reveals that a large part of the "market curve" is above  $4\frac{1}{4}$  percent. Furthermore, since the market for longer bonds is very thin (very little buying or selling) the "market yield curve" in the longer area is low as an index of what the Treasury would have to pay for a long bond if one were to be issued today.

(Chart 7 follows:)

CHART 7



\*Estimated yields at constant maturities.

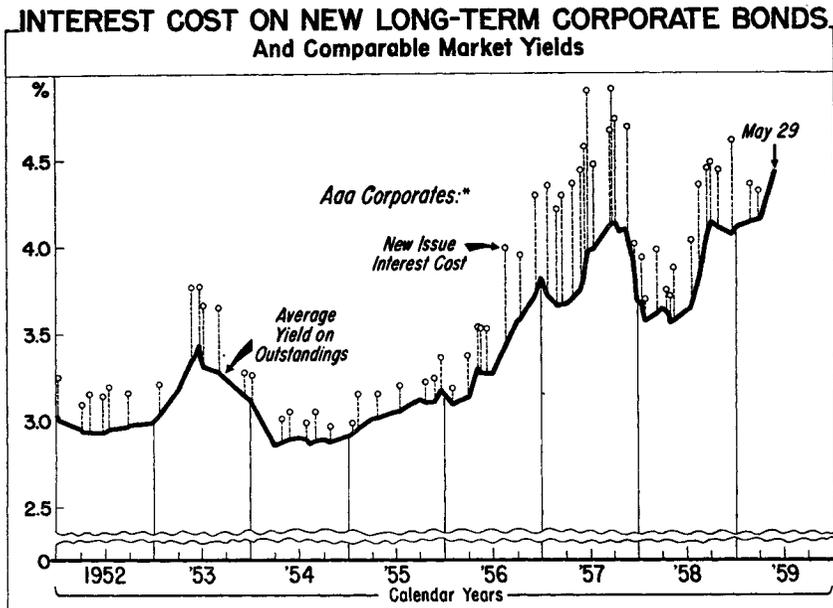
Secretary ANDERSON. To date the Treasury has been able under the  $4\frac{1}{4}$  percent ceiling to sell bonds beyond 5 years to maturity. Last January we sold more than three-quarters of a billion dollars of 21-year bonds to yield 4.07 percent and in March we sold more than half a billion dollars of 4-percent bonds due in  $10\frac{1}{2}$  years. But the market has moved down further since these offerings (down in price, up in yield) and with the present level of interest rates the Treasury would be seriously restricted by the present ceiling from taking advantage of reasonable opportunities to improve the structure of the public debt by issuing intermediate and longer term bonds.

It should be mentioned that since March 1942 the Treasury has had the right to offer securities at a discount. It is permissible under present statutory authority, therefore, for the Treasury to issue a bond with a  $4\frac{1}{4}$ -percent coupon rate at a price below par to yield any rate of interest to the investor above  $4\frac{1}{4}$  percent which may be required by market conditions. The Treasury has not believed it appropriate, however, to circumvent the  $4\frac{1}{4}$ -percent ceiling in this way and is taking the direct approach to the problem by requesting appropriate legislation.

As the President stressed in his message the Treasury borrows at the lowest interest rate at which it can successfully sell the securities it should issue. However, the Treasury must secure its funds in the competitive market for credit as it exists at the time it needs the money. It must sell its securities at rates sufficient to attract buyers who always have the alternative opportunity to buy outstanding securities or new issues of corporate or municipal securities.

These are conditions which are true of both Government and private borrowing. Typically, over recent years, the average new

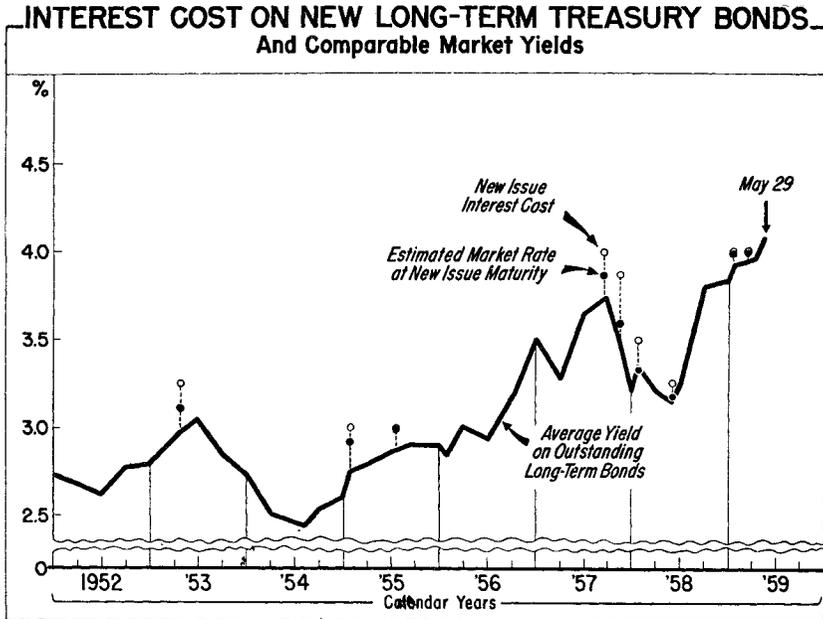
CHART 8



\*Moody's Investors Service.

highest grade corporate security, for example, has cost the borrower about three-tenths of 1 percent more than the market rate on outstanding issues. The Treasury's pricing of new issues has been even closer to the market pattern of rates on outstanding issues than corporate pricing, as is shown in chart 9, in comparison between the new Treasury issue interest cost and the estimated market rates. All borrowers—including the Treasury—try to do their borrowing as cheaply as possible, but each new issue must be attractive or fail.

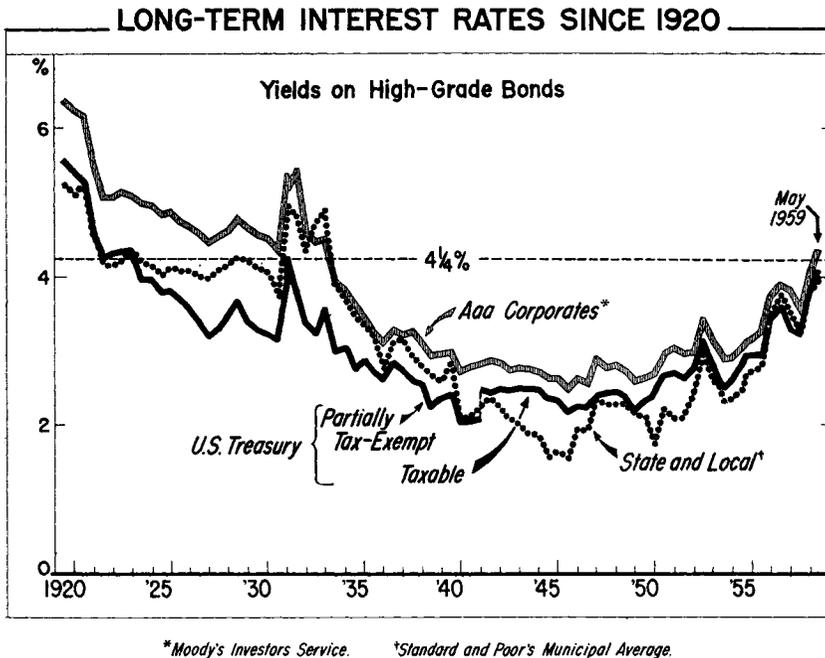
CHART 9



Secretary ANDERSON. Interest yields on long-term Government securities are higher today in the United States than at any time since the 1920's except for a very brief period in the early 1930's. They are still, however, among the lowest in the world.

Long-term Government-bond yields in Canada average approximately 5 percent; long-term yields in the United Kingdom are almost the same, and have been as high as 5½ percent within the past 2 years.

CHART 10



Any comparison between present interest rates in the United States and the rates on Government bonds in 1918, at the time the  $4\frac{1}{4}$ -percent rate was originally established, should also recognize that the original  $4\frac{1}{4}$ -percent rate was in large part a tax-exempt rate, whereas all Treasury bonds issued since February 1941 have been fully taxable—and at income tax rates which are substantially higher than in 1918.

Secretary ANDERSON. The request for removal of the limit reflects an honest appraisal of market conditions for what they are—conditions which have now made the  $4\frac{1}{4}$ -percent ceiling a barrier to effective debt management. Under current conditions, continuation of the  $4\frac{1}{4}$ -percent ceiling would not only deny the Government the opportunity to extend debt, but also could easily increase reliance on short-term financing to such an extent as to result in further imbalance in the debt structure, add to inflationary pressures, and push short-term rates to relatively high levels.

It has been alleged that the removal of the  $4\frac{1}{4}$ -percent ceiling would raise interest rates. This is simply not the case. The inflationary aspects of debt management policy under the present ceiling would raise increasing apprehension both here and abroad as to the future value of the dollar. Nothing contributes so strongly to forcing interest rates upward as fear of inflation. Those investors who want to invest in fixed-dollar obligations (rather than in stocks) will demand higher interest rates to compensate for their expectation of a shrinking purchasing power of the future repayments of principal and interest.

Those who feel that removing the 4¼-percent ceiling would raise rates need only look to the market for shorter term issues, where no ceiling applies.

Treasury 91-day bill rates in a competitive market have moved up and down with the business cycle—up to almost 2½ percent in 1953, down to five-eighths of 1 percent a year later, up to 3⅝ percent in 1957, down to five-eighths of 1 percent a year ago, and up again to over 3 percent now. Even the 5-year rate has fluctuated from below 2 percent to more than 4 percent within the last business cycle.

The President has requested that the limit be removed, not just raised to a higher figure. If the principle of flexibility has any meaning at all, it is clear that applies here. Any figure selected for a new limit would carry with it the connotation that the Government thought that is where interest rates should properly go. As Secretary Glass said in 1919—such a “maximum would surely be taken by the public as the minimum.”

#### HOW INTEREST RATES OPERATE

Popular discussion of interest rates is often clouded by misunderstanding of their nature in a free market economy. It is often incorrectly stated that the level of rates is determined by actions of the Federal Reserve authorities, or that the Treasury determines general interest rate policy each time it issues a new security. The view is also incorrectly expressed that interest rates somehow are fixed at high levels by large financial institutions.

The rise in interest rates which has occurred since last summer—following a rather sharp decline in the preceding 8 months—has been incorrectly attributed by some to have been the result of Federal Reserve and Treasury policies, and it is said that these policies have, in effect, cost the Treasury large sums in interest payments on the public debt. This view is followed with the suggestion that interest rates are “too high” and that something must be done to bring them down.

A supplemental statement that I am submitting contains a description of the factors affecting interest rates in our free market economy, a discussion of the forces causing higher interest rates during the current fiscal year, and an analysis of the various courses of action which might be effective in inducing lower rates of interest. I shall simply summarize briefly at this point the major conclusions reached in my supplemental statement.

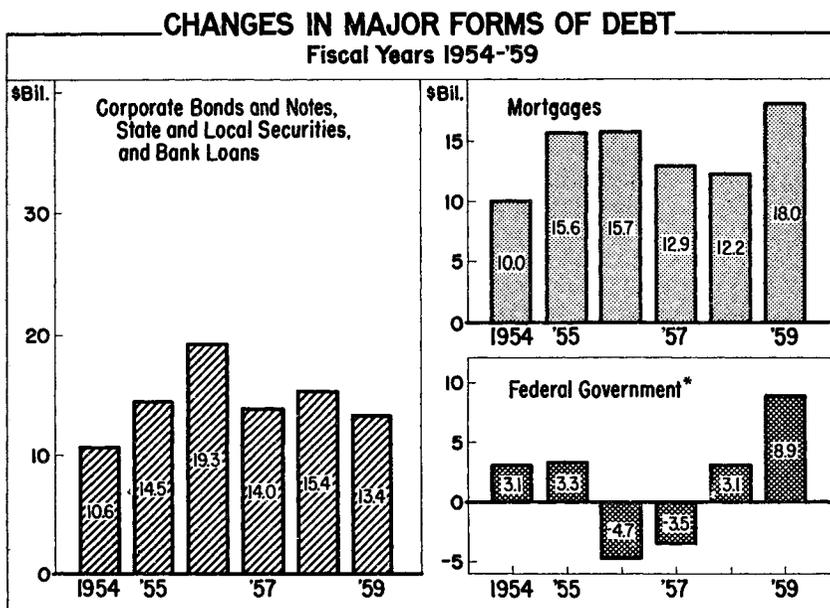
The interest rate is a price—the price of borrowed money. It responds to forces that operate through demand and supply in free credit markets. This being the case, the primary determinants of interest rates are the actions of millions of individuals and institutions rather than those of the Treasury or the Federal Reserve. The rise in interest rates since the end of World War II has resulted primarily from unprecedented demands for credit on the part of individuals, businesses, and State and local governmental units. In addition, the Federal debt has expanded, rather than contracting as it did during the prosperity of the 1920's.

A major factor contributing to the rise in interest rates since last summer has been the record peacetime Federal budget deficit of approximately \$13 billion. As is shown in the chart, during the cur-

rent fiscal year expansion in several categories of debt—which reflect demand pressures in credit markets—have been moderate in comparison with other recent years. Mortgage debt has increased substantially since last summer, but the total expansion in corporate bonds and notes, State and local government securities, and bank loans has been less than in any fiscal year since 1954. In addition, growth in consumer credit, except for recent months, has been moderate. On the other hand, the rise of almost \$9 billion in publicly held Federal securities is in sharp contrast to the moderate increases in fiscal years 1954, 1955, and 1958 and the decrease in 1956 and 1957.

(Chart No. 11 follows:)

CHART 11



\*Excluding debt held by Federal Reserve Banks and Government Investment Accounts.

Secretary ANDERSON. These figures support the judgment that the Federal deficit, rather than debt management or monetary policies, has been an important major factor promoting higher interest rates during this fiscal year, a fact which my supplementary statement treats in detail.

Is there, as some suggest, some practicable way of inducing lower interest rates in this country without causing great harm to our Nation?

The interest burden on the public debt—now about \$8 billion per year—is, of course, of deep concern. Of much more concern, however, is the need to maintain freedom and flexibility in our economy and, at the same time, avoid more erosion in the purchasing power of the dollar. The causes of inflation in a highly industrialized, free-market economy are many and complex. Consequently, a program of inflation control must be broad gaged, and cannot rely on monetary and fiscal policy alone.

Nevertheless, monetary and fiscal policy are indispensable instruments in our attempts to protect the value of the dollar. Logic and experience show that attempts to maintain interest rates at artificially low levels—either through creation of high-powered money by the central bank or by legislative attempts to maintain artificially low interest-rate ceilings—foster inflationary pressures. Inflation works its greatest hardships on people of modest means, whose savings are primarily in savings accounts, savings bonds, insurance policies, and similar types of fixed-dollar assets. Furthermore, an inflationary upsurge is usually followed by recession—the greatest enemy of sustained, rewarding economic growth.

Therefore, in any attempts to promote lower rates of interest, I would strongly counsel against some suggested techniques (discussed in detail in my supplemental statement) that would rely upon the ability of the Federal Reserve System to create large amounts of high-powered dollars.

This does not mean, however, that we cannot take actions which, although perhaps not leading immediately to lower levels of interest rates, would remove some of the significant pressures in the Government fiscal field that have tended to push rates higher during the past year.

In particular, we must have a clear demonstration of our willingness to maintain fiscal and monetary discipline. A period of high and rising business activity, such as the present, requires a surplus in Federal fiscal operations for debt retirement, and freedom for Federal Reserve authorities to conduct flexible credit policies. A budget surplus in the coming fiscal year can convert the Federal Government from a net borrower in credit markets to a net supplier of funds through debt retirement. Pressures on interest rates can be considerably less than if the Treasury had to compete strongly with other borrowers for funds to finance a deficit.

As I have said before, the clearly mistaken view that inflation is somehow inevitable has tended to push interest rates higher. Inflationary expectations generate higher rates primarily because borrowers are anxious to obtain funds that they expect to repay in cheaper dollars, whereas many individuals and institutions with funds to invest prefer equities over debt obligations, or will make loans or purchase bonds only if interest rates are high enough to compensate for the expected rise in prices.

Any actions that would let borrowers and lenders know that the value of the dollar will be preserved would remove one of the pressures promoting higher interest rates. This can be done only by means of a broad-gaged attack on all of the forces and practices that stimulate inflationary pressures. I would reemphasize, however, that under current conditions the most important single action would be a clear demonstration of our determination to maintain fiscal and monetary discipline.

Coupled with this demonstration is the need for greater flexibility in debt management, so that a better balance in the debt structure can be achieved, and so that markets will not become unsettled over such matters as an impinging interest rate ceiling. The removal of the 4¼ percent ceiling on new issues of Treasury bonds would be an important and necessary step in this direction.

The overriding advantage of this approach to reducing pressures on interest rates stems from the fact that the actions would be consistent with the requirements of sustainable economic growth, and would also transmit effects through market forces of demand and supply rather than by means of Government decree or regulation.

By proceeding in this way, the Federal Government would be promoting "maximum employment, production, and purchasing power," as required in the Employment Act of 1946, in a manner consistent with those crucially important but often overlooked words in the act which stipulate that such actions be carried out "in a manner calculated to foster and promote free competitive enterprise and the general welfare."

#### NEEDED INCREASES IN THE DEBT LIMIT

I turn now to the third part of my discussion of the major elements in our public debt legislative package; namely, the President's request for an increase in the public debt limit, as provided for in section 2 of the first proposed bill.

The existence of a restrictive debt limit plays an important part in our struggle for fiscal soundness. Unlike my views on the 4¼ percent interest rate ceiling, I believe a specific dollar ceiling on the public debt serves a useful purpose and can be effective in focusing attention in a unique way on the part of the executive departments, the Congress, and the public to the problems of sound Government finance. Such a limit should be restrictive enough to accomplish this purpose, yet not so rigid as to impede the normal operations of the Treasury. The debt limit changes the President has requested meet this test.

Last July the President recommended enactment of legislation to increase the regular (permanent) statutory debt limit from \$275 billion to \$285 billion and to provide for an additional temporary increase of \$3 billion to expire June 30, 1960. Instead, the act of Congress approved September 2, 1958, increased the regular statutory debt limit to \$283 billion and the temporary increase of \$5 billion for the period ending June 30, 1959, provided for in the act of February 26, 1958, was allowed to continue in effect. As a result, the statutory debt limit will revert to \$283 billion on June 30, 1959, with no provision for any temporary increase in the limitation beyond that time.

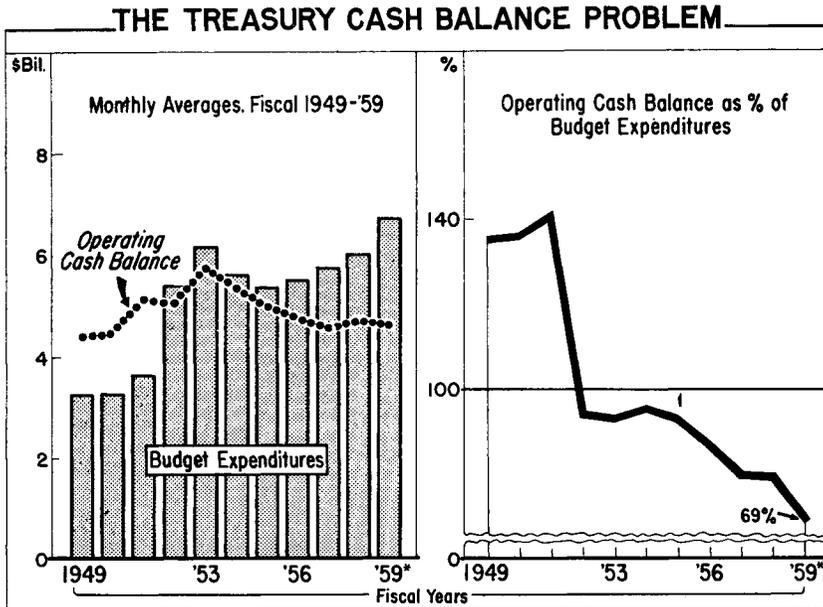
On June 30, 1957, after 2 fiscal years of budget surpluses aggregating more than \$3 billion, the public debt subject to the statutory debt limitation was \$270.2 billion. However, as a result of the recession in late 1957 through early 1958, the Treasury incurred a budget deficit of \$2.8 billion in the fiscal year 1958 and will incur a budget deficit of almost \$13 billion during the year that will end on June 30, 1959, based on the President's January budget estimates.

The financing of these budget deficits is now expected to bring the public debt subject to limit to approximately \$285 billion on June 30, 1959—\$2 billion over the present regular ceiling. As a result the President is proposing an increase in the regular statutory limit to \$288 billion, an increase equal to the \$275 billion debt limit in effect at the beginning of the fiscal year plus the estimated deficit for the current year.

This will enable the Treasury to conduct its debt operations with a margin of \$3 billion to allow the flexibility in debt management operations and contingencies. A \$3 billion margin is essential to proper handling of the Government's operations. The Treasury has been operating on an average cash balance of about \$4½ billion during each of the last 3 fiscal years. This is relatively small; the average operating cash balance this year has averaged only 69 percent of average monthly budget expenditures—the lowest percentage for any recent year, as is shown on the right side of the chart below. The Treasury's cash balance is no higher today than it was a decade ago, when budget spending was half its present rate.

(Chart No. 12 follows:)

CHART 12



\*Estimate on basis of January 1959 Budget Message.

Secretary ANDERSON. The efficient use of cash balances in this way has, however, gone about as far as it can without impairing efficiency of Treasury operations. There are times when a somewhat larger cash balance would have given the Treasury much needed flexibility in timing its borrowing operations so that it could ride out a period of market apathy for new issues, rather than forcing the Treasury to borrow in an unfavorable atmosphere because it was running out of cash.

In addition to maintaining an adequate cash balance, the Treasury should also be prepared to sell new issues of securities a week or so in advance of the maturity of old securities if such action would add materially to the success of a particular financing operation. This was true, for example, of the recently completed May 1959 financing. As part of this financing the Treasury sold \$2 billion of 11-month

Treasury bills with an issue date of May 11 to provide most of the funds necessary to pay off a \$2.7 billion Treasury bill issue maturing on May 15. For the intervening 4 days, therefore, there was an increase in debt of \$2 billion. This was possible only because the Treasury had some flexibility under the \$288 billion temporary ceiling—flexibility which we requested and which the Congress approved last summer.

A third reason for our firm belief that a \$3 billion debt leeway is a minimum relates to the possibility which always exists that there may be sudden demands on the Treasury in event of a national emergency, when the Congress might not be in session.

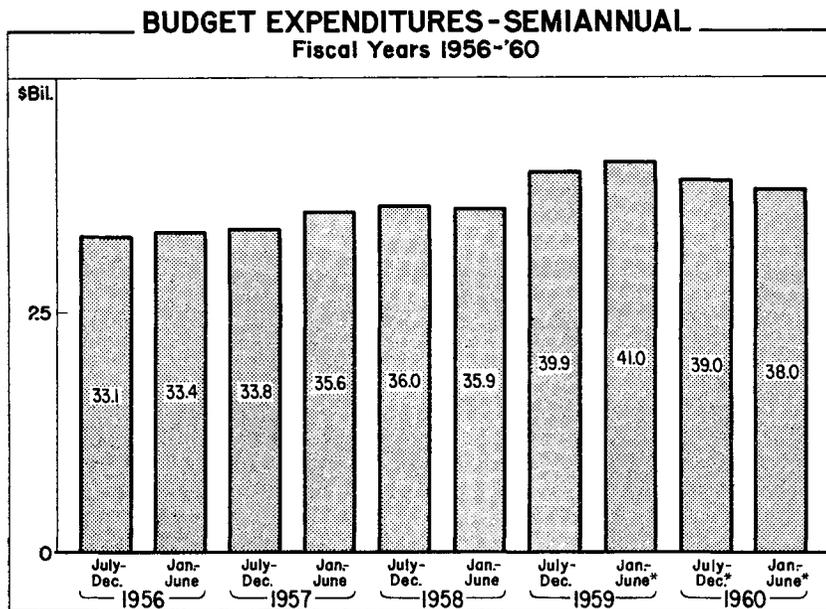
#### OUR DEBT PROJECTIONS FOR FISCAL 1960

The outlook for the fiscal year beginning July 1, 1959, is for a level of budget receipts sufficient to cover budget expenditures. Even with this improvement in our fiscal outlook, however, there will still be a large seasonal deficit in the first half of the fiscal year, offset by a heavy seasonal surplus next spring.

There is no distinct seasonal pattern in budget expenditures between the two halves of the year, as indicated by the chart below, which is based on the January budget estimates.

(Chart No. 13 follows:)

CHART 13

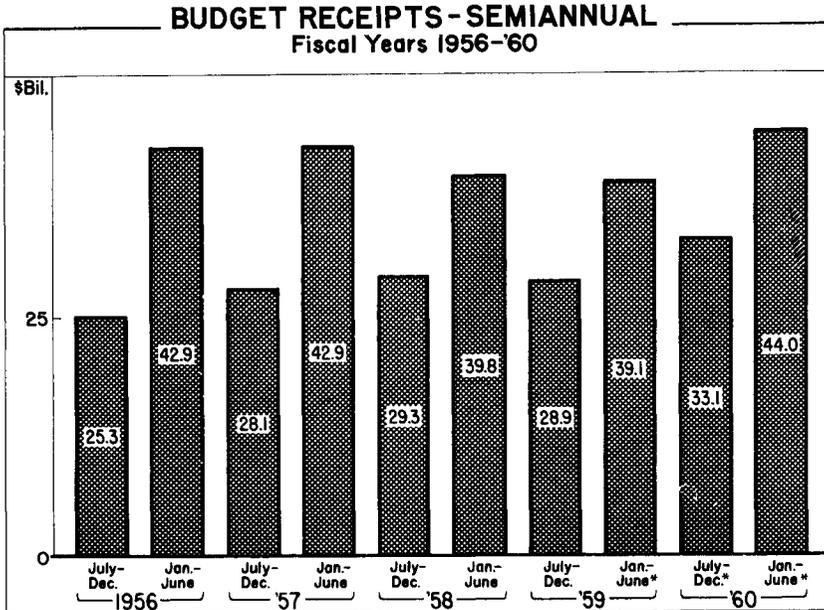


\*Estimate on basis of January 1959 Budget Message.

Secretary ANDERSON. On the other hand the budget receipts follow a distinct seasonal pattern. Even when the speedup in corporate tax collections, growing out of revisions in the Revenue Code of 1954, is completed there will still be a substantial seasonal disparity in tax receipts. As you know, smaller-sized corporations will continue to concentrate payments in the spring which, together with the concentration of individuals' declarations and final payments, will still result in relatively high tax receipts in January-June of each year. Again, the January budget estimates provide the basis for these figures.

(Chart No. 14 follows:)

CHART 14

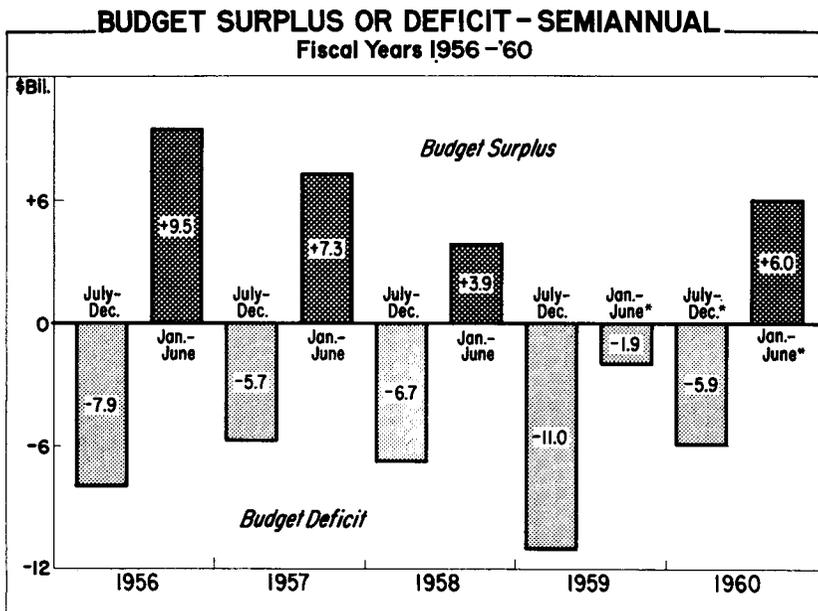


*\*Estimate on basis of January 1959 Budget Message.*

We expect, therefore, that even with a balance between expenditures and receipts for the fiscal year as a whole expenditures will exceed receipts by approximately \$6 billion during the July-December half of the year. The July-December 1959 deficit will be only slightly more than half of the \$11 billion deficit in July-December 1958.

(Chart No. 15 follows:)

CHART 15



\*Estimate on basis of January 1959 Budget Message.

Secretary ANDERSON. At intermediate points, such as December 15 and January 15, the cumulative deficit—and, therefore, borrowing needs—will reach or exceed \$7 billion. That is why the President has requested a temporary debt ceiling of \$29½ billion. We are asking that this temporary limit be provided only through June 30, 1960, although a valid case can be made for a provision that would, for a longer period of time, control the debt at fiscal yearends and yet provide for seasonal requirements within the year. It is entirely appropriate for the Congress to review the debt limit situation each year, however, if it so desires.

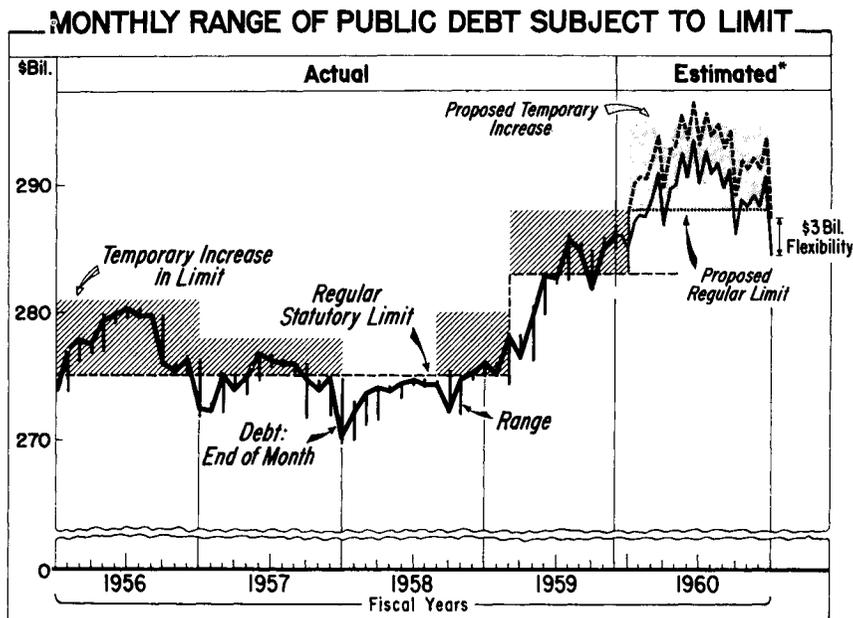
Table 1, attached at the end of this statement, indicates in detail our current semimonthly projection of the debt subject to the limit during the fiscal year 1960, assuming a constant \$3½ billion operating cash balance.<sup>1</sup> The projections are stated both before and after the allowance for \$3 billion flexibility. As you will note from the table, and also from chart 16 below, on December 15, for example, even the \$29½ billion temporary debt limit would appear to be insufficient for a few days, but we will be able to operate within that limitation without undue impairment of our flexibility.

Chart 16 also indicates the wide fluctuations in the amount of debt outstanding within each month during the fiscal year just ending.

<sup>1</sup> Similar data for the fiscal year 1959 are shown in table 2 at the end of the statement.

(Chart No. 16 follows:)

CHART 16



Secretary ANDERSON. The fiscal 1960 estimates on which the current request for an increase in the debt limitation is based are the same as those contained in the budget which the President submitted to you earlier this year—budget receipts of \$77.1 billion and budget expenditures of \$77 billion.

Those estimates were prepared 6 months ago and as the President indicated in his message on public debt management, it now appears that interest on the public debt during the forthcoming year will amount to about \$8½ billion instead of the \$8 billion included in the budget.

As I pointed out earlier, only a negligible amount of this half-billion-dollar increase, perhaps less than \$5 million, represents the net additional cost of the new savings bond program. For all practical purposes the entire increase is attributable to the rise in interest rates which has taken place since the earlier estimate was made. The President also made it clear in his public debt message that the strength of our economic recovery beyond earlier expectations has improved the revenue outlook for the fiscal year 1960 sufficiently to offset the increased interest cost.

#### FACILITATING EXCHANGES OF TREASURY SECURITIES

Before discussion of the remaining sections of the first proposed bill, I would like to complete my statement by discussing briefly the provisions of the second proposed bill.

I have already spelled out in some detail the problem of an ever-shortening public debt and the Treasury's determination to issue intermediate and long-term bonds whenever market conditions are appropriate.

Typically, new Treasury bond issues arise either from a new issue sold for cash or a new issue offered in exchange to holders of securities which are maturing within a matter of weeks. Many of these maturing securities were originally long-term bonds, bought initially by long-term investors such as individuals, personal trust accounts, life insurance companies, mutual savings banks, or pension funds.

When the bonds approach maturity, however, most of these longer term investors have already liquidated their holdings and at maturity the bonds are usually held largely by commercial banks or by non-financial corporations or other short-term investors. Therefore, both of the traditional methods of issuing long-term securities which the Treasury uses involve a substantial amount of churning in the market as long-term investors seek to raise the cash to pay for a new cash issue or to buy the maturing issue which gives them the right to exchange the maturing issue for the new one.

There is a third approach, however, to the problem of selling longer term securities to long-term investors, and it is an approach which we believe would add materially to the Treasury's ability to encourage such investors to maintain investment in long-term securities. This approach may be characterized as "advance refunding." It is a technique which was used in the Canadian conversion loan operation last summer, whereby \$6 billion of securities having from 6 months to 8 years yet to run to maturity were exchanged for securities with maturities ranging from 3 to 25 years—an operation involving about 40 percent of that country's national debt.

Because of fundamental differences in the financial systems of the two nations, the U.S. Treasury has no intention of embarking on such an ambitious program in attempting to solve our debt problem. The basic thought behind the Canadian operation should be given careful consideration, however, as to its possible application in the United States in a much more limited way.

One of many possibilities in this direction, when and if market conditions are appropriate at some time in the future, is to offer new long-term bonds to the holders of the large amount of 2½-percent bonds sold immediately before or during World War II.

Such a new issue, or issues, would be sold on terms that would be attractive to the present holders and would permit the Treasury to do a substantial amount of debt extension on a straight exchange basis with existing holders, and, therefore, with a minimum of effect on the Government securities and capital markets. These are investors who already hold substantial amounts of Government securities. We want to keep them invested in Governments if we can.

Under present law, however, the exchange of one Federal security for another in any refunding operation requires that the gain or loss from the exchange must be recognized for tax purposes if value of the old security on the books of the investor is above or below the market value of the new issue as of the date of exchange. In practice, this type of advance refunding operation would be expected to establish a loss for tax purposes to most holders because the Treasury would be

likely to engage in advance refunding only if the obligations to be exchanged are selling below par in the market. The 2½-percent bonds referred to, for example, were selling at prices ranging from \$83 to \$88 per \$100 bond as of end of May. The terms of the new, longer issue would, of course, be set so that it would be worth approximately the same price in the market as the issue being turned in. Whether an investor would accept such an offer or not would be entirely his own decision. No holder can be compelled to give up his present contract rights by taking an exchange issue unless he wants to.

Under these circumstances, the present taxable character of the exchange represents an immediate tax advantage to any taxable holder since he may take a loss which he can employ for tax purposes. If he holds the new issue to maturity or sells at a higher price, he may realize a corresponding gain on the new security. He will then have to pay a tax on this gain, but in the meantime he has had the benefit of postponing the tax on the loss deduction under present law.

Under the proposed bill postponing the recognition of gain or loss, the reason that an investor may find an exchange more attractive, despite the denial of a tax advantage, is because of his balance sheet and reserve position. So long as gain or loss on the exchange must be recognized for tax purposes many governmental authorities who supervise financial institutions require that the institution record the loss on its books. This means a corresponding reduction in earnings and in surplus, which is understandably distasteful to many investors.

If recognition of gain or loss were to be postponed until the ultimate disposition of the new security, however, it would become possible on the assumption that governmental supervisory authorities approve, for the institutional investor to carry the new securities at the same basis of valuation that he has been carrying the old ones. Thus, removal of the need to accept a book loss would make the exchange more attractive to many investors. Any investor who would benefit, under present law, from taking a tax loss could sell the old security and buy the new issue in the market.

Enactment of the second proposed bill would permit the investor to carry over the valuation basis of the bonds which are directly exchanged for the new bonds in this way. This could be done only under rules which we would prescribe for each exchange of securities so that the recognition of gain or loss for tax purposes could be deferred. There would be no change in present provisions of law where exchanges of obligations other than U.S. Government securities are involved.

I would like to emphasize again that the practical application of this bill at the time of any such exchange—to the extent that the bondholder is a taxpayer in the first place—is to postpone recognition of a tax loss and, therefore, would tend initially to increase rather than reduce revenues.

Actually, the effect on tax revenues will be small because of the character of many of the institutions involved—pension funds, mutual savings banks, savings and loan associations, and charitable organizations.

I thank you for your patience in bearing with me through my long statement. I hope it has given you some insight into our problems and why we feel prompt enactment of both proposed bills is essential.

(The tables referred to follow :)

TABLE 1.—Forecast of public debt outstanding, fiscal year 1960, based on constant operating cash balance \$3.5 billion (excluding free gold) (based on 1960 budget document)

[In billions]

	Operating balance, Federal Reserve banks and deposi- taries (excluding free gold)	Public debt subject to limitation	Allowance to provide flexibility in financing and for contingencies	Total public debt limita- tion indicated
July 15, 1959 .....	\$3.5	\$287.1	\$3.0	\$290.1
July 31 .....	3.5	287.6	3.0	290.6
Aug. 15 .....	3.5	287.5	3.0	290.5
Aug. 31 .....	3.5	288.9	3.0	291.9
Sept. 15 .....	3.5	290.8	3.0	293.8
Sept. 30 .....	3.5	286.7	3.0	289.7
Oct. 15 .....	3.5	289.7	3.0	292.7
Oct. 31 .....	3.5	290.0	3.0	293.0
Nov. 15 .....	3.5	292.5	3.0	295.5
Nov. 30 .....	3.5	290.6	3.0	293.6
Dec. 15 .....	3.5	293.5	3.0	296.5
Dec. 31 .....	3.5	290.2	3.0	293.2
Jan. 15, 1960 .....	3.5	292.6	3.0	295.6
Jan. 31 .....	3.5	290.9	3.0	293.9
Feb. 15 .....	3.5	291.7	3.0	294.7
Feb. 29 .....	3.5	289.8	3.0	292.8
Mar. 15 .....	3.5	291.3	3.0	294.3
Mar. 31 .....	3.5	286.1	3.0	289.1
Apr. 15 .....	3.5	288.9	3.0	291.9
Apr. 30 .....	3.5	288.3	3.0	291.3
May 15 .....	3.5	289.3	3.0	292.3
May 31 .....	3.5	288.3	3.0	291.3
June 15 .....	3.5	290.6	3.0	293.6
June 30 .....	3.5	284.4	3.0	287.4

NOTE.—When the 15th of a month falls on Saturday or Sunday, the figures relate to the following business day.

TABLE 2.—Actual cash balance and public debt outstanding, July 1958–May 1959

[In billions]

	Operating balance, Federal Reserve banks and depositaries (excluding free gold)	Public debt subject to limitation
Actual:		
July 15, 1958 .....	\$5.5	\$275.2
July 31 .....	3.9	275.1
Aug. 15 .....	5.3	277.8
Aug. 31 .....	5.3	278.2
Sept. 15 .....	1.5	276.3
Sept. 30 .....	3.9	276.4
Oct. 15 .....	4.7	280.0
Oct. 31 .....	3.3	279.9
Nov. 15 .....	2.2	279.9
Nov. 30 .....	5.3	282.7
Dec. 15 .....	2.1	282.2
Dec. 31 .....	3.8	282.6
Jan. 15, 1959 .....	1.7	282.6
Jan. 31 .....	4.5	285.5
Feb. 15 .....	2.8	284.8
Feb. 28 .....	3.9	284.8
Mar. 15 .....	2.1	284.6
Mar. 31 .....	3.2	281.7
Apr. 15 .....	4.2	285.4
Apr. 30 .....	4.4	285.0
May 11 .....	6.1	286.8
May 15 .....	4.2	285.0
May 31 .....	4.7	286.0

NOTE.—From Feb. 26 to Sept. 2, 1958, the statutory debt limitation was \$280,000,000,000 including a temporary increase of \$5,000,000,000 which was scheduled to expire June 30, 1959. The act approved Sept. 2, 1958, increased the limitation to \$288,000,000,000, which will revert to \$283,000,000,000 on June 30, 1959.

When the 15th of a month falls on Saturday or Sunday, the figures relate to the following business day.

(Supplemental statement of Secretary Anderson follows:)

Supplemental Statement on Public Debt Management  
by Secretary of the Treasury Robert B. Anderson before the  
House Ways and Means Committee,  
10:00 A.M., June 10, 1959

#### INTEREST RATES IN A FREE MARKET ECONOMY

As I observed in the main portion of my statement before this committee, popular discussion of interest rates is often clouded by misunderstanding of their nature in a free market economy. The purpose of this supplementary statement is to discuss in some detail the nature of interest rates - particularly the factors that cause them to rise or fall; the reasons for the increase in rates since last summer; and several alternative courses of action that might be effective in inducing a lower level of interest rates.

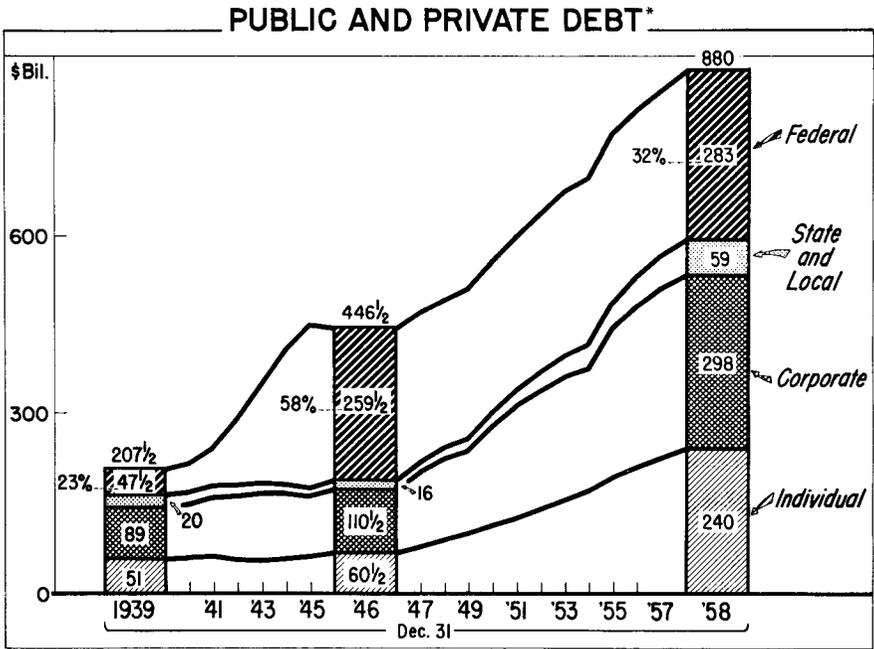
#### Demand and Supply in Credit Markets

Speaking broadly, the interest rate is nothing more nor less than a price, namely, the price of borrowed money. As a price, the rate reacts to the same sort of influences as other prices in a free market economy - influences that operate through the demand for and supply of funds available in credit markets. Just as an increase in the demand for goods or services tends to increase the prices of these items, so does an increase in the demand for funds tend to increase interest rates. And an increase in the supply of funds available in credit markets has the same basic effect as an increase in the supply of any good or service in any market; price tends to fall. This is

true under our present market arrangements; it will remain true so long as credit markets remain free and borrowers and lenders are permitted to manage their affairs with a minimum of interference and regulation.

From the side of demand, the principal impact on interest rates reflects the actions of four groups of borrowers: individuals, corporations, State and local governmental units, and the Federal Government. As is shown in the chart, total indebtedness of these borrowers has almost doubled since 1946.

Chart-A



\*Gross debt.

Individuals, borrowing to finance purchases of a variety of goods and services and to construct or purchase homes, increased their gross indebtedness from \$60-1/2 billion to \$240 billion between 1946 and 1958. The gross debt of business corporations, which seek credit to finance working capital needs and for longer-run purposes in expanding and modernizing plant and equipment, rose from \$110-1/2 billion to \$298 billion. State and local governmental units, confronted with growing needs for schools, highways and streets, and a variety of other facilities, have borrowed heavily in the postwar period; their gross debt expanded from \$16 billion in 1946 to \$59 billion in 1958. The Federal Government, the fourth major borrower in credit markets, seeks funds to meet seasonal needs and to finance a deficit. The public debt increased from \$259-1/2 billion in 1946 to \$283 billion in December 1958. As of the end of June, the debt is expected to total \$285 billion.

The postwar pressure on interest rates arising from the demand for credit is apparent. Concomitant with the large expansion in demand, however, has been a growth in the supply of funds available in credit markets. These funds come ultimately from two sources: savings or money creation. It makes little difference to the borrower whether the ultimate source is one or the other; dollars flowing out of money creation are fully as spendable as those made available from savings. The ultimate source may be of crucial importance from the standpoint of achieving price stability and sustainable economic growth, however, simply because dollars generated through money

creation represent an increase in the total pool of dollars available for spending and, if not matched by a more or less equal increase in output of goods and services, tend to force prices up. It is no accident that consumer and wholesale prices have more than doubled during the past twenty years, in view of the fact that a fourfold increase in the active money supply was only partly matched by an approximate doubling of real production of goods and services.

There is no need to go in detail into the various forms of saving - by individuals, business firms, and governmental units - or to differentiate sharply between funds flowing from current saving and those that represent savings of earlier years that subsequently are made available to borrowers. The really important point relates to the distinction between funds obtained from existing pools of dollars and those generated by money creation.

How does money creation take place? Largely through the lending and investing activities of the more than 13,000 commercial banks in this country. Suppose that John Doe wants funds for use in his business, or to improve his home, or to meet medical or other expenses. And suppose that he applies for a loan from a commercial bank to obtain the funds. If the loan is granted, John Doe simply signs his promissory note and acquires a credit to his deposit account in the bank. This transaction represents no transfer of existing dollars; quite the contrary, John Doe has an extra \$100, \$1,000, or \$10,000, depending on the amount of the loan, but no other individual or institution has any less money. Money creation has indeed taken place. Moreover, not only

John Doe, but thousands of business firms, many State and local governmental units, and the Federal Government also borrow, directly or indirectly, from commercial banks. Each bank credit extension of this type which is not offset by a reduction in other bank loans or investments results in an equivalent amount of new money creation.

Do commercial banks have unlimited ability to create money in this fashion? Not by any means. People borrow money primarily in order to spend, and the banker who makes such loans knows that within a relatively short period of time the newly created deposit will probably be withdrawn from his bank. This will probably take the form of a transfer to another bank, perhaps in the same city, perhaps somewhere else in the Nation. But, the important point is that the banker must be able to meet a drain of cash out of his bank; and his ability to do so depends on his cash reserve position. In other words, he cannot afford to make large extensions of credit unless he has extra cash on hand (or on deposit with his Federal Reserve Bank) to meet the resulting drains, or unless he is in a position to obtain additional cash as the drains take place.

This is where the Federal Reserve System comes into the picture. Through various devices (e.g., discount policy, open market operations, and control over member banks' reserve requirements), Federal Reserve authorities can influence the cost and availability of bank cash reserves. In so doing, the willingness and ability of commercial banks to make new loans and investments - and thus add to the flow of funds available in credit markets - is very much affected.

The resiliency of bank credit expansion and contraction can serve as an important balancing wheel in credit markets -- or, it can operate as a serious destabilizing factor in our attempts to achieve a stable price structure and relatively full and efficient use of our economic resources. The critical question is, of course, the rate at which bank deposits come into or go out of existence. During a period of high and rising business activity, when credit demands are especially strong, and when men, machines and materials are being used at high capacity, an excessive amount of money creation tends to add to inflationary pressures. Spending in the economy as a whole may expand rapidly but, with resources in relatively full use, the volume of goods and services that can be produced can only be increased slowly. Inflation is then the result. And judging by past experience, an inflationary upsurge is likely to be followed by readjustment and recession, so that our end objective of achieving maximum economic growth is actually impeded.

Since recession is a serious deterrent to sustained economic growth, bank credit expansion may be desirable when economic activity is lagging. Under these conditions, the men, machines and materials necessary to support increases in production are available. Greater spending by consumers and business firms is to be desired.

Consequently, sustained and rewarding economic growth -- which requires reasonable price stability and relatively full and efficient use of our economic resources - can be attained only if the aggregate flow of credit is consistent with the ability of the economy to absorb

that flow, when translated into spending, at a given time. And, the Federal Reserve System, in fulfilling its statutory obligations, is constrained to employ its monetary powers flexibly. In a free market economy, an inevitable result of the interaction of demand and supply forces in credit markets - including the impact of Federal Reserve actions - is fluctuations in interest rates.

Stated simply, flexible credit policies, attuned to the business situation as it unfolds over time, can be effective only if interest rates are free to respond to the forces of demand and supply in credit markets. But it must be emphasized that the major forces affecting those rates stem from actions of free and independent holders of funds. The law of supply and demand is a powerful and inescapable economic force; attempts to thwart it in the past have inevitably led to greater difficulties later on.

At times interest rates seem to decline faster than might be expected in view of basic trends in credit demands, savings, and the availability of bank credit. At other times they seem to rise faster than might seem warranted in view of these forces. For example, the sharp decline in rates in late 1957 and early 1958 seemed to outrun basic forces of demand and supply, and the same can be said of the sharp increase in rates in the summer of 1958.

The explanation of such sharp shifts can be found primarily in the impact of expectations on credit markets. In late 1957 it became clear that recessionary forces were gathering strength. The Federal Reserve System, consistent with its responsibility to conduct its

operations flexibly, shifted from the restrictive policy of the preceding 2-1/2 years toward a policy of monetary ease. In view of the shift in the business situation, which implied a slackening demand for funds in credit markets, and in view of the reversal of Federal Reserve policy, which implied an increase in availability of bank credit, market participants reasoned that the uptrend in interest rates that had prevailed since 1954 would be reversed, and that the outlook for some time to come was for declining rates.

Declining interest rates are synonymous with rising prices for outstanding Government and other types of bonds. Consequently, individuals and institutions with funds to invest tended to step up purchases of such instruments - the supply of funds available in credit markets expanded sharply; and individuals and institutions with bonds for sale became more reluctant to part with them - the demand for funds subsided, relatively speaking. The result: sharp declines in interest rates (or increases in bond prices), stimulated largely by expectations of lagging business and easy money.

The decline in business activity came to an end much sooner than many observers anticipated. In June 1958, the strengthening business picture gave rise to rumors that Federal Reserve policy might be in the process of shifting away from the aggressively expansive policies of preceding months. Many investors in debt instruments, including Government bonds, became anxious to dispose of the securities before interest rates rose and bond prices declined; potential buyers became less anxious to buy. The result: sharp increases in interest rates, stimulated largely by expectations.

Thus, one type of expectation is related primarily to the swings in business activity and the impact of flexible monetary policies. But at times other types of expectations exert important influences. During the past year, the increase in interest rates has been stimulated partly by a growing - but, in my judgment, mistaken - conviction that inflation is inevitable. Many investors have been reluctant to purchase debt instruments, which carry a fixed interest return and principal payment, as opposed to equities. This reluctance to purchase bonds, and the preference for equities, has contributed to relatively low bond prices (high interest rates) and high stock prices.

It is important to emphasize, however, that effects of expectations are likely to be short-lived, unless later ratified by the expected events. The sharp decline in interest rates in late 1957 and early 1958 could not have been sustained had it not been for the fact that recession did occur, credit demands did subside, and monetary policy did assume a posture of aggressive ease. Again, the sharp rise of last summer was later ratified, in part, by the vigorous expansion of business activity, with the accompanying demands for credit, and the impact of a \$13 billion Federal deficit on credit markets. Finally, the impact of inflationary expectations on the level of interest rates can be minimized only when it becomes clear to participants in free credit markets that the integrity of the dollar will be preserved.

In summary, interest rates in a free market economy are influenced by a number of factors which can best be understood in terms of the forces working through demand and supply in credit markets. Of primary importance on the demand side are borrowings by individuals, businesses, State and local governmental units, and the Federal Government. The supply of funds available in credit markets is mainly a reflection of the availability of financial savings, coupled with net changes in commercial bank credit. Federal Reserve policy, by influencing reserve positions of commercial banks, affects the rate of flow of bank funds into credit markets.

Before examining the reasons for the rise in interest rates in this country since last summer, it might be worthwhile to discuss briefly two popularly held views concerning the nature of interest rates that, in my judgment, are mistaken.

One often hears the statement that increases in interest rates are necessarily inflationary, in that interest is a cost of doing business and sellers of goods tend to pass on rate increases in the form of higher prices. The people who hold this view overlook the fact that rising interest rates are indicative of pressures in credit markets growing out of strong demands for funds relative to the supply. Inasmuch as individuals and institutions borrow money primarily to facilitate spending, rising interest rates reflect an inability of all potential borrowers to obtain as much credit as they would like to have. In other words, spending is impeded, and the rise in interest rates is one measure of the degree of restriction on spending. And,

under normal circumstances, anything that tends to dampen spending when business activity is high and rising tends to diminish - not to augment - inflationary pressures.

Moreover, available figures indicate clearly that interest, as a cost of doing business, is a decidedly minor expense. In 1957, for example, net interest costs of all manufacturing corporations were only  $\frac{4}{10}$  of 1 percent of gross sales. Thus, if the cost of an article selling for \$100, only 40 cents represented interest cost. Admittedly, interest expenses of wholesalers and retailers, who also must finance some of their operations by borrowing, would add slightly to total interest cost included in items bought by final consumers. Still, however, the contribution of interest expense to total cost would be small.

It has been suggested that public utility rates are influenced significantly by interest costs, since such firms rely heavily on bonded indebtedness. In this case, however, net interest expense is estimated to be less than  $4\frac{1}{2}$  percent of gross revenues.

The evidence seems clear that an increase in interest rates exerts only a small direct effect on prices of goods and services, and that this impact is far outweighed by the restrictions on total spending stemming from limited availability of funds in credit markets.

There is also a misconception concerning the identity of the recipients of interest payments on the Federal debt. Some observers appear to believe that large financial institutions are not only the major recipients of such payments, but that their share has increased as interest rates have advanced in the postwar years.

The accompanying table, which presents estimates of the distribution of interest payments on the public debt in 1946 and 1958, indicates clearly that such is not the case. In 1946, the major financial institutions - commercial banks, mutual savings banks, and insurance companies - received an estimated \$2.1 billion in interest on holdings of Government securities, or about 45 percent of the total of such payments. By 1958, the share of these institutions had declined to \$2.0 billion, representing only 26 percent of total payments.

**Estimated Distribution of the Interest on the Public Debt  
Fiscal Years 1946 and 1958**

(In billions of dollars)

	Budget Expenditures	
	1946	1958
<b>Investor classes:</b>		
<b>Individuals:</b>		
Savings bonds.....	.7	1.5
Other securities.....	<u>.5</u>	<u>.4</u>
Subtotal.....	1.2	1.9
Commercial banks.....	1.4	1.5
Mutual savings banks.....	.2	.2
Insurance companies.....	.5	.3
Nonfinancial corporations.....	.2	.6
State and local governments.....	.2	.4
Miscellaneous investors.....	.2	.4
Federal Reserve banks.....	.1	.8
Government Investment Accounts.....	<u>.7</u>	<u>1.5</u>
Total.....	4.7	7.6

Moreover, a significant portion of the interest income of banks has been passed on to customers in the form of higher rates on time and savings deposits. For example, in 1946 member bank interest payments to depositors were only 20 percent of interest income on their holdings of Treasury securities. Reflecting the sharp increase in rates paid on time and savings deposits in the past few years, member banks in 1958 paid almost 90 percent of their interest income on Governments to depositors.

Other important trends brought out by the table include an \$800 million increase in interest payments on savings bonds, held mostly by individuals; a \$700 million expansion in payments to Federal Reserve banks, which returned 90 percent of their net earnings to the Treasury; and an \$800 million increase in payments to Government investment accounts, which are operated almost wholly for the benefit of individuals.

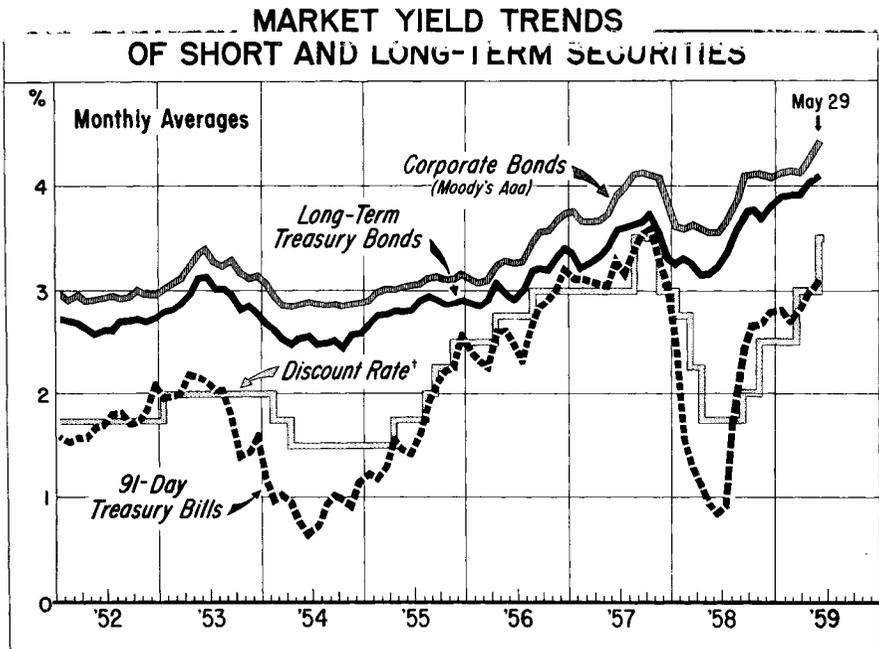
These figures indicate, therefore, that a substantial portion of payments on the debt accrue directly or indirectly to the benefit of individuals, many of whom are of relatively modest means. Moreover, the increase in interest payments since 1946 reflects increased payments primarily to individuals, Federal Reserve banks, and Government investment accounts, rather than to private financial institutions.

The Rise in Interest Rates Since Last Summer

Trends in interest rates over a period of several years, or of several months, can be understood only in terms of the major demand and supply forces at work. Accordingly, it might be worth while to examine closely the increase in rates that has occurred during the current fiscal year in order to gain an understanding of the factors underlying the advance.

Interest rates on Treasury and other securities have risen considerably from the lows reached during the recession of 1957—58.

Chart-B



\*Federal Reserve Bank of New York.

Office of the Secretary of the Treasury

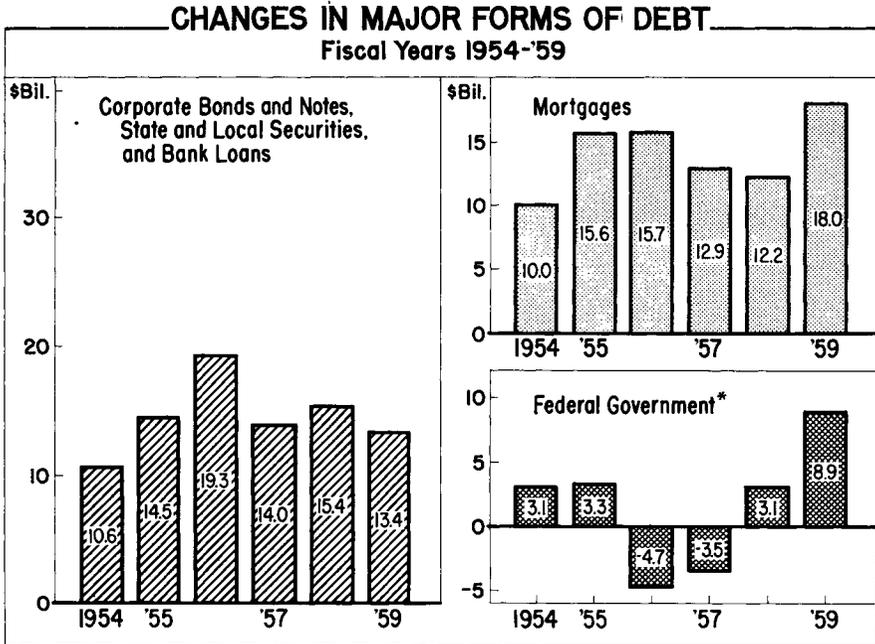
B-1261-C

Yields on long-term Treasury bonds, which averaged 3.12 percent in April 1958, had risen to an average of 4.08 percent in May 1959. Average issuing rates on 3-month Treasury bills, which fell below 1 percent in the spring and summer of 1958, have recently risen above 3 percent. Similarly, rates on commercial paper, bankers' acceptances, prime bank loans, corporate and municipal bonds, and other debt instruments have advanced substantially during the past year.

What factors lie behind this rise in rates? First, let's look at the demand for credit.

The growth of consumer credit in the current fiscal year has been less than in most recent years. Thus, pressure on interest rates from this source has been moderate, except for the past few months, in which demand for consumer credit has risen substantially. Individuals have indeed been active borrowers of funds, primarily in the form of mortgage credit. Total real estate mortgages, consisting largely of individuals' borrowings, are expected to increase \$18 billion this fiscal year, a greater rise than in any of the past five fiscal years. This increase can be viewed as having contributed to demand pressures in credit markets.

Total corporate bonds and notes, State and local government securities, and bank loans have increased less than in any fiscal year since 1954. Thus, these credit demands have not exerted significant pressures on financial markets.



\*Excluding debt held by Federal Reserve Banks and Government Investment Accounts.

Office of the Secretary of the Treasury

B-1377

The demand for credit on the part of the Federal Government, to finance a record peacetime deficit of approximately \$13 billion, has been much greater than in any of the preceding five fiscal years. The publicly held Federal debt will increase by almost \$9 billion in this fiscal year, as contrasted with increases of \$3.1 to \$3.3 billion in fiscal years 1954, 1955, and 1958, and declines of \$4.7 and \$3.5

billion, respectively, in 1956 and 1957. (The difference between the \$13 billion deficit and the \$9 billion increase in Federal debt in this fiscal year results primarily from a reduction in the Treasury's cash balance.)

These figures demonstrate clearly that the more important demand pressures on interest rates during the past year have stemmed from the increase in mortgage debt and the record peacetime Federal deficit. However, the rise in mortgage debt, although substantial, is not much greater than in fiscal years 1955 and 1956. Thus, it appears that a major factor contributing to the sharply rising demand for credit in fiscal 1959 has been the record peacetime Federal deficit. The addition of almost \$9 billion in Federal securities to what might be viewed as more or less normal aggregate credit demands could only exert strong pressure on interest rates.

As I noted earlier, however, trends in interest rates are also influenced by forces working through the supply of funds available in credit markets. While data on savings are difficult to interpret in terms of impact on credit markets, there appears to be no evidence that a shift in the availability of savings has contributed to the rise in rates during the past year.

As to the timing of the events in the summer of 1958, it is important to note that member bank reserve positions and short-term money market rates reflected a continuation of monetary ease until August - a full two months following the reversal of market rates on intermediate - and longer-term Government bonds. Thus, the market

appears to have led monetary policy and, as stated earlier, the market shift resulted primarily from radical changes in expectations. The shift in expectations resulted, in turn, from: (1) a growing comprehension that the recession had ended and that vigorous recovery was under way, with its consequent impact on demand for credit; (2) a belief that Federal Reserve credit policies, in view of the shift in the business situation, would soon move toward restraint in keeping with the requirements of flexible administration of such policies; (3) a realization that in fiscal year 1959 the Federal Government would be confronted with a deficit of \$10 to \$15 billion, with its strong impact on demand for credit; and (4) a growing - even if unfounded - conviction on the part of investors that further inflation would probably occur, stemming from the rigidity of prices during the recession, the impact of business recovery, and the inflationary ramifications of a record peacetime deficit during a period of rising business activity. In addition, market pressures were increased significantly by liquidation of heavy speculative holdings of Government and other securities, built up earlier in the year and in June, sometimes on relatively thin margins.

It should be emphasized again, however, that the increases in rates arising from expectations could not have been sustained had not the expectations later been ratified. And most of them were indeed ratified. Business activity has expanded vigorously; a \$13 billion deficit was confirmed by official sources; and Federal Reserve credit policy did shift away from the strongly expansive policies of early

1958. The expectation of continuing inflation has not been confirmed; whether or not it will be depends in no small measure on the degree of fiscal and monetary discipline that is maintained during this period of high and rising business activity.

Furthermore, the available evidence points only to a mild degree of credit restraint since last summer. For one thing, the strong upward trend in production, employment, and income with, as yet, absence of strong inflationary pressures, indicates that credit has been sufficiently available to meet the needs of the economy. Moreover, monetary growth since last summer, as measured by the annual rate of expansion in the seasonally adjusted money supply, has been at least equal to and perhaps slightly greater than what is usually thought of as a normal rate.

All things considered, it seems to me clear that the major factor contributing to the rise in interest rates during the past year has been the \$13 billion Federal deficit. It has exerted a twofold impact: first, by stimulating expectations in the summer of 1958 of strong credit demands and of a further erosion in the value of the dollar; and, second, by adding almost \$9 billion in Federal securities to the demand side of credit markets.

#### Consequences of Various Proposals to Induce Lower Interest Rates

Are there any courses of action, open to Congress, the Executive Branch, or the Federal Reserve System, which might be successful in inducing lower interest rates? It must be emphasized that any such

actions, to be effective without leading to later difficulties, must operate through the basic forces of demand and supply. As I stated earlier, the law of supply and demand is a powerful economic force. Any attempt to hold interest rates to artificially low levels would be doomed to ultimate failure unless appropriate steps were taken to adjust demand and supply forces consistent with the selected level of rates. And even then, later difficulties may well arise. The situation is parallel to attempts to maintain price ceilings on goods and services during national emergencies; prices can be prevented from rising, if inflationary pressures are strong, only through resort to rationing, allocation of materials and labor, and so on. Similarly, interest rates can be kept from responding to the forces of demand and supply only through direct intervention in credit markets and a consequent abridgement of economic freedom. It is therefore assumed that any courses of action to be considered would involve influencing demand and supply.

With this stipulation accepted, six proposals might be mentioned. Several of these proposals, however, would so harm the Nation that responsible people would be unwilling even to consider them. They are presented solely for the purpose of bringing forward issues which apparently are often misunderstood.

(1) One approach would be for the Government, through various means, to promote recessionary pressures in the economy. Interest rates commonly decline during recessions, partly because of a slackening demand for funds on the part of individuals and businesses, partly

because of a relative increase in availability of financial savings, and partly because of greater availability of bank credit in connection with a flexible shift of monetary policy toward credit ease.

This first alternative is, of course, absurd; no responsible government would attempt to induce recession - with its accompanying loss of production and rise in unemployment - simply to produce lower rates of interest. But the introduction of this alternative highlights the fact that high and rising interest rates are a sign of expanding business. For a responsible government, the choice between high levels of business activity and employment as opposed to low interest rates is actually no choice at all. Stated differently, high interest rates are not an end in themselves; rather they are the usual accompaniment of the active credit demands that characterize expansion in production, employment, and income.

(2) It has been suggested that interest rates could be reduced if the Federal Reserve banks were directed by Congress to purchase all new issues of Government securities; this would tend to reduce pressures on interest rates, since the Federal Reserve banks would in effect create the funds necessary for the purchase of the securities. The actual process would involve credit to the Treasury's deposit balance in Federal Reserve banks in return for the newly issued Government securities.

There are at least two serious objections to this course of action. In the first place, the prohibition of direct sales of securities by the Treasury to the central bank, except under unusual

and very limited circumstances, has been an important characteristic of our financial mechanism ever since the establishment of the Federal Reserve System in 1913. As one adjunct to their primary function of influencing the flow of money and credit, the Federal Reserve banks were envisaged, by the framers of the Act, as fiscal agents for the Government — to hold Treasury working balances; to clear Treasury checks; to issue, redeem and pay interest on Government securities; and so on — not as a source of credit to finance the Government's needs. Experience in a number of foreign countries has demonstrated the dangers of easy access to central bank credit on the part of the branch of Government that has the responsibility for financing the Government's requirements. Fiscal discipline is especially difficult to preserve if the exchequer has, in effect, a "blank check" on the money—creating authority.

A second major objection to sale of new Treasury issues directly to the Federal Reserve banks arises from the fact that the transaction would provide the basis for a highly inflationary expansion of the money supply. The recipients of Treasury checks drawn on the newly created deposits at the Reserve banks would deposit most of the proceeds in Federal Reserve member banks, and the member banks in turn would send the checks to their District Reserve banks for payment. Payment would be effected in the usual way, by crediting — or increasing — the reserve balances of the banks on the books of the Reserve banks. Bank reserves would be increased by the amount of the credits; this would provide a basis for additional lending and in-

vesting by the banking system by an amount equal to about six times the increase in reserve balances. Growth in the money supply would, therefore, be strongly stimulated. Interest rate pressures would have been restrained only at the cost of highly inflationary increases in bank credit and the money supply. Moreover, as I pointed out in the main portion of my statement, strong inflationary pressures tend to promote even higher levels of interest rates.

Recognizing the objection that large-scale purchases of Government securities by the Federal Reserve banks would be highly inflationary, advocates of this course of action sometimes maintain that the inflationary growth in the money supply could be avoided simply by raising member bank reserve requirements. In other words, the new reserves created by the Federal Reserve purchases would be immobilized immediately by increasing the percentages of idle funds that member banks must hold in relation to deposits.

There is an important practical objection to this proposal. The purchase of, say, \$5 billion of new Government securities by the Federal Reserve banks would result in the creation of \$5 billion in new bank reserves, but these reserves would flow into the banking system, and be disseminated among individual banks, in accordance with market forces. No one could predict the ultimate distribution of the new reserves in advance. Some banks would receive a large portion, some a smaller portion; the ultimate distribution would depend primarily upon the location of the individuals and institutions who received the Government payments financed by the deficit borrowing.

An increase in member bank reserve requirements, however, affects all banks in a given classification (central reserve city, reserve city, and "country") equally in terms of percentage points of reserve requirements. Consequently, a blanket increase in reserve requirements of the magnitude required to neutralize the reserve-creating impact of large-scale Federal Reserve purchases of Governments might well lead to severe dislocations and disturbances in credit markets. Some banks would have ample reserves, others would find themselves severely pinched. It can be argued that market forces would tend to correct these imbalances, and they would -- over time. But in the short run, forces might well be set in motion leading to abrupt swings in interest rates and availability of credit; credit "droughts" in one part of the country and "surpluses" in another; and so on. And, in any event, the credit market, while highly efficient, by no means operates with complete perfection in transferring funds from areas of plenty to areas of shortage.

To this important practical objection against selling Government securities to the Reserve banks and then offsetting the inflationary impact by raising member bank reserve requirements can be added a more basic objection, if it is assumed that one purpose of the action would be to prevent interest rates from rising. As I noted earlier, purchases of \$5 billion of Federal securities by the Reserve banks would result in an equivalent increase in the money supply as the recipients of the checks deposited the proceeds in their commercial banks. In the first instance, then, there would be an important

inflationary impact, resulting from the spending of the funds by the Government and the expansion in the money supply.

A large increase in reserve requirements could indeed nullify the growth in the money supply, but only by severely restricting the lending and investing activities of commercial banks. This, in turn, would exert pressure on individuals, business firms, and State and local governments, and tend to force interest rates for such borrowers to higher levels. The inflationary impact of the increase in money supply resulting from Treasury borrowing from the Reserve banks can be offset only if credit contraction occurs in other segments of the economy; the \$5 billion increase in deposits held by recipients of the Treasury checks must be offset by a \$5 billion decline in funds of other individuals and institutions. This can be achieved, in free credit markets, only through credit restriction, which implies additional pressure on interest rates. Thus, during a period of prosperity and a growing demand for credit, the choice is either between a somewhat higher level of interest rates, or stimulation of inflationary pressures through monetary expansion. There are no other choices.

The recommendation that Federal Reserve banks buy all or substantial portions of new issues of Treasury securities involves one other aspect that deserves discussion. Specifically, it has been recommended that the Federal Reserve banks be required to purchase only that portion of a new issue that investors other than commercial banks would not purchase; thus, the Reserve banks, in effect, would replace commercial banks as buyers of Governments. This recommendation involves other choices.

The recommendation that Federal Reserve banks buy all or substantial portions of new issues of Treasury securities involves one other aspect that deserves discussion. Specifically, it has been recommended that the Federal Reserve banks be required to purchase only that portion of a new issue that investors other than commercial banks would not purchase; thus, the Reserve banks, in effect, would replace commercial banks as buyers of Governments. This recommendation

tion is based partly upon the assumption that commercial banks do not perform a necessary service in buying Government obligations. Their ability to create money, it is maintained, permits them to buy these securities; but in fact the authority over money creation is constitutionally vested in Congress. Thus, it is argued that the Government should perform this function, through the Federal Reserve banks, without burdening taxpayers with interest charges.

This argument deserves several comments. In the first place, as noted earlier, purchases of Government securities directly by Federal Reserve banks would be highly inflationary. Secondly, whether or not the commercial banks perform a "necessary" service in creating money, there is little doubt that they perform an important economic function. Demand deposits in commercial banks have assumed a monetary function simply because people prefer to hold funds and make payments in that form, rather than in the form of currency. Moreover, money is essential to efficient performance of a highly industrialized market economy and, if the commercial banks did not perform the money-creating function, some other institution or agency would have to do so.

Furthermore, commercial banks do indeed perform a useful service in purchasing and holding Government securities. The business of commercial banking, in essence, is that of holding relatively illiquid assets -- principally loans and investments -- against liabilities that are largely redeemable on demand. This involves risk and, in assuming that risk, stockholders of commercial banks are entitled to

a return for a service performed. The fact that an asset is a Government security rather than a commercial loan is not germane; marketable Government securities, while devoid of risk relating to interest and principal payments, do possess risk as to the price at which they can be sold in the market. Because of the nature of their liabilities, banks must be prepared — and at times may be compelled — to liquidate assets in order to meet deposit drains. They are therefore providing an economic service by holding illiquid assets which the public does not desire to hold at the time, and in return furnishing the public with the liquidity — or money — that it desires.

There are at least two important reasons why the money-creating function should not be assigned wholly to the Federal Reserve banks. In the first place, under our institutional arrangements the money-creating function is closely allied with that of granting credit to a wide variety of borrowers. It is a cardinal principle of our type of government that private institutions should dominate credit-granting activities; otherwise, the ability to obtain credit might rest less on credit-worthiness and more on noneconomic factors.

Secondly, lodgment of the money-creating authority wholly in the Federal Reserve banks, along with expanded authority for the Reserve banks to lend directly to the Government, would permit the Government to finance its residual needs through the Reserve banks and thus by-pass the market. This would violate the basic principle set forth earlier, namely, that direct entry of the Government to the central bank for purposes of meeting fiscal requirements should be severely limited.

In many respects, the question of transferring in whole or in part the money-creating function from the commercial banks to the Federal Reserve banks is actually a question of whether the banking system should be nationalized. When it is said that "the commercial banks do not perform a necessary service in purchasing Government securities," it should be realized that there are many other services that the Government could perform for itself. It could, for example, organize its own construction crews to build the interstate highways, rather than encouraging the States to undertake this work through private contractors; it could establish its own transportation network for carrying mail and other Government property; it could set up manufacturing establishments to produce missiles, airplanes, warships, and a variety of items now purchased from private industry — it could, in short, perform many of the economic functions now performed by the private sector of the economy. The crucial question is, of course, whether it could perform those functions as efficiently as private enterprise and — of prime importance — whether the act of doing so would not ultimately destroy economic and political freedom in our Nation.

(3) A third suggestion for inducing lower interest rates would involve a Congressional directive forcing the Federal Reserve banks to "peg" prices of Government securities at some predetermined level, presumably par. Then, if market holders decided to sell Government securities, purchases by the Federal Reserve banks would provide a floor under which bond prices could not fall (interest rates on Governments could not rise).

The unfortunate experience with this technique between the end of World War II and 1951 should convince serious observers of the dangers involved; the Federal Reserve System could indeed be transformed into an "engine of inflation" rather than a responsible central bank attempting to promote sustainable economic growth. Once market yields on Governments rose to the predetermined levels, the System would be able to operate in only one direction: as a creator of bank reserves, through purchases of the securities, in whatever amounts market holders might desire. Flexible administration of credit policies would be impossible.

The dangers of this course of action, especially during a period of high and rising business activity, are obvious. Nor is it at all certain that, in the long run, the Federal Reserve banks could be successful in keeping interest rates from rising. As inflationary pressures mounted, borrowers of funds would be strongly encouraged to borrow heavily as soon as possible, in order to repay the debts in eroded dollars. Lenders would be encouraged to cut back on lending, realizing that the dollars they received in payment would be worth less in real terms. Consequently, the pressure on interest rates to increase would magnify — borrowers would be willing to pay higher rates, lenders would be willing to lend only at higher rates. In order to stem the tide, the Federal Reserve banks would have to buy more and more Governments from market holders, and thus create even more bank reserves and provide a basis for further inflationary credit expansion. The spiral could ultimately come to a halt only as a result of a crisis and subsequent readjustment.

Some observers point to experience in this country in 1947 and 1948, when the Federal Reserve was indeed pegging prices of Government securities at predetermined levels, as an illustration of an instance in which the consequences were not too bad. But it should be recalled that the Federal Government experienced a total cash surplus of almost \$14 billion in calendar years 1947 and 1948. The lesson of that experience is that an inflationary monetary policy can be offset in part by large cash surpluses in Federal fiscal operations; but, if the cash surpluses had not existed, inflationary pressures would have been much more severe than they were. A disastrous spiral might well have occurred. Nowadays, advocates of System pegging of Governments most often do so because of a desire to facilitate easy Federal financing of deficits. The combination of a large Federal deficit and unbridled creation of bank reserves, in a period of high and rising business activity, could only result in the severest type of inflationary pressures, ultimate reaction and recession, and disruption of the process of economic growth.

(4) A fourth alternative that should perhaps be mentioned in passing relates to the apparent preference of some investors to purchase equities rather than debt instruments. To the extent this preference prevails, stock yields tend to be low and bond yields tend to be high. It might be, therefore, that some action which would contribute to a severe break in the stock market would in turn contribute to a shift from stocks to bonds; interest rates would tend to decline.

To suggest that a break in the stock market be induced either through Federal regulation or otherwise would, of course, be irresponsible. Moreover, to the extent that preference for equities over bonds reflects a fear of inflation, the answer to the problem is to remove the bases of the fear of inflation. As stated earlier, this would require, in part, a clear demonstration of the determination of the Government to maintain fiscal and monetary discipline. Conviction on the part of investors that the value of the dollar will be protected would do more than any other single thing to increase the attractiveness of debt instruments and thereby reduce pressures on interest rates.

(5) Inasmuch as Treasury securities occupy an important position in credit markets, interest rates could perhaps be reduced if significant progress were made in retiring part of the public debt. In this respect, there have been several proposals over the past few months to set aside a specified portion of Government revenues each fiscal year; these funds would be earmarked for debt retirement.

During a period of prosperity, retirement of some portion of our huge public debt is certainly desirable; if we cannot achieve some debt reduction when incomes are high and rising, there is serious question as to whether we shall ever be able to do so. Consequently, all proposals to establish a fixed annual percentage of debt retirement should be given serious consideration.

Many of the proposals, however, fail to drive to the heart of the problem, in that no provision is made for assuring that Government

revenues would actually exceed expenditures by an amount large enough to permit the selected percentage of debt retirement. The use of, say, \$2.8 billion of tax revenues to effect a 1 percent reduction in the debt would, in the absence of a surplus in the budget, achieve nothing; additional borrowing would be necessary to supplant the tax revenues used for debt retirement. In essence, therefore, the securities retired would be replaced in the market by an equivalent amount of new securities; interest rate pressures would not be reduced. Moreover, total public debt would actually grow, instead of decline, if the revenue-tax relationship continued to reflect an over-all deficit. Again, I should like to repeat that these plans are laudable in purpose; but undue attention to them tends to obscure the hard, basic fact that meaningful debt retirement can be effected only by means of an over-all surplus of budget receipts over expenditures.

(6) There is a sixth and final alternative for reducing pressures on interest rates, although it must be admitted that success in pursuing this sixth course of action would not necessarily result in lower rates. This is because the basic trends in demand and supply in free credit markets reflect the actions of millions of individuals and institutions, and these actions might work toward higher rates even though some of the more significant pressures were reduced.

The sixth alternative can be summarized quite simply, as follows:

(a) Convert the Federal Government from a net borrower to a supplier of funds in credit markets by achieving a surplus in the budget during periods of high and rising business activity. A net

surplus permits the Treasury to retire debt, on balance; consequently, Government actions would result in a net supply of funds available for private borrowers, not a subtraction as is the case when the Federal Government borrows to finance a deficit.

(b) Convince investors that the value of the dollar will be protected, thus removing the pressures for higher interest rates stemming from a conviction that further inflation is likely to occur. This can be done only by means of attention to all of the factors and practices that stimulate inflationary pressures. But it should be re-emphasized that the most important single action would be a clear demonstration of the Government's determination to maintain fiscal and monetary discipline. During periods of high and rising business activity, fiscal and monetary discipline requires a surplus in the budget, for debt retirement, and freedom for Federal Reserve authorities to pursue flexible monetary policies.

(c) Provide the Treasury with sufficient flexibility for sound management of the public debt, so that a better balance in debt structure can be achieved - including larger amounts of longer-term securities outstanding - and so that bond markets will not become unsettled over such things as an impinging interest-rate ceiling. The Government securities market is understandably sensitive to the existence of an artificial interest-rate ceiling; this is one reason why the President has proposed that the 4-1/4 percent limit be removed completely, rather than merely raised. An increase in the limit would only act as a signal to investors that the new ceiling

is the new "normal" level as defined by Government action.

As I emphasized in the main portion of my statement, the interest burden on the public debt - now close to \$8 billion - is of deep concern to me. But the alternative to sound fiscal and monetary policies - further shrinkage in the purchasing power of the dollar - concerns me even more. In the long run, no one benefits from inflation; by stimulating the excesses that develop in a period of business expansion, and thus sowing the seeds of readjustment and recession, inflation actually hinders the attainment of a high rate of economic growth. Moreover, inflation strikes hardest at those groups in our society least able to protect themselves. The man of modest means, not the rich man or the large business institution, is the primary victim of a shrinking dollar.

The overriding advantage of this sixth and final approach to reducing pressures on interest rates stems from the fact that the actions it requires would not only be directly beneficial in terms of economic growth, but would also transmit effects through market forces of demand and supply rather than by means of Government decree or regulation. And I would like to repeat that, in proceeding in this way, the Federal Government would be promoting "maximum employment, production, and purchasing power," as required in the Employment Act of 1946, in a manner consistent with those crucially important but often overlooked words in the Act which stipulate that such actions be carried out "in a manner calculated to foster and promote free competitive enterprise and the general welfare."

Statement on Technical Phases  
of Proposed Debt Management Legislation  
by Secretary of the Treasury Robert B. Anderson  
before the House Ways and Means Committee,  
10:00 A. M., June 10, 1959

Sections 1 through 3 of the first proposed bill have been discussed in the opening statement; this statement reviews sections 4 through 6.

\* \* \*

Section 4 of the bill would amend section 22 (1) of the Second Liberty Bond Act, as amended (31 U.S.C. 757c(1)), to direct the Secretary of the Treasury to relieve any authorized agent from liability to the United States for a loss incurred in savings bonds redemptions where written notice of liability or potential liability has not been given by the United States to the agent within 10 years after the date of the payment. This limitation would be similar to the limitation upon the time within which the Government may proceed against a person who cashes a Government check upon a forged endorsement. In that case the time limit imposed upon the Government is six years.

Presently the law directs the Secretary to relieve an agent from liability only when he can determine that the loss resulted from no fault or negligence on the agent's part, regardless of the length of time between the date of payment and the date the loss is discovered. In some cases the time lapse may be considerable because the owner of the bonds may not discover their loss or theft until their maturity

or thereabouts, and would have no reason to expect that they might have been fraudulently negotiated. It should be emphasized that this proposed legislation in no way limits the time within which the real owner may make a claim upon a savings bond which was fraudulently negotiated.

Where there is a long lapse of time between the date of the payment and the date the United States discovers it has, or may have, incurred a loss resulting therefrom, it would be extremely difficult for a paying agent to prove that the loss resulted from no fault or negligence on its part. In view of this, as well as the fact that the risks involved arise from the assumption of a task which was urged upon them by the United States and which was not related to the ordinary course of their business, the Treasury Department believes that so-called "qualified" paying agents, that is, commercial, banks, trust companies, savings and loan associations, building and loan associations, and similar financial institutions, should have some limitation upon the time during which they may be liable.

Because they would have the same problem of proof, and for the sake of uniformity and orderly administration, the proposed legislation would give the same immunity to the Treasurer of the United States, the Federal Reserve Banks, and the Post Office Department or the Postal Service, which are also accountable for losses incurred by the United States in savings bond redemptions.

The proposed legislation excludes cases arising under special regulations issued by the Treasury Department which authorize qualified paying agents to pay savings bonds without obtaining the signatures of the owners on the bonds, if the agents unconditionally assume liability to the United States for any loss resulting from such payments. In making payments under these regulations, which paying agents requested for their own and their customers' convenience, they represent that they have the owners' instructions to redeem the bonds, and guarantee the validity of the transactions.

\* \* \*

Section 5 of the bill would amend section 3701 of the Revised Statutes (31 U.S.C. 742) to clarify the exemption it accords to the interest on obligations of the United States from State and local income taxes.

Section 3701 of the Revised Statutes provides that obligations of the United States shall be exempt from taxation by or under State or local authority. The Supreme Court of the United States has held that this provision also exempts the interest on obligations of the United States from taxation by or under State or local authority (N. J. Realty Title Ins. Co. v. Div. of Tax Appeals (1950), 338 U.S. 665).

In recent years the State of Idaho has taken the position that its income tax law enacted in 1933 has required the inclusion of interest on obligations of the United States in computing gross income (from

which taxable net income was determined), and that the Federal statutes have not precluded this requirement. The Idaho statute provided that there shall be levied "upon every individual . . . a tax which shall be according to and measured by his net income." The term "gross income" (from which taxable net income was determined) was defined to include, among other items, "all interest received from federal, state, municipal or other bonds." The law elsewhere provided, however, that "all income, except . . . income not permitted to be taxed under . . . the constitution or laws of the United States, shall be included and considered in determining net income of taxpayers."

It has apparently been the position of the State of Idaho not that the Federal Government is without power to exempt the interest on its obligations from State income taxes, but rather that it has not exempted that interest from a tax such as the Idaho tax.

The reasoning of the Idaho authorities appears to have been as follows: The Federal statute has exempted the interest on Federal obligations from State taxation, and the State tax statute excluded income not permitted to be taxed by the Federal exempting statute, but the Idaho statute did not attempt to tax this income. Rather it carefully provided that there should be levied "upon every individual . . . a tax . . . measured by his net income." Apparently their position has been that this has a different effect from the State statute before 1933, which provided that there should be levied "upon the net income of every individual . . . a tax," which was therefore a tax not permitted under the Federal exempting statute.

The Treasury and the Department of Justice have felt that the position of the State of Idaho rests upon a distinction of words which is without substance. We have not, however, been able to persuade the Idaho authorities to change their position. Since this position does not rest upon a theory of lack of Congressional power to exempt interest on Federal obligations from a tax such as Idaho has had, but rather upon the theory that Congress has not exercised its power, the Treasury and the Department of Justice believe that the simplest resolution of the matter would be through Congressional action which would clarify the exemption by expressly exempting Federal obligations and the interest on them from every form of State and local income taxes. The proposed provision would accomplish that purpose.

It should be mentioned that on March 20, 1959, the State of Idaho adopted a new income tax law. The new law declares it to be its intent to impose a tax identical as far as possible to the income tax imposed by the Federal Internal Revenue Code. Since the Federal Internal Revenue Code imposes a tax "on the taxable income of every individual" it has been suggested that Idaho may no longer attempt to maintain its position that the Federal exemption statute does not extend to its income tax. We have communicated with responsible State authorities, however, and have been unable to obtain assurances that the State will discontinue requiring the inclusion of interest on obligations of the United States in computing State income taxes.

In these circumstances, we believe it to be highly desirable for the Congress to make the exemption statute more specific at this time. If positions such as Idaho has held are adopted by other States the resulting taxation could have a serious adverse effect on the sale of United States savings bonds, which are so widely held by individuals, and could have undesirable effects on Treasury financing operations in general.

\* \* \*

Section 6 of the bill would authorize the issuance of obligations of the United States to Government trust funds at the issue price. The Congress has established some fifty Government trust funds. Portions of any of these funds not currently needed may be invested in obligations of the United States. With respect to six of these trust funds, however, the Congress has specified that Government obligations may be acquired on original issue only at par. Thus in the Act of August 14, 1935, establishing the Unemployment Trust Fund, it was provided that "such obligations may be acquired (1) on original issue at par, or (2) by purchase of outstanding obligations at the market price." Substantially identical language has been used in four other provisions dealing with five other trust funds. The trust funds and the citations to the pertinent provisions governing them are: Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund (42 U.S.C. 401(d)); the Railroad Retirement Account (45 U.S.C. 2280(b)); the special trust account for the payment of bonds of the

Philippines (22 U.S.C. 1393(g)(5)); and the Highway Trust Fund (23 U.S.C. 173(e)(2)). The reason for providing in these relatively few cases that acquisition on original issue must be at par is not known.

When the first of these provisions was enacted in 1935 the Treasury could not issue interest-bearing bonds at a discount. In 1942 the law was amended to permit issuance at a discount, but none were issued in this manner before last November. Therefore the requirement that obligations be acquired on original issue only at par has not created a problem until recently. With the possibility of more obligations being issued at a discount or at a premium in the future, however, the requirement that these six trust funds acquire obligations on original issue only at par is highly discriminatory against them. For example, the Treasury recently issued 4½% bonds of 1980 at 99; the public could subscribe for these bonds at 99 and any of the trust funds other than these six could acquire them at 99, but the law prohibited any of these six trust funds from acquiring them on original issue except at 100. If the Secretary of the Treasury had issued these bonds at par on original issue for account of these funds, they would have earned interest at a lower effective rate than any of the other trust funds or any member of the public acquiring them on original issue.

There does not appear to be any sound reason for this result. It has therefore been recommended that these provisions of law be amended to authorize these trust funds to acquire obligations of the United States on original issue at the issue price, which is the price the other trust funds or the public would pay.

The CHAIRMAN. Without objection, we will include in the record of the hearings the statement of the President to the Congress of the United States delivered on Monday, and also, immediately following that, the statement of the Secretary of the Treasury to the Speaker, including the drafts of the two bills referred to by the Secretary in his appearance this morning.

(Statements referred to follow :)

THE WHITE HOUSE

*To the Congress of the United States:*

Successful management of the debt of the Federal Government is one of the most important foundation stones of the sound financial structure of our Nation.

The public debt must be managed so as to safeguard the public credit. It must be managed in a way that is consistent with economic growth and stability. It must also be managed as economically as possible in terms of interest costs. The achievement of these goals is complicated today by several factors, despite the fact that U.S. Government securities are the safest investment in the world. Our growing prosperity, combined with Government programs to support mortgages and other types of debt obligations, has strengthened the position of these mortgage and other investments with which the Treasury must compete when it sells Government securities.

In addition, the rapid growth in borrowing demands of corporations, individuals, and State and local governments (which issue tax-exempt obligations) tends to diminish the amount of funds available for investment in direct Federal Government securities. Furthermore, the market for all fixed dollar obligations has been affected by a recent preference among some buyers for common stocks.

The achievement of a fiscal position that allows our revenues to cover our expenditures—as well as to produce some surplus for debt retirement—will improve substantially the environment in which debt management operates. Greater flexibility of debt management action is required, however, under present-day conditions if a reasonable schedule of maturities is to be maintained and the safeguards against inflation strengthened.

I am, therefore, asking the Secretary of the Treasury to transmit to the Congress today proposed legislation designed to improve significantly the Government's ability to manage its debt in the best interest of the Nation.

The legislation provides principally for—

(1) Removal of the present 3.26 percent interest rate ceiling on savings bonds. This, together with other changes, will reinvigorate the savings bond program.

(2) Removal of the present 4¼ percent interest rate ceiling on new issues of Treasury bonds. The present ceiling seriously restricts Treasury debt management and is inconsistent with the flexibility which the Secretary of the Treasury has on rates paid on shorter term borrowing.

(3) An increase in the regular public debt limit from \$283 billion to \$288 billion, and an increase in the temporary limit from \$288 billion to \$295 billion. These increases are essential to the orderly and prudent conduct of the financial operations of the Government, even with expenditures covered by revenues in the fiscal year 1960, as the Budget proposes.

SAVINGS BONDS

Removal of the present 3.26-percent maximum limit on savings bond interest, together with certain other changes, will permit the Treasury to improve the terms of savings bonds. This will strengthen the contribution of the program both to habits of thrift throughout the Nation and to a better structure of the public debt.

The Treasury is proposing the following revisions in the savings bond program, subject to approval of enabling legislation: A 3¾-percent interest rate to maturity for all series E- and H-Savings Bonds sold on or after June 1, 1959; an improved interest rate on all series E- and H-bonds outstanding and continued to be held; and improved extension terms for outstanding series E-bonds when they mature.

## FOUR AND ONE-QUARTER PERCENT MAXIMUM INTEREST RATE ON NEW BOND ISSUES

There is no statutory maximum on the interest rate which can be paid by the Treasury for marketable borrowing of 5 years or less (bills, certificates, and notes). The Secretary of the Treasury should have similar flexibility with regard to Treasury bonds (which run 5 years of more to maturity).

The Treasury always tries to borrow as economically as it can, consistent with its other debt management objectives. But in our democracy no man can be compelled to lend the Government on terms he would not voluntarily accept. Therefore, when the Government borrows, it can do so successfully only at realistic rates of interest that are determined by the supply and demand for securities, as reflected in the prices and yields of outstanding issues established competitively in the Government securities market.

I am aware of the fact that many proposals have been made which are designed to produce lower interest rates. However, any debt management device which would seek to interfere with the natural interaction of the competitive forces of our free economy and produce unnatural reductions in interest rates would not only breach the fundamental principles of the free market, but under current conditions could be drastically inflationary. The additional cost of the Government alone from increased prices of the goods and services it must buy might far exceed any interest saving. The ultimate harm to the entire Nation of such a price rise could be incalculable.

Market yields on a number of Treasury bonds are already above  $4\frac{1}{4}$  percent. With one exception all bonds which have 5 years or more to run to maturity have market yields above 4 percent. The Treasury recently has done substantial short-term borrowing. But it must avoid undue shortening of the public debt and therefore should continue to sell intermediate and longer term bonds whenever market conditions permit. It should not be prohibited from doing so by the existence of an artificial ceiling which under today's conditions makes it virtually impossible to sell bonds in the competitive market.

## DEBT LIMIT

The Treasury's current estimates, assuming that revenues cover expenditures for the fiscal year 1960 as a whole, indicate the need for an increase in the regular (or permanent) statutory public debt limit from \$283 billion to \$288 billion. The \$288 billion figure is \$13 billion above the permanent limit of \$275 billion in effect at the beginning of the fiscal year 1959. This \$13 billion increase is approximately equal to the Federal Government deficit during the current fiscal year, as estimated in the Budget submitted in January.

The Treasury expects the debt to approximate \$285 billion on June 30, 1959, leaving about \$3 billion leeway under the proposed \$288 billion regular ceiling—a leeway which is essential to protect the Government in case of unforeseen emergencies and to provide necessary flexibility in debt management operations.

Even with budget receipts covering expenditures in the next fiscal year the debt is expected to rise considerably above \$288 billion next fall and winter as the Treasury borrows to cover seasonal needs. This seasonal borrowing can then be repaid before the end of the fiscal year. I am asking, therefore, for a temporary increase of \$7 billion in the public debt limit beyond the \$288 billion permanent ceiling to cover those seasonal borrowing needs. This temporary limit would expire June 30, 1960, and can be reviewed prior to that time.

Certain other technical proposals to improve the management of the public debt are also included in the proposed legislation.

The enactment of this program is essential to sound conduct of the Government's financial affairs. It will contribute significantly to the Treasury's ability to do the best possible job in the management of the public debt. I urge, therefore, that the Congress give prompt consideration to this request.

There is another matter to which I wish to call your attention, quite apart from the legislative program discussed above. When I submitted my budget to you in January interest costs on the public debt for the fiscal year 1960 were estimated at \$8 billion. The increase in interest rates that has taken place since that estimate was made is now expected to add about half a billion dollars to this figure.

At the same time, however, I am informed that, because of the strength of economic recovery and growth beyond our earlier expectations, our revenue estimates for fiscal year 1960 will be sufficient to offset the increased interest cost on the public debt.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE, June 8, 1959.

41950 O—59—6

FOR RELEASE AT NOON (EDT), MONDAY, JUNE 8, 1959

The Secretary of the Treasury today sent the following letter and attachments to the Speaker of the House:

THE SECRETARY OF THE TREASURY  
Washington

June 8, 1959

Dear Mr. Speaker:

In accordance with the President's Message today on public debt management, there are transmitted herewith drafts of two bills to facilitate management of the public debt (Attachments A and B).

As mentioned in the President's Message, these bills provide primarily for three major steps designed to strengthen the public debt management program, as follows:

- (1) Removal of the present 3.26% interest rate ceiling on savings bonds which, together with other changes, will permit the Treasury to go forward with a re-invigorated savings bonds program;
- (2) Removal of the present 4-1/4% interest rate ceiling on new Treasury bond issues; and
- (3) An increase in the regular public debt limit from \$283 billion to \$288 billion, with a temporary increase to \$295 billion through June 30, 1960.

The bills also provide certain technical amendments designed to improve the management of the public debt.

As an attachment to the proposed legislation, I am also transmitting herewith further details on the new savings bonds program, most of which I plan to put into effect as of June 1, 1959, if the proposed legislation is enacted (Attachment C).

As the President stressed in his Message, this program is urgently needed in the public interest to allow the Treasury to operate with appropriate flexibility in meeting its debt management responsibilities within the context of competitive markets and without resort to improvident procedures or controls.

It is hoped that the Congress can consider the proposed bills with reasonable promptness. We will be glad to present further details and all of the information concerning the proposals which will enable the Congress to effectively consider these important proposals.

Sincerely yours,

A handwritten signature in cursive script, reading "Robert B. Anderson".

Secretary of the Treasury

The Honorable Sam Rayburn  
Speaker, House of Representatives  
Washington 25, D. C.

Enclosures

## A BILL

To facilitate management of the public debt,  
and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1 of the Second Liberty Bond Act, as amended (31 U.S.C. 752), is amended by striking out the following: ", not exceeding  $4\frac{1}{4}$  per centum per annum,".

SEC. 2. (a) The first sentence of section 21 of the Second Liberty Bond Act, as amended (31 U.S.C. 757b), is amended to read as follows:

"SEC. 21. The face amount of obligations issued under authority of this Act, and the face amount of obligations guaranteed as to principal and interest by the United States (except such guaranteed obligations as may be held by the Secretary of the Treasury), shall not exceed in the aggregate \$288,000,000,000 outstanding at any one time."

(b) During the period beginning on the date of the enactment of this Act and ending June 30, 1960, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act, as amended, shall be temporarily increased by \$7,000,000,000.

SEC. 3. Paragraphs (1) and (2) of subsection (b) of section 22 of the Second Liberty Bond Act, as amended (31 U.S.C. 757c (b)(1) and (2)), are amended to read as follows:

"(b)(1) Savings bonds and savings certificates may be issued on an interest-bearing basis, on a discount basis, or on a combination interest-bearing and discount basis. Such bonds and certificates may be sold at such price or prices and rate or rates of interest and in such denomination or denominations and may be redeemed before maturity upon such terms and conditions as the Secretary of the Treasury may prescribe.

"(b)(2) The Secretary of the Treasury, with the approval of the President, is authorized to provide by regulation:

"(i) that owners of series E and H savings bonds may, at their option, retain the bonds after maturity, or after any period beyond maturity during which they have earned interest, and continue to earn interest upon them;

"(ii) that series E and H savings bonds on which the rates of interest have been fixed prior to such regulations will earn interest at higher rates."

SEC. 4. Subsection (i) of section 22 of the Second Liberty Bond Act, as amended (31 U.S.C. 757c (i)), is amended by inserting after the third sentence thereof the following:

"Relief from liability shall be granted in all cases where the Secretary of the Treasury shall determine, under rules

and regulations prescribed by him, that written notice of liability or potential liability has not been given, within ten years from the date of the erroneous payment, to any of the foregoing agents or agencies whose liability is to be determined: Provided, That no relief shall be granted in any case in which a qualified paying agent has assumed unconditional liability to the United States."

SEC. 5. (a) Section 3701 of the Revised Statutes (31 U.S.C. 742) is amended by adding at the end thereof the following:

"This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except franchise or other non-property taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

(b) The following provisions of the Second Liberty Bond Act, as amended, relating to the tax-exempt status of obligations of the United States, are repealed, without changing the status of any outstanding obligation:

- (1) Subsection (b) of section 5 (31 U.S.C. 754(b));
- (2) The second and third sentences of section 7 (31 U.S.C. 747);
- (3) Subsection (b) of section 18 (31 U.S.C. 753(b));
- (4) The first sentence of subsection (d) of section 22 (31 U.S.C. 757c(d)).

SEC. 6. The following provisions of law are amended by striking out the words "on original issue at par" and inserting in lieu thereof the words "on original issue at the issue price":

(a) Section 6(g)(5) of the Act of March 24, 1934, as amended (22 U.S.C. 1393(g)(5));

(b) Section 201(d) of the Act of August 14, 1935, as amended (42 U.S.C. 401(d));

(c) Section 904(b) of the Act of August 14, 1935, as amended (42 U.S.C. 1104(b));

(d) Section 15(b) of the Act of August 29, 1935, as amended (45 U.S.C. 2280(b));

(e) Section 209(e)(2) of the Act of June 29, 1956 (23 U.S.C. 173(e)(2)).

SEC. 7. The amendments made by section 3 shall be effective as of June 1, 1959.

Section-by-section Analysis  
of  
A Bill to Facilitate Management of the Public Debt

Section 1 would remove the present limit of 4-1/4 percent on the rate of interest on new issues of Treasury bonds.

Section 2 would provide a permanent increase in the debt limit to \$288 billion and would provide a temporary debt limit of \$295 billion through June 30, 1960.

Section 3 would remove the present limit of 3.26 percent on the rate of interest on savings bonds, it would remove the present limits on maturities of savings bonds, it would authorize further extensions of Series E savings bonds which have been authorized to earn interest after maturity, it would authorize similar extensions of Series H savings bonds, and it would authorize the increasing of interest rates upon Series E and H savings bonds after rates of interest have been fixed by contract.

Section 4 would relieve agents authorized to make payments in connection with the redemption of savings bonds from liability to the United States for erroneous payment unless written notice of potential liability is given within ten years from the date of the erroneous payment.

Section 5 would make it clear that present provisions of law exempting obligations of the United States from State and local taxation cover State income taxes.

Section 6 would permit certain Government trust funds which can now acquire Government securities on original issue only at par to acquire them at the issue price like any other purchaser from the Treasury.

Section 7 would provide an effective date of June 1, 1959, for amendments authorizing increased interest rates on savings bonds.

## A BILL

Attachment B

To permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to common nontaxable exchanges) is amended by adding at the end thereof the following new section:

"SEC. 1037. CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS.

"(a) General rule.--When so provided by regulations promulgated by the Secretary in connection with the issue of obligations of the United States, no gain or loss shall be recognized on the surrender to the United States of obligations of the United States issued under the Second Liberty Bond Act in exchange solely for other obligations issued under such Act. For rules relating to the recognition of gain or loss in a case where the preceding sentence would apply except for the fact that the exchange was not made solely for other obligations of the United States, see subsections (b) and (c) of section 1031.

"(b) Application of section 1232.--Notwithstanding any provision of this section, section 1031(b), or section 1031 (d), section 1232 shall apply to any recognized gain to which it would otherwise apply, except that in the case of an exchange

of a transferable obligation for another transferable obligation, the issue price of the obligation received by the taxpayer in exchange shall be considered to be the same as the issue price of the obligation given by the taxpayer in exchange. For purposes of this section, the holding period of any transferable obligation received by the taxpayer in exchange for another transferable obligation shall include the holding period of the obligation given by the taxpayer in exchange except with respect to any gain recognized at the time of the exchange.

"(c) Cross references.--For rules relating to the basis of obligations of the United States acquired in an exchange for other obligations described in subsection (a), see subsection (d) of section 1031."

(b) The table of sections for part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

"Sec. 1037. Certain exchanges of United States obligations."

(c) Section 1031 (b) (relating to gain from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(d) Section 1031 (c) (relating to loss from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(e) Section 1031 (d) (relating to basis in the case of exchanges of property held for productive use or investment) is amended by striking out "this section, section 1035 (a), or section 1036 (a)," in the first sentence thereof and inserting in lieu thereof "this section, section 1035 (a), section 1036 (a), or section 1037 (a),".

SEC. 2. Section 4(a) of the Public Debt Act of 1941, as amended (31 U.S.C. 742a), is amended by striking out "under the Internal Revenue Code," and inserting in lieu thereof "except as provided under the Internal Revenue Code,".

SEC. 3. The amendments made by this Act shall be effective for taxable years ending after the date of enactment of this Act.

Section-by-section Analysis  
of  
A Bill to Permit the Secretary of the  
Treasury to Designate Certain Exchanges of  
Government Securities to be without Recognition  
of Gain or Loss for Income Tax Purposes

Section 1 would permit the Secretary of the Treasury to designate certain exchanges of Government Securities upon which recognition of gain or loss would be deferred for Federal income tax purposes. The characterization of the gain or loss so deferred, however, would not be affected except as the actual holding period would convert short-term gain or loss into long-term gain or loss. Also, a special rule is provided to eliminate the possible creation of original issue discount in the case of exchanges of transferable Government securities.

Section 2 would conform the Public Debt Act of 1941 to accord with the amendments of the Internal Revenue Code proposed in section 1.

Section 3 would provide an effective date.

## Attachment C

TREASURY SAVINGS BOND PROGRAM IF PROPOSED LEGISLATION IS ENACTED

(June 1959)

At the present time approximately \$42-1/2 billion Series E and H bonds are outstanding, owned by perhaps as many as 40 million Americans. Approximately 8 million Americans are buying bonds currently on payroll savings plans in industry and Government throughout the Nation. Many of these savings grow out of the convenience of the payroll plan and are savings which would not be taking place in such volume if the savings bond program did not exist.

The E and H program is the only broad area in the debt management picture where the Treasury has been successful in attracting long-term savings into Government securities during the period since the close of World War II. Holdings of Government securities by individuals outside of the E and H program have declined by \$13 billion during the last 12 years, while holdings by savings institutions have gone down by \$10-1/2 billion. During the same period the volume of E and H bonds outstanding has risen by \$12-1/2 billion.

In recent years the E and H program has been attracting a declining share of individuals' liquid savings. In 1958, for example, only 6% of these savings (in saving accounts in banks, savings and loan shares, and E and H bonds) was accounted for by the savings bond program, as against 24% in the early postwar years.

Savings bonds are attractive to many investors largely because of their safety and their convenience of purchase and redemption. However, with interest rates on savings bonds lagging behind the increases in interest paid on other

forms of saving it is apparent that in all fairness to present holders, as well as to new purchasers of savings bonds, some upward revision in interest rates is called for. In addition to increased rates, certain other features are being added to the program which will make it a much more positive force in stimulation of savings than it has been for many years. An increased volume of savings is important to the welfare of our Nation and contributes effectively to the sound financing of industry and government. It reduces the pressures leading to excessive increases in bank credit, which in turn result in an expansion of money supply beyond the normal needs of a growing economy.

The new savings bond program has three major features (subject, of course, to the enactment of enabling legislation):

(1) All E and H bonds sold beginning June 1, 1959, will earn  $3\frac{3}{4}\%$  if held to maturity --  $1\frac{1}{2}\%$  higher than at present -- with lesser improved yields for shorter periods of holding.

(2) All E and H bonds outstanding will also earn approximately  $1\frac{1}{2}\%$  more than they do now if held to maturity beginning with their first semiannual interest period which starts on or after June 1, 1959, with lesser improvement if redeemed earlier.

(3) All E bonds on which an extension has already been promised and which had not yet reached first maturity (before June 1, 1959) will be offered an improved extension on which  $3\frac{3}{4}\%$  will be paid if held the full additional ten years, with lesser yields (starting at  $3\frac{1}{2}\%$ ) for shorter periods of holding.

Each of these three items is discussed in the paragraphs which follow.

(1) One-half Percent Increase on New Bonds

The increase in interest earnings from 3-1/4% to 3-3/4% for full term of holding on E bonds is realized by shortening the term to maturity from the present 8 years and 11 months to 7 years and 9 months. The purchase price of the bond will continue to be 75% of its maturity value, thus preserving the advantages of the present well-ingrained system of bond purchases through payroll savings.

The amount of interest earned if the new E bond is redeemed before maturity will also be improved. The rate of interest earned at the 1-year point will be increased from 2.28% to 2.33%, at the 2-year point from 2-3/4% to 3%, and at the 3-year point from 3% to 3-1/4%. This modest increase in earnings for short-term holdings reflects the desire of the Treasury not to compete unfairly with the rates paid on accounts in private savings institutions for short periods of time. At the same time, the increased incentive to hold the new bond to maturity to earn the full 3-3/4% emphasizes even more strongly the Treasury's desire to appeal primarily to longer-term savers.

The planned increase in rates returns the relationship between E bonds and other forms of saving roughly to the same position they held when the E bond rate was increased from 2.90% to 3% seven years ago. The increase makes no attempt, however, to restore fully the 1952 relationship between the 3% E bond rate at that time and the 2.6% average rate on long-term marketable

Treasury bonds. Even the new 3-3/4% rate is more than 1/4% below comparable marketable bond yields at the present time (See Appendix 1 for detail on the new E bond).

The new H bond, like its predecessor, will continue to be a current income bond issued at par, redeemable at par on one month's notice at any time after six months' holding, and maturing at par at the end of its 10-year life. The H bond will continue to have approximately the same increasing schedule of interest earnings as the E bond by means of increasing interest checks up to two years, with a constant amount thereafter (See Appendix 2 for detail on the new H bond).

The present interest rate ceiling on savings bonds is 3.26%. Thus, the ceiling will have to be lifted in order to put the new rates into effect. A retroactive effective date of June 1 has been requested, however, so every bond bought on or after that date will benefit by the new terms regardless of what is stated on the bond. This procedure is similar to that followed when E and H bond terms were changed a little over two years ago.

(2) Increased Earnings for Outstanding E & H Bonds

In all previous savings bond revisions the Treasury has taken the position that no change should be made in the terms of savings bonds already outstanding. In both 1952 and 1957 it was pointed out to holders of such bonds that if they felt they could do better by turning in their old bond and buying a new one they were free to do so; but it was also pointed out that in the vast majority of cases it was still to their benefit to retain the existing bonds. In 1957, for example, this was true for continued holding of all bonds which had not

yet reached first maturity, except for those purchased in the 2-1/2 years preceding the change in terms. It was true also for most of the holders of bonds in the extension period who would in many cases be dissuaded from buying the new bond since they would have to pay upon redemption whatever taxes were due on the accumulated interest on the old bond. On the other hand, continued holding would defer the taxes, as well as permit continued earning of interest on the amount of deferred tax.

This position was quite satisfactory under conditions where the changes were only 1/10% as in 1952, or 1/4% as in 1957. Under the conditions applying to a more substantial increase in the interest rate on E and H bonds, however -- particularly when added to the earlier increases -- the volume of potential switches out of the old bond in order to buy the new one is much larger and could reach significant proportions. Such switches would be costly enough from the standpoint of the Treasury even if they would indeed result in purchases of the new bonds. As a practical matter it is recognized, however, that once the incentive to redeem the old bond is increased many holders, despite the more attractive interest rate, will prefer either to spend their money or invest it elsewhere at even higher rates of interest and would be lost to the savings bond program. This tendency would be accentuated by the fact that it is rarely possible to reinvest the exact proceeds of a redeemed bond in a new bond since the number of available denominations is limited.

There is, in addition, an important question of equitable treatment of all bondholders. The Treasury has something of a trusteeship function on behalf of millions of individual savers who do not follow interest rates trends closely. They buy bonds and hold bonds with understandable faith that the Government is giving them a square deal.

The new plan provides, therefore, for improved yields to start with the first 6-month interest period beginning June 1, 1959, or thereafter. Only future earnings will be affected; no retroactive increase in interest rates for past periods is involved. To bring the future earnings of bonds bought since January 1957 -- which are on a 3-1/4% basis if held for the full term to maturity -- in line with the new 3-3/4% bond, 1/2% per year will be added to the interest earnings of such bonds for the remaining period to maturity if held until that maturity, with lesser increases of interest for each future period if redeemed before maturity.

Similarly, bonds issued from May 1952 through January 1957 will have 1/2 of 1% added to the yield of their present 3% bonds from now until maturity if they are held until that date. Bonds sold from December 1949 through April 1952 will have an increase of .60% above their original rate of 2.90%, so that they too, in effect, will earn 3-1/2% from the beginning of the next interest accrual period until maturity if held that long (For list of categories of E bonds outstanding see Appendix 3 on revision of existing E bonds, Table 1).

The Treasury's decision to increase gradually the interest rate on outstanding bonds, rather than giving each bond a full 1/2% or .60% increase beginning with the next interest earning period, again reflects a desire to encourage continued holding of these securities.

The increased interest return on Series E bonds will be achieved through an improvement in the guaranteed redemption value on each bond over and above the schedule of redemption values printed on the bond. No action by the bondholder is necessary. In the first period the increased interest adjustment may be as little as 1/8¢ on a \$100 bond, but in all cases a full half percent

(or .60%, as the case may be) will be earned for future periods if the bond is held to its first maturity date (For examples, see Appendix 3 on revision of existing E bonds, Tables 4-6).

A similar adjustment will be made for all bonds which have passed their original maturity date and are in the extension period. In the case of bonds purchased from May 1942 through May 1949 -- bonds which already have a 10-year extension at 3% -- the rate will be raised to approximately 3-1/2% for the remaining number of 6-month interest periods to maturity if held for the full term. Similarly, the rates on bonds sold from May 1941 through April 1942, which have a 10-year 2.90% extension, will be raised by .60% so that they also, in effect, will earn 3-1/2% if held to the second maturity date (For examples, see Appendix 3 on revision of existing E bonds, Tables 2-3).

The only outstanding bonds remaining are those sold from June through November 1949. These will be reaching first maturity on, or within the first 6 months thereafter, the effective date of the revision and thus will be entitled to the new 10-year extension described below.

The improved interest on Series H bonds will be paid directly to the holder as part of his regular semiannual interest check, beginning with interest checks payable on December 1, 1959. As in the case of interest earned on E bonds, the full 1/2% improvement in earnings from now until maturity will be realized only if the H bond is held until maturity (See Appendix 4 on revision of existing H bonds, Tables 1-3, for list of categories and examples).

(3) Improved Extension Terms on Bonds Which Have Already Been Promised a Further Extension

All unmatured bonds (before June 1, 1959) issued June 1949 through April 1957 have already been promised a 10-year 3% extension, which period had not

yet begun. There will be a 3-3/4% extension for all of these bonds if the bonds are held for the full 10-year extension period, with lesser yields (beginning at 3-1/2%) if redeemed before the end of the 10-year extension period. The decision to offer a gradually increasing rate on the future extension of these bonds reflects again the Treasury's desire to give an added interest incentive for longer-term holding (See Appendix 3, Table 7, for detail on revised extension of E bonds).

When the Treasury started issuing the present 3-1/4% E bond in the spring of 1957, it offered no extension beyond the original maturity of 8 years and 11 months. The Treasury is now announcing that a 10-year extension will be provided after maturity for the 3-1/4% E bonds issued May 1957 through May 1959, as well as the new 3-3/4% E bonds with issue dates beginning June 1959. However, other terms and conditions (including interest rates) pertaining to the 10-year extension will not be announced until the first of these bonds approaches maturity.

The first extended savings bonds will reach the end of their extension period in May 1961 (bonds originally sold in May 1941). The Treasury is announcing that, as that date approaches, the holders of all bonds which reached first maturity before June 1, 1959 (issued May 1941 through May 1949) will have the opportunity to extend their bonds for a further 10-year period, with other terms and conditions (including interest rates) to be announced prior to May 1961. As part of its legislative program, therefore, the Treasury has asked for removal of the present 10-year limitation on E bond extension, thus permitting this program to go forward at the appropriate time.

The Treasury also has asked that its present authority to extend Series E bonds be broadened to include Series H bonds. The Treasury has not reached any decision whether or not to extend H bonds when they begin coming due in February 1962. Broadening of the present authority will permit the Treasury

to treat these securities in the same manner as the Congress has approved with regard to Series E bonds if it is deemed advisable.

The above three-pronged program is designed to make savings bonds more attractive and will add materially both to the encouragement of desirable habits of thrift throughout the country and to the ability of the Treasury to achieve a better balanced structure of the public debt. The attached appendices present further detail on each aspect of the new program.

Subject to enabling legislation

## Appendix 1

Revised Series E Savings Bond -- New Purchases  
On or After June 1, 1959

## Summary of Terms and Conditions

- (1) Date of announcement -- June 8, 1959 (Treasury Circular No. 653 - Fifth Revision).
- (2) Effective date -- The revised terms apply to all bonds sold on or after June 1, 1959.
- (3) Issue price -- 75% of maturity (par) value.
- (4) Issue date -- First day of month in which payment is received by an authorized issuing agent.
- (5) Maturity date -- 7 years and 9 months from issue date.
- (6) Interest -- Accrues to par to provide an investment yield of 3-3/4% compounded semiannually if held to maturity; lesser yields if redeemed at earlier dates. 1/
- (7) Redeemability prior to maturity at option of Treasury -- None.
- (8) Redeemability prior to maturity at option of holder -- At any time not less than 2 months from issue date without notice, at stated redemption values, at any qualified bank or other paying agent, any Federal Reserve Bank or branch, or at the United States Treasury. 1/
- (9) Negotiability -- None.
- (10) Eligibility as collateral for loans -- None.
- (11) Eligible subscribers -- For cash, any investor other than commercial banks. In exchange for matured and maturing Series F and G savings bonds, any holder other than commercial banks.
- (12) Limits on subscriptions by eligible subscribers -- Annual limit for cash \$10,000 (maturity value). Series E bonds obtained in exchange for matured and maturing Series F and G savings bonds are excluded from this limitation.
- (13) Denominations -- \$25, \$50, \$100, \$200, \$500, \$1,000, and \$10,000 (maturity value). (Also \$100,000 denomination for certain employee savings plans).
- (14) Bearer or registered -- Registered form only; may be registered in name of single owner (with or without beneficiary) or in co-ownership form.

- (15) Extension privileges -- A 10-year extension will be provided if owner wishes to hold his bond beyond maturity. Other terms and conditions (including interest rates) of the extension will not be announced until bonds approach maturity.
- (16) Handling of subscriptions before new bonds are printed -- Old stock will be used until new bonds are available. In all cases the regulations will apply the new terms and conditions to all bonds purchased on or after June 1, 1959. If the purchaser wishes, he may exchange any bond issued on or after June 1, 1959 on old stock for a new bond with the same dating when new stock is available, although his rights would be in no way impaired if he does not do so.
- 

1/ For schedule of redemption values and investment yields see Table 1 attached.

Subject to enabling legislation

## Appendix 1 -- Table 1

Revised Series E Savings Bond -- New Purchases  
On or After June 1, 1959Schedule of Redemption Values and Investment Yields  
(Based on \$100 Bond, Maturity Value; \$75, Issue Price)

Period after issue date	Redemption value during each period	Approximate investment yields 1/	
		On issue price to beginning of each period	On current redemption value from beginning of each period to maturity
First half year.....	\$ 75.00	--	3.75%
1/2 to 1 year.....	75.64	1.71%	3.89
1 to 1-1/2 years.....	76.76	2.33	3.96
1-1/2 to 2 years.....	78.04	2.67	4.01
2 to 2-1/2 years.....	79.60	3.00	4.01
2-1/2 to 3 years.....	81.12	3.16	4.03
3 to 3-1/2 years.....	82.64	3.26	4.05
3-1/2 to 4 years.....	84.28	3.36	4.06
4 to 4-1/2 years.....	86.00	3.45	4.06
4-1/2 to 5 years.....	87.80	3.53	4.04
5 to 5-1/2 years.....	89.60	3.59	4.03
5-1/2 to 6 years.....	91.44	3.64	4.02
6 to 6-1/2 years.....	93.28	3.67	4.01
6-1/2 to 7 years.....	95.16	3.70	4.01
7 to 7-1/2 years.....	97.08	3.72	3.99
7-1/2 to 7 years and 9 months.	99.00	3.74	4.06
Maturity value (7 years and 9 months from issue date)...	100.00	3.75	--

Office of the Secretary of the Treasury

June 1959

1/ Compounded semiannually.

## Appendix 1 - Table 2

## Revised\* and Present Series E Bond First Maturity Period Redemption Values and Investment Yields

(\$100 bond, face value)

Period after issue date (years)	Redemption value			Yield for 1/:					
				Period held 2/			Remaining period to maturity 3/		
	Revised	Present	Increase	Revised	Present	Increase	Revised	Present	Increase
0 - 1/2.....	\$ 75.00	\$ 75.00	-	-	-	-	3.75%	3.25%	.50%
1/2 - 1 .....	75.64	75.60	\$.04	1.71%	1.60%	.11%	3.89	3.35	.54
1 - 1-1/2.....	76.76	76.72	.04	2.33	2.28	.05	3.96	3.38	.58
1-1/2 - 2.....	78.04	77.92	.12	2.67	2.56	.11	4.01	3.39	.62
2 - 2-1/2.....	79.60	79.24	.36	3.00	2.77	.23	4.01	3.39	.62
2-1/2 - 3.....	81.12	80.60	.52	3.16	2.90	.26	4.03	3.39	.64
3 - 3-1/2.....	82.64	82.00	.64	3.26	3.00	.26	4.05	3.38	.67
3-1/2 - 4.....	84.28	83.40	.84	3.36	3.06	.30	4.06	3.38	.68
4 - 4-1/2.....	86.00	84.84	1.16	3.45	3.11	.34	4.06	3.37	.69
4-1/2 - 5.....	87.80	86.28	1.52	3.53	3.14	.39	4.04	3.37	.67
5 - 5-1/2.....	89.60	87.76	1.84	3.59	3.17	.42	4.03	3.36	.67
5-1/2 - 6.....	91.44	89.24	2.20	3.64	3.19	.45	4.02	3.36	.66
6 - 6-1/2.....	93.28	90.72	2.56	3.67	3.20	.47	4.01	3.37	.64
6-1/2 - 7.....	95.16	92.24	2.92	3.70	3.21	.49	4.01	3.37	.64
7 - 7-1/2.....	97.08	93.76	3.32	3.72	3.21	.51	3.99	3.39	.60
7-1/2 - 7-3/4.....	99.00			3.74					
7-1/2 - 8.....		95.32	3.68		3.22	.52	4.06	3.41	.65
7-3/4 (maturity).....	100.00			3.75			-		
8 - 8-1/2.....		96.88			3.23			3.49	
8-1/2 - 8-11/12.....		98.44			3.23			3.81	
8-11/12 (maturity).....		100.00			3.25			-	

PUBLIC DEBT AND INTEREST RATE CEILINGS

Office of the Secretary of the Treasury

June 1959

\* Bonds issued after May 31, 1959.

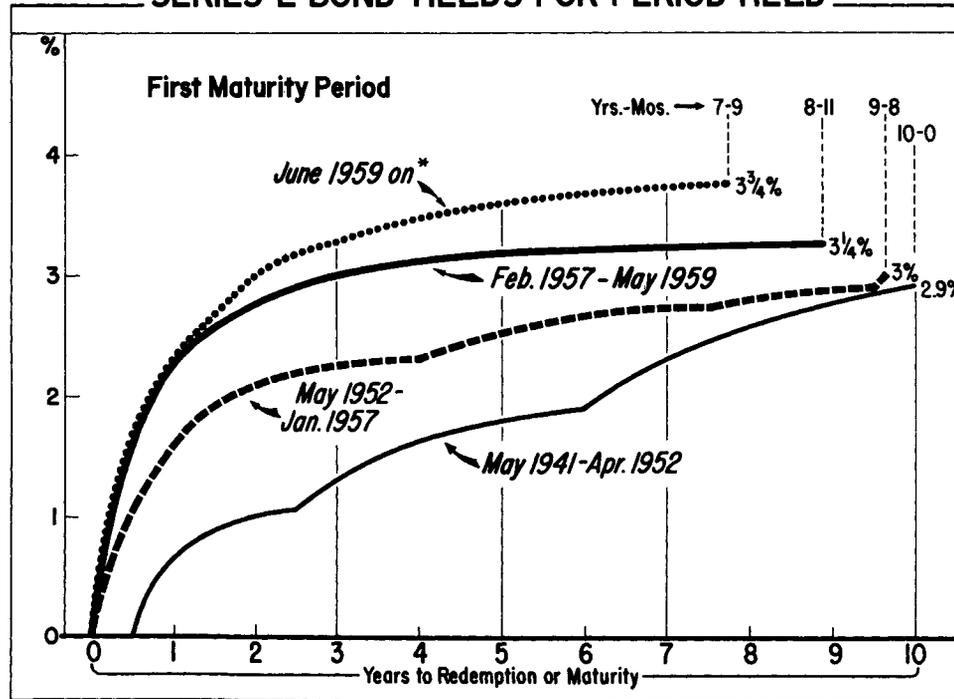
1/ Compounded semiannually.

2/ From issue date to the beginning of any subsequent 1/2 year period.

3/ On current redemption value from the beginning of each 1/2 year period to maturity.

Appendix I - Chart I

SERIES E BOND YIELDS FOR PERIOD HELD



\*Subject to enabling legislation.

Subject to enabling legislation

## Appendix 2

Revised Series H Savings Bond -- New Purchases  
On or After June 1, 1959

## Summary of Terms and Conditions

- (1) Date of announcement -- June 8, 1959 (Treasury Circular No. 905 - Second Revision).
- (2) Effective date -- The revised terms apply to all bonds sold on or after June 1, 1959.
- (3) Issue price -- Par.
- (4) Issue date -- First day of month in which payment is received by a Federal Reserve Bank or branch, or the United States Treasury.
- (5) Maturity date -- 10 years from issue date.
- (6) Interest -- Varying semi-annual interest checks to provide an investment yield of approximately 3-3/4% per annum if held to maturity; lesser yields if redeemed at earlier dates. 1/
- (7) Redeemability prior to maturity at option of Treasury -- None.
- (8) Redeemability prior to maturity at option of holder -- On first day of any month after 6 months from issue date on 1 month's notice, at par, at any Federal Reserve Bank or branch, or at the United States Treasury.
- (9) Negotiability -- None.
- (10) Eligibility as collateral for loans -- None.
- (11) Eligible subscribers -- For cash, any investor other than commercial banks. In exchange for matured and maturing F and G savings bonds, any holder other than commercial banks.
- (12) Limits on subscriptions by eligible subscribers -- Annual limit for cash \$10,000 (maturity value). Series H bonds obtained in exchange for matured and maturing Series F and G savings bonds are excluded from this limitation.
- (13) Denominations -- \$500, \$1,000, \$5,000, and \$10,000.
- (14) Bearer or registered -- Registered form only; may be registered in the name of single owner (with or without beneficiary) or in co-ownership form.

- (15) Extension privileges — None.
- (16) Handling of subscriptions before new bonds are printed — Old stock will be used until new bonds are available. In all cases the regulations will apply the new terms and conditions to all bonds purchased on or after June 1, 1959. If the purchaser wishes, he may exchange any bonds issued on or after June 1, 1959 on old stock for a new bond with the same dating when new stock is available, although his rights would be in no way impaired if he does not do so.
- 

1/ For schedule of varying amounts of checks and investment yields see Table 1 attached.

Subject to enabling legislation

Appendix 2 - Table 1

Revised Series H Savings Bond -- New Purchases  
On or After June 1, 1959 <sup>1/</sup>

Schedule of Semiannual Interest Checks and Investment Yields  
(Based on \$1,000 Bond <sup>2/</sup>)

Period of time bond is held after issue date	Interest check	Approximate investment yields <sup>3/</sup>	
		From issue date to each interest payment date	From each interest payment date to maturity
At issue date.....	-	-	3.75
1/2 year.....	\$ 8.00	1.60%	3.88
1 year.....	14.50	2.25	3.95
1-1/2 years.....	16.00	2.56	4.00
2 years.....	20.00	2.91	4.00
2-1/2 years.....	20.00	3.12	4.00
3 years.....	20.00	3.26	4.00
3-1/2 years.....	20.00	3.36	4.00
4 years.....	20.00	3.44	4.00
4-1/2 years.....	20.00	3.49	4.00
5 years.....	20.00	3.54	4.00
5-1/2 years.....	20.00	3.58	4.00
6 years.....	20.00	3.61	4.00
6-1/2 years.....	20.00	3.64	4.00
7 years.....	20.00	3.66	4.00
7-1/2 years.....	20.00	3.68	4.00
8 years.....	20.00	3.70	4.00
8-1/2 years.....	20.00	3.71	4.00
9 years.....	20.00	3.72	4.00
9-1/2 years.....	20.00	3.74	4.00
10 years (maturity).....	20.00	3.75	-

Office of the Secretary of the Treasury

June 1959

<sup>1/</sup> With investment return approximating return on revised Series E bond.  
<sup>2/</sup> Redemption value at all times = \$1,000.  
<sup>3/</sup> Compounded semiannually.

Subject to enabling legislation

Appendix 2 - Table 2

Revised\* and Present Series H Bond Interest Checks and Investment Yields  
(\$1,000 Bond) 1/

Period after issue date (years)	Interest checks			Yield for 2/					
				Period held <u>3/</u>			Remaining period to maturity		
	Revised	Present	Increase	Revised	Present	Increase	Revised	Present	Increase
0	-	-	-	-	-	-	3.75%	3.25%	.50%
1/2.....	\$ 8.00	\$ 8.00	0	1.60%	1.60%	0	3.88	3.35	.53
1 .....	14.50	14.50	0	2.25	2.25	0	3.95	3.38	.57
1-1/2.....	16.00	16.90	\$-.90	2.56	2.62	-.06%	4.00	3.38	.62
2 .....	20.00	16.90	3.10	2.91	2.80	.11	4.00	3.38	.62
2-1/2.....	20.00	16.90	3.10	3.12	2.92	.20	4.00	3.38	.62
3 .....	20.00	16.90	3.10	3.26	2.99	.27	4.00	3.38	.62
3-1/2.....	20.00	16.90	3.10	3.36	3.04	.32	4.00	3.38	.62
4 .....	20.00	16.90	3.10	3.44	3.08	.36	4.00	3.38	.62
4-1/2.....	20.00	16.90	3.10	3.49	3.11	.38	4.00	3.38	.62
5 .....	20.00	16.90	3.10	3.54	3.14	.40	4.00	3.38	.62
5-1/2.....	20.00	16.90	3.10	3.58	3.16	.42	4.00	3.38	.62
6 .....	20.00	16.90	3.10	3.61	3.18	.43	4.00	3.38	.62
6-1/2.....	20.00	16.90	3.10	3.64	3.19	.45	4.00	3.38	.62
7 .....	20.00	16.90	3.10	3.66	3.20	.46	4.00	3.38	.62
7-1/2.....	20.00	16.90	3.10	3.68	3.21	.47	4.00	3.38	.62
8 .....	20.00	16.90	3.10	3.70	3.22	.48	4.00	3.38	.62
8-1/2.....	20.00	16.90	3.10	3.71	3.23	.48	4.00	3.38	.62
9 .....	20.00	16.90	3.10	3.72	3.24	.48	4.00	3.38	.62
9-1/2.....	20.00	16.90	3.10	3.74	3.24	.50	4.00	3.38	.62
10 (maturity)	20.00	16.90	3.10	3.75	3.25	.50	-	-	-

Office of the Secretary of the Treasury

June 1959

\* Bonds issued after May 31, 1959.  
1/ Redemption value at all times = \$1,000.  
2/ Compounded semiannually.  
3/ From issue date to any interest payment date.

PUBLIC DEBT AND INTEREST RATE CEILINGS

105

---

Subject to enabling legislation

## Appendix 3

Revision of Existing Series E Savings Bonds  
Outstanding Bonds Issued before June 1, 1959

Summary of Revisions in Terms and Conditions

- (1) Date of announcement -- June 8, 1959 (Treasury Circular No. 653 - Fifth Revision).
- (2) Effective date for start of increased yields -- June 1, 1959 for all existing bonds dated June and December of any issue year; for all others the next date on which their redemption values increase. Therefore, the first change in redemption values from the schedules published in 4th revision of Treasury Department Circular No. 653 dated April 22, 1957, will take place 1/2 year after June 1, 1959 in the case of bonds dated June and December of any year and 1/2 year after the next date (after June 1959) on which redemption values increase in the case of all other bonds.
- (3) Revision of future yields until next maturity date -- Beginning December 1, 1959, on bonds issued in June and December of any year (all other bonds on the next date of increase in value), future redemption values will be increased to provide an increase in investment yields for the remaining period to next maturity. At next maturity date the amount of the increase in investment yield (compounded semiannually) will be:  $\frac{5}{10}$  of  $1\%$  per annum on bonds now earning more than  $2.90\%$  per annum for their full current maturity period and;  $\frac{6}{10}$  of  $1\%$  per annum on bonds now earning  $2.90\%$  per annum for their full current maturity period, with lesser increases in investment yields if bonds are redeemed before next maturity.  $\frac{1}{2}$
- (4) Extension privileges at first maturity -- On bonds which have not already reached first maturity before the effective date of this revision:
  - (a) Bonds issued June 1949 through April 1957 -- if owner does not wish to cash his bond at maturity he may hold his bond for a period of 10 years more with interest accruing at a rate of approximately  $3-1\frac{1}{2}\%$  per annum (compounded semiannually) for the first 1/2 year period of holding during the 10-year extension and increasing gradually to approximately  $3-3\frac{3}{4}\%$  per annum (compounded semiannually) for the entire 10 years if held to the end of the extension period.  $\frac{2}{2}$  (The redemption value of any bond at the beginning of the new extension will be the base upon which interest will accrue during the 10-year extension period.)
  - (b) Bonds issued May 1957 through May 1959 -- a 10-year extension will be provided if owner wishes to hold his bond beyond maturity. Other terms and conditions (including interest rates) of the extension will not be announced until bonds approach maturity.

- (5) Second extension privileges -- On bonds which have reached first maturity before June 1, 1959 (issued May 1941 through May 1949) a second 10-year extension will be provided if owner wishes to hold his bond beyond second maturity (20 years from issue date). Other terms and conditions (including interest rates) of the extension will not be announced until bonds approach second maturity.
- (6) No changes in other terms or conditions.
- 

- 1/ The categories of outstanding E bonds are shown in Table 1 attached. For examples of redemption values and investment yields in each category see Tables 2 through 6 attached.
- 2/ Schedule of redemption values and investment yields during extension shown in Table 7.

Appendix 3 - Table 1

Categories of Outstanding Series E Bonds, May 31, 1959

Issue year and month	Current maturity period		Range of yields for remaining time to next maturity <sup>1/</sup>	Range of time to next maturity <sup>1/</sup> (years)	Yields during new extension <sup>2/</sup>
	Yield for full current maturity period	Present			
<b>Bonds in extension period:</b>					
May 1941 - April 1942.....	2.90%	4.17% - 4.26%	4.77% - 4.86%	1-1/2 - 2-1/2	3/
May 1942 - May 1949.....	3.00	3.00 - 3.07	3.50 - 3.57	2-1/2 - 9-1/2	3/
<b>Maturing bonds:</b>					
June 1949 - November 1949.....	2.90	-	-	-	3.50% - 3.75%
<b>Bonds in first maturity period:</b>					
December 1949 - April 1952....	2.90	4.08 - 4.26	4.68 - 4.86	1/2 - 2-1/2	3.50 - 3.75
May 1952 - January 1957.....	3.00	3.28 - 3.89	3.78 - 4.39	2-1/6 - 7-1/6	3.50 - 3.75
February 1957 - May 1959.....	3.25	3.35 - 3.39	3.85 - 3.89	6-5/12 - 8-5/12	4/
Office of the Secretary of the Treasury					June 1959

<sup>1/</sup> Based on next date of increase in redemption values.<sup>2/</sup> For schedule of redemption values and investment yields during extension see Table 7.<sup>3/</sup> A 10-year second extension will be provided. Other terms and conditions (including interest rates) of the second extension will not be announced until bonds approach next maturity.<sup>4/</sup> Bonds issued February through April 1957 have the same extension privilege as bonds issued May 1952-January 1957. For remaining bonds a 10-year extension will be provided; other terms and conditions (including interest rates) of the extension will not be announced until they approach maturity.

Subject to enabling legislation

## Appendix 3 - Table 2

Example of Revision in Existing Series E Savings Bonds,  
Category of Bonds Issued May 1941 through April 1942\*Redemption Values and Investment Yields of Bonds Issued June through November 1941

(Based on \$100 face value bond)

Period after first maturity (years)	Approximate investment yield 1/ on:								
	Redemption value:		Value at effective date of revision to:		Issue price to beginning of each period:		Current redemption value from beginning of each period to maturity		
	during each period	each period	each period	each period	each period	each period	each period	each period	
	Original	Revised	Original	Revised	Original	Revised	Original	Revised	
0 - 1/2.....	\$100.00				2.90%		2.90%	-	
1/2 - 1.....	101.25				2.88		2.92	-	
1 - 1 1/2.....	102.50				2.86		2.94	-	
1-1/2 - 2.....	103.75				2.84		2.97	-	
2 - 2 1/2.....	105.00				2.82		3.01	-	
2-1/2 - 3.....	106.25				2.81		3.05	-	
3 - 3 1/2.....	107.50				2.79		3.10	-	
3-1/2 - 4.....	108.75				2.77		3.16	-	
4 - 4 1/2.....	110.00				2.75		3.23	-	
4-1/2 - 5.....	111.25				2.74		3.32	-	
5 - 5 1/2.....	112.50				2.72		3.43	-	
5-1/2 - 6.....	113.75				2.71		3.56	-	
6 - 6 1/2.....	115.00				2.69		3.73	-	
6-1/2 - 7.....	116.25				2.67		3.96	-	
7 - 7 1/2.....	117.50				2.66		4.26	-	
7-1/2 - 8.....	120.00				2.70		4.26	-	
8 (June 1 - Nov. 1, 1959 2/)- 8-1/2..	122.67			-	2.75				
8-1/2 - 9.....	125.33	125.44	4.34%	4.52%	2.79	2.80	4.17	4.82%	
9 - 9 1/2.....	128.00	128.40	4.30	4.62	2.83	2.85	4.12	5.02	
9-1/2 - 10.....	130.67	131.56	4.26	4.72	2.87	2.90	4.08	5.11	
10 (2nd maturity)...	133.33	134.92	4.21	4.82	2.90	2.96	-	-	

Office of the Secretary of the Treasury

June 1959

\* For categories of outstanding Series E bonds see Table 1.

1/ Compounded semiannually.

2/ Effective date of revision for bonds issued June through November 1941.

Subject to enabling legislation

Appendix 3 - Table 3

Example of Revision in Existing Series E Savings Bonds,  
Category of Bonds Issued May 1942 through May 1949\*

Redemption Values and Investment Yields of Bonds Issued June through November 1942

(Based on \$100 face value bond)

Period after first maturity (years)	Redemption value during each period	Approximate investment yield 1/ on:						
		Value at		Issue price to beginning of each period		Current redemption value from beginning of each period to maturity		
		Original	Revised	Original	Revised	Original	Revised	
0 - 1/2.....	\$100.00			2.90%		3.00%	-	
1/2 - 1.....	101.50			2.90		3.00	-	
1 - 1-1/2.....	103.00			2.90		3.00	-	
1-1/2 - 2.....	104.50			2.91		3.01	-	
2 - 2-1/2.....	106.00			2.90		3.02	-	
2-1/2 - 3.....	107.60			2.91		3.02	-	
3 - 3-1/2.....	109.20			2.91		3.02	-	
3-1/2 - 4.....	110.80			2.91		3.03	-	
4 - 4-1/2.....	112.40			2.91		3.04	-	
4-1/2 - 5.....	114.00			2.91		3.05	-	
5 - 5-1/2.....	115.80			2.92		3.04	-	
5-1/2 - 6.....	117.60			2.92		3.04	-	
6 - 6-1/2.....	119.40			2.93		3.03	-	
6-1/2 - 7.....	121.20			2.93		3.04	-	
7 (June 1 - Nov. 1, 1959 2/) - 7-1/2..)	123.00		-	2.93		3.05	3.55%	
7-1/2 - 8.....	124.80	124.84	2.93%	2.99%	2.93	2.93	3.07	3.66
8 - 8-1/2.....	126.60	126.80	2.91	3.07	2.93	2.94	3.12	3.79
8-1/2 - 9.....	128.60	129.08	2.99	3.24	2.94	2.96	3.10	3.85
9 - 9-1/2.....	130.60	131.48	3.02	3.36	2.94	2.98	3.10	3.92
9-1/2 - 10.....	132.60	134.00	3.03	3.46	2.94	3.00	3.14	4.00
10 (2nd maturity)..	134.68	136.68	3.05	3.55	2.95	3.02	-	-

Office of the Secretary of the Treasury

June 1959

\* For categories of outstanding Series E bonds see Table 1.

1/ Compounded semiannually.

2/ Effective date of revision for bonds issued June through November 1942.

Subject to enabling legislation

Appendix 3 - Table 4

Example of Revision in Existing Series E Savings Bonds,  
Category of Bonds Issued December 1949 through April 1952\*

Redemption Values and Investment Yields of Bonds Issued June through November 1950

(Based on \$100 face value bond)

Period after issue date  (years)	Redemption value during each period	Approximate investment yield 1/ on:							
		Value at		effective date		Issue price to		Current redemp-	
		Original:Revised	Original:Revised	beginning of	beginning of	beginning of	beginning of	tion value from	beginning of
0 - 1/2.....	\$ 75.00							2.90%	-
1/2 - 1 .....	75.00							3.05	-
1 - 1-1/2.....	75.50					.67%		3.15	-
1-1/2 - 2 .....	76.00					.68		3.25	-
2 - 2-1/2.....	76.50					.99		3.38	-
2-1/2 - 3 .....	77.00					1.06		3.52	-
3 - 3-1/2.....	78.00					1.31		3.58	-
3-1/2 - 4 .....	79.00					1.49		3.66	-
4 - 4-1/2.....	80.00					1.62		3.75	-
4-1/2 - 5 .....	81.00					1.72		3.87	-
5 - 5-1/2.....	82.00					1.79		4.01	-
5-1/2 - 6 .....	83.00					1.85		4.18	-
6 - 6-1/2.....	84.00					1.90		4.41	-
6-1/2 - 7 .....	86.00					2.12		4.36	-
7 - 7-1/2.....	88.00					2.30		4.31	-
7-1/2 - 8 .....	90.00					2.45		4.26	-
8 - 8-1/2.....	92.00					2.57		4.21	-
8-1/2 - 9 .....	94.00					2.67		4.17	-
9 (June 1 - Nov. 1, 1959 2/ ) - 9-1/2..	96.00			-		2.76			
9-1/2 - 10 .....	98.00	98.16	4.17%	4.50%	2.84	2.85		4.12	4.74%
10 (maturity).....	100.00	100.60	4.12	4.74	2.90	2.96		4.08	4.97

Office of the Secretary of the Treasury

June 1959

\* For categories of outstanding Series E bonds see Table 1.

1/ Compounded semiannually.

2/ Effective date of revision for bonds issued June through November 1950.

Subject to enabling legislation

Appendix 3 - Table 5

Example of Revision in Existing Series E Savings Bonds  
 Category of Bonds Issued May 1952 through January 1957\*

Redemption Values and Investment Yields of Bonds Issued June through November 1952

(Based on \$100 Face Value Bond)

Period after issue date (years)	Redemption value during each period	Approximate investment yield 1/ on:							
		Value at		effective date		Issue price to		Current redemp-	
		Original	Revised	Original	Revised	Original	Revised	Original	Revised
0 - 1/2.....	\$ 75.00							3.00%	-
1/2 - 1 .....	75.40					1.07%		3.10	-
1 - 1-1/2.....	76.20					1.59		3.16	-
1-1/2 - 2 .....	77.20					1.94		3.19	-
2 - 2-1/2.....	78.20					2.10		3.23	-
2-1/2 - 3 .....	79.20					2.19		3.28	-
3 - 3-1/2.....	80.20					2.25		3.34	-
3-1/2 - 4 .....	81.20					2.28		3.41	-
4 - 4-1/2.....	82.20					2.30		3.49	-
4-1/2 - 5 .....	83.60					2.43		3.50	-
5 - 5-1/2.....	85.00					2.52		3.51	-
5-1/2 - 6 .....	86.40					2.59		3.54	-
6 - 6-1/2.....	87.80					2.64		3.58	-
6-1/2 - 7 .....	89.20					2.69		3.64	-
7 (June 1 - Nov. 1, 1959 2/)- 7-1/2... }	90.60					2.72		3.74	4.24
7-1/2 - 8 .....	92.00	92.04	3.09%	3.18%	2.74	2.75	3.89	4.48	
8 - 8-1/2.....	93.60	93.76	3.28	3.46	2.79	2.81	4.01	4.71	
8-1/2 - 9 .....	95.20	95.56	3.33	3.59	2.83	2.87	4.26	5.08	
9 - 9-1/2.....	96.80	97.44	3.34	3.67	2.86	2.93	4.94	5.94	
9-1/2 - 9-2/3.....	98.40	99.40	3.33	3.74	2.88	2.99	9.92	11.81	
9-2/3 (maturity)...	100.00	101.32	3.74	4.24	3.00	3.14	-	-	

Office of the Secretary of the Treasury

June 1959

\* For categories of outstanding Series E bonds see Table 1.

1/ Compounded semiannually.

2/ Effective date of revision for bonds issued June through November 1952.

Subject to enabling legislation

Appendix 3 - Table 6

Example of Revision in Existing Series E Savings Bonds,  
Category of Bonds Issued February 1957 through May 1959\*

Redemption Values and Investment Yields of Bonds Issued February through May 1957

(Based on \$100 face value bond)

Period after issue date  (years)	Redemption value during each period	Approximate investment yield 1/ on:							
		Value at		effective date		Issue price to		Current redemp-	
		Original	Revised	Original	Revised	Original	Revised	Original	Revised
0 - 1/2.....	\$ 75.00							3.25%	-
1/2 - 1 .....	75.60					1.60%		3.35	-
1 - 1-1/2.....	76.72					2.28		3.38	-
1-1/2 - 2 .....	77.92					2.56		3.39	-
2 - 2-1/2.....	79.24					2.77		3.39	-
2-1/2 (Aug.1-Nov. 1, 1959 2/) - 3.....	80.50					2.90			
3 - 3-1/2.....	82.00	82.04	3.47%	3.57%	3.00	3.01	3.39	3.89%	
3-1/2 - 4 .....	83.40	83.48	3.44	3.54	3.06	3.08	3.38	3.92	
4 - 4-1/2.....	84.84	85.00	3.45	3.58	3.11	3.15	3.37	3.95	
4-1/2 - 5 .....	86.28	86.56	3.43	3.60	3.14	3.21	3.37	3.99	
5 - 5-1/2.....	87.76	88.20	3.43	3.64	3.17	3.27	3.36	4.02	
5-1/2 - 6 .....	89.24	89.84	3.42	3.65	3.19	3.31	3.36	4.05	
6 - 6-1/2.....	90.72	91.56	3.41	3.66	3.20	3.35	3.37	4.10	
6-1/2 - 7 .....	92.24	93.36	3.40	3.71	3.21	3.40	3.37	4.15	
7 - 7-1/2.....	93.76	95.24	3.39	3.74	3.21	3.44	3.39	4.19	
7-1/2 - 8 .....	95.32	97.16	3.38	3.77	3.22	3.48	3.41	4.23	
8 - 8-1/2.....	96.88	99.12	3.37	3.80	3.23	3.52	3.41	4.30	
8-1/2 - 8-11/12....	98.44	101.16	3.36	3.82	3.23	3.55	3.49	4.45	
8-11/12 (maturity).	100.00	103.20	3.39	3.89	3.25	3.61	-	4.85	

Office of the Secretary of the Treasury

June 1959

\* For categories of outstanding Series E bonds see Table 1.

1/ Compounded semiannually.

2/ Effective date of revision for bonds issued February through May 1957.

Subject to enabling legislation

## Appendix 3 - Table 7

Revised Extension on Series E Savings Bonds Reaching First Maturity  
June 1, 1959 through September 1, 1966 (Bonds issued June 1949 through April 1957) <sup>1/</sup>Summary of Redemption Values and Investment Yields on Bonds Issued  
June through November 1949(Based on \$100 face value bond) <sup>1/</sup>

Period after first maturity date	Redemption value during each period	Approximate investment yields <sup>2/</sup>	
		On first maturity value to beginning of each period	On current redemption value from beginning of each period to extended maturity
First half year.....	\$100.00	—	3.75%
1/2 to 1 year.....	101.76	3.52%	3.76
1 to 1-1/2 years.....	103.56	3.53	3.77
1-1/2 to 2 years.....	105.40	3.54	3.79
2 to 2-1/2 years.....	107.32	3.56	3.80
2-1/2 to 3 years.....	109.24	3.57	3.81
3 to 3-1/2 years.....	111.24	3.58	3.82
3-1/2 to 4 years.....	113.28	3.59	3.83
4 to 4-1/2 years.....	115.36	3.60	3.85
4-1/2 to 5 years.....	117.52	3.62	3.86
5 to 5-1/2 years.....	119.72	3.63	3.87
5-1/2 to 6 years.....	121.96	3.64	3.88
6 to 6-1/2 years.....	124.28	3.66	3.89
6-1/2 to 7 years.....	126.64	3.67	3.91
7 to 7-1/2 years.....	129.04	3.68	3.93
7-1/2 to 8 years.....	131.56	3.69	3.93
8 to 8-1/2 years.....	134.12	3.70	3.94
8-1/2 to 9 years.....	136.72	3.71	3.96
9 to 9-1/2 years.....	139.40	3.73	3.98
9-1/2 to 10 years.....	142.16	3.74	4.00
Extended Maturity Value (10 years from first maturity)	145.00	3.75	—

Office of the Secretary of the Treasury

June 1959

<sup>1/</sup> Bonds reaching first maturity beginning December 1, 1959 will have maturity values higher than their face value. The ratio of the value at first maturity to the redemption value for any given period of holding will be approximately equal in all cases.

<sup>2/</sup> Compounded semiannually.

## Appendix 3 - Table 8

Revised\* and Present Series E Bond Extension Period Redemption Values  
and Investment Yields  
(\$100 Bond, Face Value) <sup>1/</sup>

Period after first maturity date: (years)	Redemption Value			Yield for <sup>2/</sup> :					
				Period held <sup>3/</sup>			Remaining period to second maturity		
	Revised	Present	Increase	Revised	Present	Increase	Revised	Present	Increase
0 - 1/2.....	\$100.00	\$100.00	0	-	-	-	3.75%	3.00%	.75%
1/2 - 1 .....	101.76	101.50	\$ .26	3.52%	3.00%	.52%	3.76	3.00	.76
1 - 1-1/2.....	103.56	103.00	.56	3.53	2.98	.55	3.77	3.00	.77
1-1/2 - 2 .....	105.40	104.50	.90	3.54	2.96	.58	3.79	3.01	.78
2 - 2-1/2.....	107.32	106.00	1.32	3.56	2.93	.63	3.80	3.02	.78
2-1/2 - 3 .....	109.24	107.60	1.64	3.57	2.95	.62	3.81	3.02	.79
3 - 3-1/2.....	111.24	109.20	2.04	3.58	2.96	.62	3.82	3.02	.80
3-1/2 - 4 .....	113.28	110.80	2.48	3.59	2.95	.64	3.83	3.03	.80
4 - 4-1/2.....	115.36	112.40	2.96	3.60	2.94	.66	3.85	3.04	.81
4 1/2 - 5 .....	117.52	114.00	3.52	3.62	2.93	.69	3.86	3.05	.81
5 - 5-1/2.....	119.72	115.80	3.92	3.63	2.96	.67	3.87	3.04	.83
5-1/2 - 6 .....	121.96	117.60	4.36	3.64	2.97	.67	3.88	3.04	.84
6 - 6-1/2.....	124.28	119.40	4.88	3.66	2.98	.68	3.89	3.03	.86
6-1/2 - 7 .....	126.64	121.20	5.44	3.67	2.98	.69	3.91	3.04	.87
7 - 7-1/2.....	129.04	123.00	6.04	3.68	2.98	.70	3.93	3.05	.88
7-1/2 - 8 .....	131.56	124.80	6.76	3.69	2.98	.71	3.93	3.07	.86
8 - 8-1/2.....	134.12	126.60	7.52	3.70	2.97	.73	3.94	3.12	.82
8-1/2 - 9 .....	136.72	128.60	8.12	3.71	2.98	.73	3.96	3.10	.86
9 - 9-1/2.....	139.40	130.60	8.80	3.73	2.99	.74	3.98	3.10	.88
9-1/2 - 10 .....	142.16	132.60	9.56	3.74	2.99	.75	4.00	3.14	.86
10 (2nd maturity)..	145.00	134.68	10.32	3.75	3.00	.75	-	-	-

Office of the Secretary of the Treasury

June 1959

\* Bonds reaching first maturity after May 31, 1959, (bonds issued June 1949 through April 1957).

<sup>1/</sup> For bonds reaching first maturity June - November 1959. Later maturing bonds will have first maturity values higher than their face value (see Footnote 1 - Table 7).<sup>2/</sup> Compounded semiannually.<sup>3/</sup> On first maturity value to beginning of any subsequent 1/2 year period.

Subject to enabling legislation

## Appendix 4

Revision of Existing Series H Savings Bonds  
Outstanding Bonds Issued before June 1, 1959

## Summary of Revisions in Terms and Conditions

- (1) Date of announcement -- June 8, 1959 (Treasury Circular No. 905 - Second Revision).
- (2) Effective date for start of increased interest -- June 1, 1959 for existing bonds dated June and December of any issue year; for all others the next date on which interest checks are due. Therefore, the first change in the amount of interest checks from the schedules published in Treasury Department Circular No. 905 - revised, dated April 22, 1957, will take place 1/2 year after June 1, 1959 in the case of bonds dated June and December of any year and 1/2 year after the next date (after June 1959) on which interest checks are due in the case of all other bonds.
- (3) Revision of interest payable in the future until maturity -- Beginning with interest checks due on December 1, 1959 for bonds issued June and December of any year (all other bonds on interest checks due 1/2 year after the effective date of the revision for such bonds) the amount of each check until maturity will be increased to provide a graduated increase in investment yield for the remaining period to maturity. At maturity the increase in investment yield will amount to approximately 1/2 of 1% (compounded semiannually), with lesser increases in investment yields if bonds are redeemed before maturity. 1/
- (4) No changes in other terms or conditions.

---

1/ The categories of outstanding H bonds are shown in Table 1 attached. For examples of changes in amounts of interest checks and investment yields see Tables 2 and 3 attached.

Subject to enabling legislation

Appendix 4 - Table 1

Categories of Outstanding Series H Bonds, May 31, 1959

Issue year and month	Current maturity period		Range of yields for remaining time to next maturity <sup>1/</sup>	Range of time to next maturity <sup>1/</sup> (years)	Extension yields
	Yield for full current maturity period	Range of yields for remaining time to next maturity <sup>1/</sup>			
		Present	Revised		
June 1952 - January 1957....	3.00%	3.34% - 3.81%	3.84% - 4.31%	2-2/3 - 7-1/6	<u>2/</u>
February 1957 - May 1959...	3.25	3.35 - 3.38	3.85 - 3.88	7-1/2 - 9-1/2	<u>2/</u>
Office of the Secretary of the Treasury					June 1959

<sup>1/</sup> Based on next date interest checks are due.

<sup>2/</sup> No extension planned at this time.

Subject to enabling legislation

## Appendix 4 - Table 2

Example of Revision in Existing Series H Savings Bonds  
 Category of Bonds Issued June 1952 through January 1957\*

Interest Checks and Investment Yields on Bonds Issued June through November 1952

(Based on \$1,000 Bond) 1/

Period after issue date (years)	Interest check	Approximate investment yields 2/							
		: From effective : date of revision:		: From issue date		: From each inter- : est payment date		: to maturity	
		: Original:	: Revised:	: Original:	: Revised:	: Original:	: Revised:	: Original:	: Revised:
0	-	-	-	3.00%	-	-	-	-	-
1/2	\$ 4.00			.80%			3.13	-	-
1	12.50			1.65			3.18	-	-
1-1/2	12.50			1.93			3.22	-	-
2	12.50			2.07			3.27	-	-
2-1/2	12.50			2.15			3.34	-	-
3	12.50			2.21			3.41	-	-
3-1/2	12.50			2.25			3.49	-	-
4	12.50			2.28			3.58	-	-
4-1/2	17.00			2.40			3.60	-	-
5	17.00			2.49			3.63	-	-
5-1/2	17.00			2.57			3.66	-	-
6	17.00			2.63			3.69	-	-
6-1/2	17.00			2.69			3.74	-	-
7 (June 1 - Nov. 1, 1959 3/)	17.00			-			2.73		
7-1/2	17.00	17.50	3.40%	3.50%	2.77	2.78	3.81	4.31%	
8	17.00	17.50	3.40	3.50	2.81	2.82	3.91	4.51	
8-1/2	17.00	20.20	3.40	3.68	2.84	2.88	4.07	4.83	
9	17.00	20.20	3.40	3.76	2.87	2.94	4.36	5.18	
9-1/2	17.00	20.20	3.40	3.82	2.89	2.99	5.10	6.06	
9-2/3 (maturity)	17.00	20.20	3.81	4.31	3.00	3.12	10.37	12.37	

Office of the Secretary of the Treasury

June 1959

\* For categories of outstanding Series H bonds see Table 1.

1/ Redemption value at all times = \$1,000.

2/ Compounded semiannually.

3/ Effective date of revision for bonds issued June through November 1952.

Subject to enabling legislation

Appendix 4 - Table 3

Example of Revision in Existing Series H Savings Bonds  
 Category of Bonds Issued February 1957 through May 1959\*

Interest Checks and Investment Yields on Bonds Issued February through May 1957

(Based on \$1,000 bond) 1/

Period after issue date (years)	Interest check	Approximate investment yields 2/							
		: From effective : date of revision:		: From issue date:		: From each inter- : est payment date		: to maturity	
		: to each interest:	: to each interest:	: to each interest:	: to maturity	: to maturity	: to maturity	: to maturity	
: Original:Revised:		: Original:Revised:	: Original:Revised:	: Original:Revised:	: Original:Revised:	: Original:Revised:	: Original:Revised:	: Original:Revised:	
0	-	-	-	-	-	3.25%	-	-	
1/2	\$ 8.00	-	-	-	1.60%	3.35	-	-	
1	14.50	-	-	-	2.25	3.38	-	-	
1-1/2	16.90	-	-	-	2.62	3.38	-	-	
2	16.90	-	-	-	2.80	3.38	-	-	
2-1/2 (Aug. 1 - Nov. 1, 1959 3/)	16.90	-	-	-	2.92	-	-	-	
3	16.90	17.40	3.38%	3.48%	2.99	3.01	3.38	3.88%	
3-1/2	16.90	17.40	3.38	3.48	3.04	3.07	3.38	3.92	
4	16.90	17.40	3.38	3.48	3.08	3.12	3.38	4.00	
4-1/2	16.90	17.40	3.38	3.48	3.11	3.16	3.38	4.05	
5	16.90	17.40	3.38	3.48	3.14	3.19	3.38	4.11	
5-1/2	16.90	19.80	3.38	3.56	3.16	3.25	3.38	4.13	
6	16.90	19.80	3.38	3.61	3.18	3.30	3.38	4.16	
6-1/2	16.90	19.80	3.38	3.65	3.19	3.35	3.38	4.19	
7	16.90	19.80	3.38	3.68	3.20	3.39	3.38	4.23	
7-1/2	16.90	19.80	3.38	3.71	3.21	3.42	3.38	4.29	
8	16.90	21.00	3.38	3.75	3.22	3.46	3.38	4.31	
8-1/2	16.90	21.00	3.38	3.78	3.23	3.50	3.38	4.35	
9	16.90	21.00	3.38	3.81	3.24	3.53	3.38	4.42	
9-1/2	16.90	22.10	3.38	3.85	3.24	3.57	3.38	4.42	
10 (maturity)....	16.90	22.10	3.38	3.88	3.25	3.61	-	-	

Office of the Secretary of the Treasury

June 1959

\* For categories of outstanding Series H bonds see Table 1.

1/ Redemption value at all times = \$1,000.

2/ Compounded semiannually.

3/ Effective date of revision for bonds issued February through May 1957.

The CHAIRMAN. In addition, without objection, the material referred to by the Secretary in his statement appended to it will be included immediately following the Secretary's statement in the record.

Mr. Secretary, aside from the request affecting the ceiling on the public debt itself, I am sure you recognize that your proposal with respect to the ceiling on the rate of interest which may be paid on the U.S. bonds will arouse a great deal of critical review of recent debt-management policies of the Treasury.

I think you would agree with me that it is perhaps advisable and good that this is the case, because this whole debt-management area is involved in the interest-rate limitation that we are discussing today. You have referred to it in your opening statement.

I think you will agree also that the Congress has a proper concern in debt-management policies and that this is not something purely mechanical.

Secretary ANDERSON. It is, indeed, Mr. Chairman.

The CHAIRMAN. Are you indicating in your statement, as at least I gain the impression, that this congressional concern over debt management is not adequately discharged by a ceiling interest rate of 4 $\frac{1}{4}$  percent?

Secretary ANDERSON. As indicated in the statement, we believe that the 4 $\frac{1}{4}$  percent impairs the ability of the Treasury to do the best possible job of debt management in providing the proper structure of the public debt.

The CHAIRMAN. Are you also saying in this regard that it may have been a mistake for us over the years to have had an interest-rate ceiling?

Would we have been better off over the years and would the lack of a ceiling have contributed to better debt management on the part of the Treasury at any time of which you are aware?

Secretary ANDERSON. Mr. Chairman, as I stated, I think that the 4 $\frac{1}{4}$ -percent rate since its establishment in 1919 for obligations 5 years and beyond has been relatively academic, because during the 1920's when we had high levels of prosperity we were reducing the debt substantially.

The result of the reduction of debt during these high levels of prosperity caused declines in interest rates because the Government was a net contributor of money by debt retirement rather than in net borrowing.

Then came the end of the 1920's, 1929, and we had the period of the thirties. Except for a brief period in the thirties, we had a great problem of depression which we were trying to overcome.

At the end of the thirties we had a war. During the war, we held the limits of interest rates and the price of securities artificially through the utilization of the Federal Reserve System, the buying and selling of securities. Also, during the war, there were not as great demands by a great many people, because we had rationing, because there was a shortage of a number of items which both business and individuals could buy.

Subsequent to the war, we have had generally rising levels of business activity. We have also had business cycles.

During the periods of business cycles, the interest rates have gone relatively high, during periods of high levels of prosperity. During periods of low levels of business activity, as I pointed out, the interest rate fell very substantially.

During some of these years of the postwar the Federal Reserve still maintained what we call the peg on the price of Government securities.

We are now at a period in our history in which we have the highest levels of business activity not for any period subsequent to the war, but for any period in the history of this country. By almost every standard as we look at the rate of business activities going up from month to month, we are setting new peaks.

I believe that what Carter Glass said in 1919 would have been true, or let me say more appropriately could have been true, if during the twenties, instead of being able to retire a third of the debt we had been adding to it in high levels of prosperity, and for these various other factors which I have cited.

I think now we have come to a point of such high levels of business activity in our country that the Congress is justified and should appropriately examine the proposals of giving the Treasury greater flexibility.

The CHAIRMAN. Mr. Secretary, you are saying then that we may have not failed to show proper concern about debt management in the past?

Secretary ANDERSON. That is correct, Mr. Chairman.

The CHAIRMAN. This ceiling of 4¼ percent has been insignificant, because in the past it has been rather academic. It has not appeared over any period of time that the interest rate itself was close to or near the ceiling itself.

Secretary ANDERSON. That is correct, Mr. Chairman.

The CHAIRMAN. You are concerned now apparently because of your recognition or acceptance of the thought that over a period of time in the future, the next several months, or the next year, or the next 2 or 3 years, interest rates generally may rise above the levels that can be paid by the Government under existing legislation?

Secretary ANDERSON. Mr. Chairman, not necessarily.

I am concerned about the fact that the Treasury should operate in a free market in the sale of its obligations. I think realistically we have to look at the fact that Government securities today, although bearing lower coupon rates, are selling in the market to yield higher than 4¼ percent interest rates.

It is my judgment that if all of us so conduct ourselves as to lead the people here and abroad to believe that we are going to pursue sound policies which will obviate the erosion of the purchasing power of our money, we will have contributed substantially to an environment in which interest rates would not rise, but which would lower.

I think, on the other hand, that all of us realize that we are in a period of growth. It is an expanding period of growth. We do not know how long it will continue. I for one hope that it continues for a long time.

One of the characteristics of a period of growth is the increase in demands for credit and the increase in interest rates, unless there is the concomitant occurrence of such an advantage as took place in the

twenties when we were substantial retirers of the debt at the same time that we were in the period of growth.

The CHAIRMAN. Mr. Secretary, I want you to understand clearly that I am not trying to get you to say something about this entire matter that should not be said publicly by you in the position that you occupy. I am sure that all the members of the committee would recognize that there are certain questions that perhaps could better be asked off the record about some of these matters, rather than on the record.

I asked this question a moment ago because this proposal has been characterized by some as meaning an increase in interest rates generally. If the Government is to pay more, as I understand their thinking, if the ceiling comes off, then others borrowing money would also have to pay more, and there would be a general increase in interest rates affecting all borrowers as a result of the Congress action you request.

If that is not the case, I think it is time for the people who have indicated that to be the case to be straightened out in their thinking, and I do not know how we can avoid a discussion of it this morning if we hope to straighten them out.

Secretary ANDERSON. I should like very much to engage in that discussion.

Mr. Chairman, if I may, I would like also to refer the members of the committee to portions of the supplemental statement which was filed here, because a portion of this subject is elaborated on in that statement, which I just didn't want to take all morning to read.

I would like to address myself to it.

Broadly speaking, the interest rate, as I said in my statement, is a price which you pay for borrowed money. As a price, the rate reacts to the same sort of influences as other prices in a free market economy, influences that operate through demand for and supply of funds that are available for lending in the credit markets, and just as an increase in the demand for beans, or bicycles, or any other commodity tends to increase the price of those items, so does an increase in the demand for credit tend to increase interest rates.

And an increase in the supply of funds available in the credit market has the same basic effect as an increase in the supply of goods and services in the market. Prices tend to fall.

This is true under present market arrangements. It will remain true so long as the credit markets remain free and borrowers and lenders are permitted to manage their affairs with a minimum of interference and a minimum of regulation.

The existence of a ceiling on interest rates on Government securities in no way affects the basic market forces, and particularly it cannot reduce the demand for funds nor can it increase the supply so as to reduce the pressure on interest rates, but its existence may indeed affect the borrower and the investor's expectations, and could so promote temporarily higher rates of interest.

I am talking about the existence of this ceiling. For example, the existence of an artificial ceiling on interest rates severely hampers the Treasury's efforts for the sound management of the public debt in securing a structure in which there is a balance between long, medium, and short securities.

Under present conditions it would be impossible virtually to market a security for more than 5 years maturity at the present ceiling. This forces the Treasury to borrow through shorter term issues. The expansion in these issues exerts a double inflationary effect, first, because of the effect of the liquidity of the economy—and I point out here that a 30-year bond is a true investment security, but a 91-day Treasury bill is very close to being money—and, secondly, because short-term securities are very often purchased in large volume by commercial banks, and thus promoting inflationary expansion in the bank deposits and the money supply.

Mr. Chairman, to the extent, therefore, that an artificial interest rate forces reliance on short-term financing, inflationary expectations are stimulated.

This in turn tends to force interest rates up because borrowers increase their demands for funds which they expect to pay in eroded dollars, and lenders become more reluctant to lend because the payments will be in dollars of reduced purchasing power.

Therefore, the borrowers will be willing to pay higher rate of interest, lenders will be willing to lend only at higher rates of interest, and the net result is that interest rates tend to be higher than if price stability were expected.

I think also, Mr. Chairman, that one should point out that we have  $4\frac{1}{4}$  percent limit, and yet this artificial ceiling is not effective in holding down the interest rate yields on outstanding issues, even though the coupon rates may be  $2\frac{1}{2}$  percent or much less. The yields are forced to this level not alone by Treasury financing, which has been largely confined to short-term issues in the past years, but also because of the strong demand for funds in this period of high levels of business activity.

Do I make myself clear, sir?

The CHAIRMAN. I do not know whether or not this explanation is convincing to those who have made the charge that I just talked about. State it another way, if there is a more convincing way to put it.

Secretary ANDERSON. As of today, as indicated in my statement, we have about \$76 billion of debt that will be due within a year. If we do nothing except to refund the issues which are now becoming due, whether they were originally 1-year certificates, or 4-year notes, or 20-year bonds, if we do nothing except to renew them by new issues of debt for 1 year or less, we will drive up the amount of debt due in a year or less to almost \$100 billion. This would be like putting the next thing to money in the next 18 months into the economy of the country, the difference between roughly \$76 billion and \$100 billion.

If we should add to that another series of short-term instruments, which would represent tax collection fluctuations, the seasonal difference between expenditures and receipts, it might be even more.

Both here and abroad as people looked at our present structure and at the yields which are being paid on Government securities outstanding, on corporate securities, and on municipal and State securities which have the advantages of tax exemption, they would very naturally say to themselves, "The Treasury is boxed in. It is forced to borrow all of its money in an area between 1 year and 5 years," in addition to the fact that if we crowd this short-term debt very heavily

in the first year or from 1 to 5 years, we are dealing largely in an area that is concerned with purchases by banks which create the money when they buy the securities, and, therefore, add to the inflationary pressures.

We are also creating a very severe pressure on the short-term interest rates.

For a period early in the 1920's, the interest rate on short-term money went as high as 6 percent. Then came the debt retirement and it fell very rapidly. Within the last 2 years we have offered bonds for 1 year, 4 years, and 12 years, something like that, all at a level rate of interest.

If we are concerned not only about the inflationary impact, but if we are concerned about the cost of increasing the national debt, the thing that affects the cost of increasing the national debt more quickly than anything else is the rapid rise of the short-term rate. If we are going to put a lot more into the short-term area, we are simply going to increase the pressure on the rate and the rate will go up.

The CHAIRMAN. Mr. Secretary, let me see if I can get a little better understanding of it by proceeding in this way: From the point of view of the management of the public debt, you are saying that one of the very bad things that could occur would be the shift of more and more dollars from long-term securities into so-called short-term securities, less than 5 years.

Secretary ANDERSON. That is correct, sir.

The CHAIRMAN. I would think that that point could be more thoroughly demonstrated to the satisfaction of most people, because when you enter the short-term money market today seeking \$76 billion, that has an effect upon the money market.

I assume from what you say that if you go into that market a year from today, not asking for \$76 billion but \$100 billion or more, it has more of an adverse effect upon the money market.

Secretary ANDERSON. That is correct, sir.

The CHAIRMAN. Your concern in this proposal must mean then that you are fearful that in the months ahead you will not have enough flexibility within the ceiling of 4 $\frac{1}{4}$  percent to market the amount that you think ought to be in long-term securities, and either a larger amount would have to be put into short-term securities, or you would have to issue the bonds at a discount in order to show more interest than 4 $\frac{1}{4}$  percent.

Without talking about whether it is good or bad to shift from long term to short term, without talking about whether or not this would mean increased interest or that the Government would be setting the pattern that would be followed by everyone else, I cannot reach any other conclusion but what I have stated as the concern that I have, namely, that you cannot get enough long-term maturities in issue in the next months ahead under this ceiling.

Secretary ANDERSON. That is correct, Mr. Chairman.

The CHAIRMAN. That means then, Mr. Secretary, and I think we might as well recognize it and face up to it, that one way or the other under existing law, in order to finance this debt, you will have to pay whatever the people with the money demand in the way of interest, and if you cannot pay them what they want on long-term securities, you will have to pay them what they want on short-term securities?

Secretary ANDERSON. That is correct, sir.

The CHAIRMAN. This then itself may not mean an increase in the interest rate that you have to pay.

I am trying to distinguish it. If you are going to have to pay a higher interest rate in your opinion, and that is what it appears to your advisers is the case, you are going to do that under existing law by doing it through the vehicle of these short-term securities?

Secretary ANDERSON. Yes, sir.

The CHAIRMAN. Because it is sounder debt management, then, you reach the conclusion, that if I have to do it anyway, let me have the opportunity of doing it through the issuance of long-term securities rather than short-term securities?

Does it boil down to that?

Secretary ANDERSON. Substantially, sir.

The CHAIRMAN. I have a habit of oversimplifying these things.

Secretary ANDERSON. It is a good habit, Mr. Chairman.

What I would like to say to you is that when you use the term "long-term bonds," I would like to interpret it as meaning 5 years or more, because we sometimes think of a bond running 5 to 10 years as an intermediate bond, and a long-term bond is something running out beyond that.

If I can do it more simply, let us say first that our concern is with the fact that it is now costing \$8 billion to carry the debt and that we are judging it is going to cost about \$8½ billion to carry the debt in 1960. If we should take the difference between \$76 billion, which we now have in short-term debt, and something more than \$100 billion, which will include that coming due on our seasonal requirements, then somewhere we have to find buyers for more than \$25 billion worth of new 1-year debt obligations.

With the interest rates already running about as high in the short-term area as some of the longer terms, we are going to add very substantially to that kind of a cost.

If, on the other hand, we look at it not from the standpoint of cost, but if we look at it from the standpoint that when we are supplying funds to the short-term market, obligations in the short-term market, we are supplying the next thing to money, then we have done the second thing of creating in the minds of the people of this country and abroad that we are headed for an inflationary process because, this being the next thing to money and being financed largely in the banks, has an inflationary aspects, and they will govern their actions accordingly.

So, while we realize that there are some reasonable limits to the amount of money that can be secured in the intermediate markets and the long-term markets, we believe that in both instances what the chairman has said is correct, that in the best interest of the country and the management of the debt we need the flexibility which we would not have without this rate.

The CHAIRMAN. I was asking the question, trying to get some information.

Frankly, I know very little about the problems that you have in the management of the public debt. I do not remember that we in this committee have gone into this phase of our jurisdiction as often or as much in detail as we have many other aspects of our jurisdiction.

What of the statement that is made that there is a relationship between this request that would permit issuance of long-term securities at a higher interest rate and the desire that is expressed to protect the dollar from further devaluation?

Is the value of the dollar in any way affected at this particular time by this request?

Secretary ANDERSON. Yes, sir; I think it is.

The CHAIRMAN. In order to protect the value of the dollar, do we reach the conclusion that it is necessary at this time that that dollar be able to earn more when used?

Secretary ANDERSON. Mr. Chairman, let me say this: I think that what we are concerned about is that, in the absence of some additional flexibility, we are concerned about the future of the dollar. I think it must be remembered that we have gone through about as stable a period from the standpoint of cost of living, the commodity price index, the fact that we have not used all of our facilities to the fullest, and a number of other factors as we have had in a long time.

I think for the future we must realize that there are two kinds of money really. One of them is the money you save and it comes from the work and the practice of people who put their brains, and their muscles, and their resources together, and the other, this money that is created. You can create money through the banking system and you can create money through the Federal Reserve System. If we go to the commercial banks with a large amount of short-term debt, they will give us their obligations and they will issue deposits for us, and we will spend the money and pay for all the things that governments pay for.

If, on the other hand, we provide some of these bonds for State sinking funds, for insurance companies, for the holders of E- and H-bonds, for a large part of the true savers in the country, and they give us funds and hold the obligations, they are true savers.

We are affected not only by what we actually do in this regard, but we are affected by what people expect to come out of our policy. If people expect that we are going to finance all of this debt in the short-term area, and if people believe that we have no alternative except to do it, and if people recognize that the short-term debt is more nearly like money than longer term debt, then all of them will govern their actions accordingly. People who have money to lend will say to themselves, "I will only lend it at higher rates of interest because my expectation is that I may get back an eroded dollar."

The CHAIRMAN. Mr. Secretary, are you of the opinion, in addition to the problems of debt management that you would have under the existing provisions without change, that a continuation of the existing limitations in themselves, in the light of what economic developments you make be able to foresee over the next few months, would contribute to further devaluation of the dollar?

Secretary ANDERSON. I wonder never like to be a prophet as to how long we are going to have a high level of business activity.

I would say that at the moment the levels look strong now and in the future.

I think if one looks at the plans which are being made for permanent construction, the amounts of money that are being borrowed, and if I recall correctly there was about \$31½ billion of construction

awards during the month of April, which is one of the highest months in our history, one sees, at least for the foreseeable future, a continued rise in the level of business activities and their demands for credit.

If, during that same period of time, we are demanding credits, and particularly in the short-term are where the credits more nearly approximate money, then I think that the anticipation or the thought of the people will be that inflation is a likely result and they will take their actions accordingly.

While I would not like to elaborate on the subject, I would like to mention that we have not only a domestic, but we have a problem involving our neighbors abroad. Our neighbors abroad do not operate in the same kind of an economic environment that we operate in.

In this country there is a real market for a substantial amount of short-term securities outside of the banks. As an example, people borrow several millions of dollars to build a building. It can only go up at a certain rate. Rather than hold the funds idle, they will put part of the funds in short-term Government securities. They will hold other corporate funds, funds which they accumulate for tax purposes or dividends.

In Europe and in other countries, this sort of practice is not followed to the same extent it is followed in the United States. Therefore, as the European and those abroad look at our situation, they say, "You have a 4 $\frac{1}{4}$ -percent ceiling on all things beyond 5 years of securities, and therefore you are forced into short-term lending," and in the shorter term, because of the interest rates going up on even the 1- or 2-year issues, they become more and more concerned. And we must remember that the central banks of very strong industrial countries, and the holders of our obligations on the part of private buying people, and companies abroad beyond their needs for working capital, also begin to make appraisals of what are the capacities of the Government of the United States to maintain a sound structure in their debt.

I would not want what I say here to imply that by the removal of this 4 $\frac{1}{4}$ -percent rate, the Treasury would either want to or intend immediately to go out and tap all of the markets at whatever rates they could be tapped for funds. I would simply want to say when the opportunity arises and the short-term, and the long-term, and the intermediate term rates are considered, and when the occasion arises that we believe there is a market demand that would readily absorb those funds without undue impingement upon the economy of the country which is dependent also on those markets, that we should have that opportunity to do so.

The CHAIRMAN. Mr. Secretary, it is quite evident that we will not be able to finish your presentation before the committee has to recess. Would it be agreeable with you to be back at 1:30?

Secretary ANDERSON. Yes, sir.

The CHAIRMAN. Without objection, the committee will reconvene at 1:30 this afternoon.

(Thereupon, at 12:10 p.m., the committee recessed, to reconvene at 1:30 p.m. same day.)

## AFTERNOON SESSION

The CHAIRMAN. The committee will please be in order.

Secretary ANDERSON. Mr. Chairman, it was suggested to me at noon by some of my staff that I perhaps was not as fully responsive to the chairman's opening question this morning as I should have been. It was not my intention to not be fully responsive, but I should like to clarify it, if I may.

The chairman's opening question, as I recall, was whether or not the removal of the 4 $\frac{1}{4}$ -percent rate would cause interest rates generally to rise.

I believe that the removal of the limitation in itself would work in the opposite direction. I believe it would work in the opposite direction for these reasons:

The Treasury does not establish the rate at which it can sell its securities. The Treasury sells in a competitive market at the lowest possible prices, with the knowledge that its issues must be priced sufficiently attractive to secure the money required to pay the Government's bills.

The market is established by the demand for and the supply of funds reflecting the actions of lenders and borrowers of every character over the Nation.

Secondly, there is nothing in the removal of the rate by itself that would tend to raise other interest rates, for interest rates are determined by the forces of demand and supply in the credit market.

Third, the existence of the ceiling may force the Treasury to borrow heavily on the short-term issues, which, as I observed this morning, is inflationary, and expectation of inflation tends to cause higher and not lower interest rates.

Fourth, if the people expect inflation, they will save less and this tends to diminish the flow of savings into long-term credit markets.

If we remove the fear of inflation, partly through being able to pursue sound management, savings should tend to be stimulated, making more funds available for investments in mortgages, State and school bonds, and that sort of thing.

Further, if there is fear of inflation, investment funds now available will seek short-term investments instead of supplying funds to essential long-term capital markets.

As I emphasized this morning, if the ceiling is removed, we do not intend to indiscriminately issue large amounts of long-term Government bonds. We have in the past 6 months offered only \$1 $\frac{1}{2}$  billion of securities of over 5-year maturity in amounts which we consider to be consistent with the availability of long-term funds in the market, and, similarly, if the ceiling is raised we would intend to issue from time to time, as market conditions permit and as we judge business, and individual, and State and local demands to fluctuate, some appropriate volume of securities of over 5 years maturity.

We would do this only as market funds become available and not in amounts that would force market rates up.

We believe that the Treasury is simply entitled to a fair share of the long-term investment funds that are available in the market.

This is the clarification I would like to make.

The CHAIRMAN. Mr. Secretary, is it your thought that the total demand for credit will exceed the amount that can be extended

without inflationary consequences through, say, the end of the fiscal year 1960?

Secretary ANDERSON. Mr. Chairman, I think that the nearest I could come to answering that directly would be to say that the state of the economy is indicative of a high level of continuing demands for credit.

As I indicated this morning while I would not want to forecast at the moment, it looks as if this sustained demand is going to be kept up, and to the extent that the demand is kept up or grows, there would be that much additional pressure on the funds.

The CHAIRMAN. If the demand is greater, somebody is likely to be priced out of the market; is that true?

Secretary ANDERSON. This comes down partially to the question of how much a rise in interest rates contributes to increased costs. This is one of the subjects which I have covered in the supplementary statement.

The CHAIRMAN. The charge has been made, of course, that the monetary policies that have been pursued in the past have tended to work contrary to the best interests of small business people and some others that have been mentioned.

If we get into a contest here for a limited supply of credit in the market, and the Government, which is of course the biggest borrower of all, finds it necessary to pay more in order to get its part, would there be people who would be adversely affected and crowded out of the market for money?

Secretary ANDERSON. The most important thing, of course, is the fact that as long as the Government has to borrow, and particularly to cover a deficit, we take money out of the market.

To the extent that we would create a surplus and retire debt, we would be contributing to the market.

To the extent that we contribute rather than demand, we would have a healthy effect on other people who want to secure money in the market.

If you maintain simply an equilibrium or a balance between your expenditures and your revenues, then you neither contribute to the market nor do you take anything out in the way of funds.

The CHAIRMAN. Do we create a hardship on States and localities in the issuance of their own bonds when we have to pay more or we pay more in the way of interest on our bonds under circumstances such as we think may exist now in the next months ahead?

Secretary ANDERSON. Again, we in the Government borrow in the same markets as cities and municipalities borrow.

The CHAIRMAN. Today they have somewhat the advantage; do they not?

Secretary ANDERSON. They have the advantage of borrowing on tax-exempt securities to the extent that funds are readily available in the market both to meet the requirements of cities and municipalities, the needs of both of them need to be satisfied.

This is one of the reasons that I emphasize that even if we did not have this ceiling, we would not go into the market indiscriminately for long-term securities, for we would take into account what all of the cities, municipalities, corporations, and others over the country were doing at the same time, because we never issue a Government security

without trying to measure the effect that we would have upon other segments of the economy that we want to prosper and do well at the same time.

The CHAIRMAN. In other words, your activity here, if the course of action is taken which you would intend to take, would not in your opinion have any adverse effect upon the availability of funds for States and localities?

What I am trying to ascertain is whether or not you reached a conclusion that the interest rate of State and local bonds would also rise if the interest rate on Federal bonds rose?

Secretary ANDERSON. Let me say again, referring to the statement which I made earlier, the extent to which we can create an environment in which there is both an accumulation of savings and a willingness on the part of the lenders to lend without fear of inflation, which they would have to compensate for by higher rates of interest, then I think we would work in the direction of providing lower rates at which municipalities, corporations, and all others can borrow.

The CHAIRMAN. There is one point that disturbs me quite a bit.

I wonder whether you have a thought on it and have reached any conclusions with respect to it.

If we take the ceiling off long-term issues, would prospective investors in Government securities expect interest rates to continue to rise, and if they did, would this not have an adverse effect upon the marketability of your long-term securities in the next few months?

Secretary ANDERSON. I do not believe that taking off the rate itself would cause people to believe that long-term interest rates would rise.

What would concern them would be a problem of whether or not the Federal Government would go indiscriminately into the market and try to sop up or use up an undue amount of the accumulations in that area for Government financing.

One of the things that we have been and would try to continue to be careful about is to try to so assess the availability of funds in those areas and the fluctuating demands of municipalities, and corporations, and others, so that we would not impinge against their requirements.

The CHAIRMAN. Mr. Secretary, you would agree, and I wonder if it is your purpose that it should be clear to everyone, that the Treasury will make every effort to prevent any further rise in the rate payable on Treasury obligations, and even to reduce these rates and costs in the future.

I would take it that any Secretary of the Treasury worth his salt would certainly want to operate in that way, and I certainly consider you are one worth more than your salt.

What can we do, in the event that the Congress should decide to go along with this request, to make that intention clear and that in the process of taking off the ceiling, we do it with the thought in mind that that intention will be clearly and at all times carried out?

Secretary ANDERSON. Mr. Chairman, I am sure, as you have indicated, that every Secretary of the Treasury, regardless of any party, would feel that one of his obligations was to finance the public debt as cheaply as he could consistent with good debt management practices.

I believe that the actions which are being taken here will contribute to the capacity of Secretaries of the Treasury in the future to do that.

I think also that perhaps as salutary a thing as could be done would be to let the world know and our country know that we intend to live within our means in times of high levels of activity and that we do feel some responsibility for the retirement of the debt.

I should like particularly to direct the attention of the committee to page 32 of the supplemental statement that was filed with you. I say here that there is a sixth and final alternative for reducing pressures on interest rates, although it must be admitted that the success in pursuing this sixth course of action would not necessarily result in lower rates.

This is because the basic trend in demand and supply in free credit markets reflect the actions of millions of individuals and institutions, and these actions might work toward higher rates even though some of the more significant pressures were reduced, but if we could convert the Federal Government from a net borrower to a supplier of funds in credit markets by achieving a surplus in the budget during periods of high and rising business activity, we would have made a substantial contribution.

The CHAIRMAN. Mr. Secretary, let me turn now to your procedures for marketing Government obligations.

The claim is made in some quarters that through use of alternative procedures, or others than those which you do use, it might be possible for you to obtain greater economy in the financing of the debt, that is to say, finance it at a lower rate of interest.

Are there in fact any alternative procedures to those which you presently use which in your opinion would accomplish any economy in the management of the public debt?

Secretary ANDERSON. Mr. Chairman, if one looks at what one pays for interest and if the criterion is how do we reduce the carrying charge for the national debt, there are alternatives.

I tried in the supplemental statement again to cover some of them. Rather than read them, I would like to here indicate generally what they are.

While I would not class it as an alternative, certainly when the economy is in a period of recession or a period of depression, there is not a great demand for funds and interest rates go down very low.

One looks at the interest rates in the thirties, at the rates at which we could borrow funds. To give a typical example, if one looks at the recessionary period of only last year, we were at the point where we were borrowing 1-year money at less than 1 percent, but this means loss of jobs, it means loss of income, it means loss of productivity, and if there is any one single enemy to sustained growth in this country, it is depression.

There is a second alternative and that might be brought about if we undertook actions which would substantially reduce the prices in the stock markets on investments in common stocks.

Here again it would be very costly to the owners of stocks and costly to the country, and it would have a very serious effect upon the actions of corporations. It is not a course of action which I think a responsible country would pursue.

There is a third suggestion which has been made, that the Federal Reserve System might, under the instructions of the Congress, hold the level of interest rates at a relatively fixed pattern by buying and selling securities in the markets. This has been tried. We did it during the war.

We pursued this course for a portion of the time after the war. It was carefully examined into. It was regarded as being highly inflationary.

The methods by which we would attempt to reduce the inflationary pressures, such as the increase of reserve requirements in the banks, would fall indiscriminately on various classes of banks over the country, so that you would have certain areas in which there would be an inadequate supply of funds and other areas in which there would be a surplus of funds.

Other suggestions have been made that the Federal Reserve System might buy outright the securities issued by the Treasury and again try to compensate by methods of sterilizing the resources or the credit expansion which would be generated by this kind of an activity.

Again you are faced with the problem of how you would make it equitable over the communities in the various parts of the country because it would take quite a long time for the moneys that were generated by this method to filter throughout the entire system.

I think also we have to realize that even in these efforts, while we might undertake the question of sterilizing the secondary or expansive effect of the money, thus created, we must remember that whether the money comes into being as a result of being financed in the commercial banks or whether it comes about as a result of being financed in the Federal Reserve System, the primary effect of the money is pretty quickly felt in our country because it is paid out by the Treasury at the rate of \$1,500 million on an average 5-day basis for all of the services and goods and materials which the Government purchases.

I have tried to elaborate to some extent on these alternatives in this supplement.

I realize, sir, that there are honest differences of judgment. I have thought and tried to analyze as best I can these sorts of alternatives.

The CHAIRMAN. Mr. Secretary, as I understand, you only auction so-called Treasury bills; is that right?

Secretary ANDERSON. Up to 1 year.

The CHAIRMAN. Have you given consideration to the possibility of marketing issues other than these 1-year Treasury bills on an auction basis?

Secretary ANDERSON. Yes, we have, and with the chairman's permission I would like Secretary Baird to respond to that question.

The CHAIRMAN. All right, sir.

Mr. CURTIS. Mr. Chairman, I would like a clarification.

The CHAIRMAN. Mr. Curtis.

Mr. CURTIS. By auction, you mean above the fixed price?

The CHAIRMAN. Just a regular auction.

Secretary ANDERSON. No; where the auction fixes the price.

Mr. CURTIS. In other words, there is not a lower one? It can be a discount?

Secretary ANDERSON. We have issued securities at a discount where you have coupons and you sell them at a discount in order to achieve

a sharper cleavage than the normal, say, one-eighth and that sort of thing, on which bonds are normally based, but in the true auction the rate is fixed by the purchaser.

The CHAIRMAN. That is the type of auction I was referring to.

Mr. BAIRD. Mr. Chairman, over a period of years the suggestion has been made many times that the Treasury consider extending the auction technique beyond what it originally was in 91-day Treasury bills.

At one time in Mr. Morgenthau's regime it was tried for a few weeks on longer term Treasury bonds and was dropped as not successful.

Secretary Anderson has extended in the last year the auction technique considerably and we have brought out a 6 months' bill. We used tax bills of approximately 8 or 9 months to a greater extent, and some 3 months ago announced a program of auctioning four times a year a block of 1-year bills.

However, we are not of the opinion, and most of our technical advisers are not of the opinion, that the auction technique permits of indefinite expansion. It works very well in the professional market, but when you come to intermediate and longer term bonds, you are getting the occasional buyer. He does not know how to appraise what to bid.

Therefore, you force all of your financing practically through the professionals in the first instance for redistribution to John Jones or the local Elks Lodge that has \$10,000 that they are waiting to build a building with. They do not understand the auction technique. They would rather buy in the market at a price they know.

Therefore, we think it would not be constructive to extend it much beyond what we have done at the present. We do not believe it would be in the public interest, nor would it save us any money.

The CHAIRMAN. Mr. Secretary, as we look back, however, without referring to any particular year, we find instances where we have made errors in evaluating the market conditions at the time and perhaps have made more under the procedures that we have followed in the way of interest rate than perhaps we should have paid. We have seen errors committed; have we not?

Secretary ANDERSON. Mr. Chairman, it would be certainly not possible to suggest that there are not errors in pricing of these securities.

The CHAIRMAN. There will always be errors, I take it, when we proceed to market securities as we do through this method that we follow of relying upon the advice of the financial community with respect to what market conditions are.

We have made mistakes in the past. We will make mistakes in the future. The result will be that if we make the mistake of under-estimation, we will not find the purchasers of our securities available. If we make a mistake of overevaluating, we pay too much interest, more than we would have otherwise had to pay.

How can we get procedures that are more precise, if it is possible, and therefore more economical than those which we have been using historically?

Secretary ANDERSON. Mr. Chairman, I should first like to call your attention to page 32 of the statement which I read this morning.

In this chart is shown the interest cost on new long-term Treasury bonds indicating the issue price and the estimated market rate at the

new maturity issue. I think that by looking at this chart you will see that over the years, 1951 up through 1959, the Treasury has been reasonably close to the market.

If you will look back on page 31, you will see the interest cost on new long-term corporate bonds. I think that we would all agree that people who wanted to borrow money for corporations would try to borrow it as cheaply as they could, and there you will see on the triple A corporate bonds the average yield on the outstanding and the new issue interest costs, and that the disparity of the margin between the rate at which the Treasury has borrowed over, say, a 10-year period is considerably less than the disparity at which corporations have borrowed.

We would welcome any suggestions as to how this thing could be improved, because we constantly think about it.

As I indicated earlier, one of the things that we have done is to price a bond at a coupon rate and then sell it at a discount or at a premium, whichever it would be, and by so doing you can price the issue much closer to the market than if you try to deal in one-eighth or that sort of a fixed percentage.

You get to where you can price it in decimal points.

As Mr. Baird indicated, we have tried to extend the auction principle more liberally than it has been used in the past. Recently we had three issues which came fairly close together. We price two of them at auction in order to try to determine from the auction what the price ought to be for the certificate which would bear a fixed rate of interest.

I think that what we have to do is to continually explore and try to develop within the atmosphere of a competitive market, securing all of the competition that we can, and that is the thing that will allow us to price as closely as possible.

The CHAIRMAN. Mr. Secretary, we are just now in the process of recovering from a downturn in business activity and we find that conditions that bear upon the money markets are perhaps leading to the situation wherein at the moment we cannot market as many of our long-term securities at  $4\frac{1}{4}$  percent as we think should be marketed.

Should we be concerned at this point as to whether or not if our economy as a whole follows the usual pattern in recovery the result will be higher interest rates before we reach a new peak in economic activity?

Should we be concerned about that as we consider this matter of our own interest rate structure?

Here we are faced with this situation. Apparently it isn't a temporary thing. Apparently it is not the result of some short-run phenomena.

Are the prospects such that we need to evaluate further increases in the demand that will result in further increases in interest rates as we consider this problem that is before us?

Secretary ANDERSON. Mr. Chairman, in a complex economic society such as ours, it would be a mistake for any of us to pick out any single limit as the primary motivating factor which influences our ambition to achieve a sustainable long-term rate of growth. The very forces of competition themselves tend to cause people to do the same things at the same time.

If one business tends to expand to develop methods by which they get cheaper prices, other competitors must follow along in order to remain competitive.

When a whole series of business activity start moving in the same kind of a direction, you have an expansive quality to the economy.

When any business starts to contract in any one area, the others tend to contract, and when a number of them contract together, the economy becomes characterized by recessionary movements.

We are now in one that is moving very solidly to higher levels. I hope that we can maintain a high level of growth in this country because it means more goods and services, it means more employment, it means more gross national product, and it means that the Government is able to do more things both in the field of security and otherwise.

As to what happens in the specific thing of interest rates during this period, I think we should remember that high rates are a sign of expanding business and that the extent to which they go depends upon our willingness to accept discipline and judgment. It depends upon whether the Government during this period is a net borrower of funds, or whether it is a net supplier of funds.

It depends upon the attitudes of people and companies.

It depends upon whether or not we are able to assure a substantial belief that savers in our country can save with safety and can supply the funds that are needed for business activities, and I think all of these things and the things which the chairman mentioned are matters with which we can be concerned and must be concerned, but it is the composite of the whole that really taxes the ingenuity of our people in our country.

The CHAIRMAN. Mr. Secretary, maybe you do not want to discuss this in public, and if you do not just tell me, but since the next witness today is the Chairman of the Federal Reserve System, I wanted to ask you the question whether or not it is your opinion that the Federal Reserve System has followed the monetary policies that should have been followed in this connection?

Secretary ANDERSON. Mr. Chairman, I would not want to try to evaluate specific activities of the Federal Reserve System. I would say to you that we have inaugurated a system of constant consultation between the Treasury and the Federal Reserve System and the President, the Council of Economic Advisers, so that each of us acting in our own spheres may do so with the benefit of the judgments and the benefit of the knowledge that we are able to acquire from the other agencies which are concerned.

I think the available evidence points only to a mild degree of credit restraint since last summer.

The CHAIRMAN. Mr. Secretary, I am not talking about that as much as I am talking about this point. Maybe it is because I am not completely informed.

However, I do not see how you can avoid a rise in interest rate in an economy growing at the rate of 3 percent a year, if the supply of money is not permitted to keep pace.

Secretary ANDERSON. I think there are two things we have to consider.

One of them is the fact that if the environment is such that people are encouraged to save, we save larger amounts of money and have larger amounts of money available for borrowings out of the savings.

I think the second thing that we must do is to take a look at the enlargement in the money supply which has taken place, say, from March 1958, to March of 1959.

It would seem to me that the principle which ought to govern in this respect is that we have a rate of growth in our money supply at something about the rate of growth in our productive capacity.

The CHAIRMAN. That is the whole point.

I am told, and I do not know whether this is true or not, but I want to find out, that over a period of time when our economy has grown, say, at the rate of about 3 percent a year, we only let our money supply grow at the rate of about 1.5 or 1.6 percent.

I do not know that it is necessary that money grow 3 percent as the economy grows 3 percent. I do not know what the figures ought to be.

However, I think everyone of us would admit that a growing economy demands more money, and if that money is not available in proportion to the demands of the economy, in the final analysis we will pay more interest for what is available.

Do we reach any conclusions looking backward?

I am not criticizing the Federal Reserve, because I would probably have done the same thing they did at the time they did it. I am not saying I would not.

However, as we look back, can we determine now that the policies they have followed, the policies of the past or present policies, are in the direction of making a contribution to holding down the rate of the interest or making a contribution toward an increase in the rate of interest?

Secretary ANDERSON. Mr. Chairman, I think if we look back that we would say that the effort has been to try to keep the rate of the growth of the money supply reasonably consistent with the rate of growth of the country.

I have before me a chart which reflects the rate of growth on a seasonally adjusted basis for the money supply from April 1958 to April 1959. While this is essentially in the line of questioning which I am sure you are going to develop with Mr. Martin, I would like to point out that, according to these figures, the annual rate of growth from April 1958 to April 1959 was 4.4 percent.

If you select months from May 1958 to April 1959, and various periods, the shorter the time period the more you get into margins of error because of the float and that sort of thing which is in the money supply. But my judgment is that the Federal Reserve has tried to follow a flexible money policy that has been reasonably consistent with the requirements of growth in our country.

I think also that one must not look entirely to growth in the money supply, because the velocity of the money supply is also an equally important factor.

The CHAIRMAN. What I had in mind, Mr. Secretary, is shown in a chart that I had looked at earlier, the Economic Indicators for May of 1959, prepared for the Joint Economic Committee.

On page 26 GNP has gone up, say, since 1952, by 20 percent. The supply of money has gone up by 11 percent. I know that you

cannot just look to the supply. You have to look to the turnover of your money as well as supply. I realize all that.

Secretary ANDERSON. That is correct.

The CHAIRMAN. I do not know that I am convinced one way or the other, but I have a very strong suspicion as we look back that one of the contributing factors as well as this matter of the wrong kind of fiscal policy may well have been this restrictive monetary policy followed by the Federal Reserve over the years, and, as you know, when we were going into this economic downturn, it took the Federal Reserve quite a little while to make up its mind to reverse its position, and then a long time before I could think we were coming out of it they reversed again and went right back to contraction.

These folks are smarter than I am. I am just wondering if you, upon looking backward, thought they had made a mistake. Apparently you did not.

Secretary ANDERSON. Mr. Chairman, may I content myself by saying that looking backward since the change of policy which occurred last summer, measured by the annual rate of expansion of the seasonally adjusted money supply, it seems to us that it has been at least equal to or perhaps slightly greater than what is normally thought of as a normal rate.

I am sure that, while Mr. Martin will answer more fully, when you get into the policy or into the problem of timing and precisely what ought to be done at any given time, all of use would heartily wish that every action we could take would be done with the benefit of hindsight.

I think one only has to look at last year. As we look back now, we see that the turn of the economy was taking place in May of last year. In June of last year there would have been very few who would have thought that this was a completely permanent turn.

I think it is important for us to remember that in our backward looking, if we try to look back 18 or 20 months, which in point of time is short, in August of 1957, almost the watchword of what we were trying to achieve in this country was economy, the saving of money, and 6 months or 7 months later, in January of 1958, we were wrestling with recession, how long would be the downturn.

We wrestled with that all during the first half of the year. Then came the knowledge that the economy began to turn the other way, that we were going to have to finance a very large deficit in periods of rising levels of activity.

One would pick up almost any periodical in September of 1958, and the problem related itself to inflation, high prices, and this sort of thing.

I think this is indicative of two things:

One is that the swings which actually take place are not as great as sometimes we think they are, as we look at the possibilities.

And the second thing is that it gives us some idea of how much of the direction that we take is based upon expectation.

Admittedly, the long-range effect of expectation will not be so severe unless the expectations are subsequently validated, but if they are subsequently validated, then the long-range effect of the expectation continues.

The CHAIRMAN. Mr. Secretary, we will have to interrupt. There is a record vote on the floor. We will be back in 20 minutes.

Secretary ANDERSON. We will wait here, sir.

(Brief recess.)

Mr. KING (presiding). The committee will come to order, please. Mr. Mason.

Mr. MASON. I have not particularly a question, Mr. Chairman, but a statement to make.

Mr. Secretary, in my opinion you have given us the most comprehensive analysis of the fiscal headaches that confront the Nation today and particularly the Treasury. It has not been a very pleasant picture that you have presented but it has been a true picture, as I see it.

In my opinion, I am just giving this as my opinion, the Congress itself is mainly responsible for the picture that you have presented and the analysis you have made in that for the last 20-odd years we have been carelessly, unnecessarily spending more money than we have taken in. That is what has been brought about, in my opinion, and that is the major reason, at least, for the situation that we are in today.

I want to say that we have never had such a comprehensive statement of the financial picture of the Nation during the years I have been in Congress as we have had this morning.

That is all, Mr. Chairman.

Secretary ANDERSON. Thank you, Mr. Mason.

Mr. KING. Mr. Karsten will inquire.

Mr. KARSTEN. Mr. Chairman, I should like to join the distinguished gentleman from Illinois in complimenting the Secretary on a very fine historical presentation. Since I have been a member of the committee I have listened to approximately six such presentations and I believe that this is the most comprehensive one that I have ever heard. It does furnish a rather complete picture.

I am frankly looking for reasons, Mr. Secretary, to support you in your requests.

On page 40 of your statement you say :

By proceeding in this way—

I assume favoring your suggestions—

the Federal Government would be promoting maximum employment, production, and purchasing power, as required in the Employment Act of 1946.

Am I to assume that a vote for your proposals would be a vote in favor of carrying out the program recommended by the Employment Act of 1946?

Secretary ANDERSON. I believe it would, Congressman.

Mr. KARSTEN. You would construe it as furthering and promoting the Full Employment Act?

Secretary ANDERSON. Yes, sir.

Mr. KARSTEN. On page 41 you make the statement :

As a result of the recession in late 1957 through early 1958, the Treasury incurred a budget deficit of \$2.8 billion in the fiscal year 1958 and will incur a budget deficit of almost \$13 billion during the year that will end on June 30, 1959.

Now, was that the result of the recession exclusively?

Secretary ANDERSON. A portion of it was the result of the recession, largely because of the decline in corporate income tax.

Mr. KARSTEN. You know many of us down here have been hearing statements that are blaming Congress for what has resulted in this situation. I wonder if you care to comment on that.

Secretary ANDERSON. An analysis of the deficit I think would reflect that a substantial portion of it was brought about by the decline of the corporate income tax, a portion of it was brought about by the very large crops with which we were blessed and on which we have crop supports and other parts of it were brought about by various other expenditures.

Mr. KARSTEN. In other words, you would not attribute the blame to the Congress for this deficit?

Secretary ANDERSON. No, sir; I think that the analysis fairly put is applicable to the recession and to the programs in existence such as crop support programs when we had a very heavy crop and that sort of thing.

Mr. KARSTEN. I also heard other statements that our present financial situation is the result of previous mistakes in previous administrations. Would you subscribe to that feeling?

Secretary ANDERSON. Well, I would think that——

Mr. KARSTEN. Of course we all make mistakes. We have to concede that.

Secretary ANDERSON. I would think what you are looking at is this: You are looking at \$286 billion, which is the difference between what the country has taken in——

Mr. KARSTEN. I did not hear you, sir.

Secretary ANDERSON. You are looking at \$286 billion, which is the——

Mr. KARSTEN. That is the national debt?

Secretary ANDERSON. Yes, approximately, which is the difference between what the country has taken in and what the country has spent since it was founded. It has taken in money all over these years; taxes and customs and all the other sources from which we acquire funds.

Mr. KARSTEN. Let us look at that national debt for the moment. What was it when the present administration assumed office?

Secretary ANDERSON. Approximately \$267 billion.

Mr. KARSTEN. Today it is what?

Secretary ANDERSON. Approximately \$286 billion.

Mr. KARSTEN. During that period of time, which is approximately 6 years, has there been any debt reduction below the initial figure that you quoted?

Secretary ANDERSON. No, sir.

Mr. KARSTEN. There has not been any debt reduction.

Well, now, to get back to the question, you would not place any blame on the Congress for this present situation as I interpret you? It is the result of the recession, this \$13 billion deficit you are talking about?

Secretary ANDERSON. Mr. Karsten, I would not like to isolate any group of people.

Mr. KARSTEN. I am trying to find reasons to support you. What you say will guide my votes.

Secretary ANDERSON. I would not like to isolate for any reason. My purpose here is not to find people who are responsible. My purpose here is to see a situation, face it realistically, and do what we should do from the debt management angle.

Mr. KARSTEN. In your statement you make the statement that it was the recession. Can we rely on that and it was not the Congress that caused this.

Secretary ANDERSON. You can rely on the fact that the biggest single cause was the decline in revenues.

Mr. KARSTEN. And that was the recession quite apart from the Congress itself.

I also cannot seem to follow you, Mr. Secretary, when you say that this program of taking off the ceiling on the interest would not have an effect on municipal securities and even down into the private investing field. It would seem to me that Government security is in the nature of a riskless security whereas other securities, particularly when you get in the commercial field, are risk investments. In risk investments it has always been my experience that you have to have a higher interest rate in order to attract the money. Am I in error in that?

Secretary ANDERSON. The primary factor affecting the movements of the cost of money is the supply and the demand at any particular time. During times of high levels of business activity one of the signs of it is that the cost of money goes up, because people are trying to expand at the same time that cities and municipalities are trying to finance their activities. They are trying to expand at the same time that the Government is meeting its requirements. If at the same time the Government is meeting excess requirements because of the failure to have revenues to compensate, then it is demanding funds at a time when all others are demanding them, consequently the pressure increases.

Mr. KARSTEN. Assuming we would go to 5 percent on Government securities, which I say are in the nature of riskless securities, could not you conceive that private securities would have to have a higher rate of interest? Would they not?

Secretary ANDERSON. It would only go to 5, Congressman, if the market pushed it there. It would not go to 5 simply because you took off a—

Mr. KARSTEN. I know that, yes. But assuming that it did go to 5. Could we not then expect higher interest rates and higher interest on private securities?

Secretary ANDERSON. If the market forced it up.

Mr. KARSTEN. Forced it up. In fact your private interest rate is going to go right on with your Government interest rates.

Secretary ANDERSON. May I say, let us assume for a moment that you still have the ceiling. Although because of market forces forcing the rate up you might not be able to sell any new longer securities, but the fact that you had the ceiling there would not prevent the yields on the outstanding securities following right along where the market is, the yield would be just the same.

Mr. KARSTEN. Is there really contemplated or in process now anything that might result in, conceivably result in depressing the interest rates?

Secretary ANDERSON. I did not get your question.

Mr. KARSTEN. Are there any actions now in process or pending or contemplated, perhaps by Federal Reserve, which could have the effect of depressing the interest rates?

Secretary ANDERSON. Well, as I indicated this morning if the Government became a net supplier of funds by reason of being able to retire part of its debt rather than a demander of funds that would certainly take off some of the pressure. Even if we only had an exact equilibrium between expenditures and balance it would not increase the pressure. If, on the other hand, at the time when everybody else is expanding the Government should show up being a net demander of funds then we obviously would increase it.

Mr. KARSTEN. Let me ask you this: This year how much of the debt will you have to refund and refinance for the remainder of this year, just roughly?

Secretary ANDERSON. Roughly \$76 billion.

Mr. KARSTEN. \$76 billion. Assume you have this authority to take the lid off the interest. Do you plan to go to long-term financing on a portion of this and if so, how much portion of it? Would you answer that?

Secretary ANDERSON. Mr. Karsten, I could not now try to make a statement as to what portion of the debt we would try to extend beyond 5 years.

Mr. KARSTEN. As a general practice, do you not try to get long-range securities, you like to finance them that way, because you can watch it, that is really an efficient way to manage it, is that correct?

Secretary ANDERSON. Well, the idea is to keep the balance so that you do not allow too many of the securities to crowd into the short-term area.

Mr. KARSTEN. You are going to have an immediate difficulty over the next 6 to 9 months with the \$76 billion at the present rate, as I understand?

Secretary ANDERSON. I think that is correct, sir.

Mr. KARSTEN. What would you think of a suggestion whereby we might grant your request to take the ceiling off the interest but limit it to short-term securities and limit it to 1 year?

Secretary ANDERSON. Congressman Karsten, I just do not believe that one should try to anticipate the extent or the duration of business cycles. I think what we would be trying to do there is to say that we are trying to forecast the time during which there is going to be a large demand for credit and also the period after this time.

Mr. KARSTEN. Maybe the interest rates might come back on your long-range financing and then could be done at lower rates.

Secretary ANDERSON. Let me say this to you, sir.

Mr. KARSTEN. I want you to get over this hump you are in right now.

Secretary ANDERSON. Let me say this to you, sir. If you take the limit off I could not believe that anybody would ever sit where I sit and have any other objectives than to finance at the lowest possible rate at which he could get money.

Mr. KARSTEN. I would agree with you on that.

Secretary ANDERSON. That being so it would seem to me that we ought not to try to forecast the length of time in which the artificial ceiling of 4½ should remain off, the length of time in which we might have rising levels of business activity and then a decline, but rather

to say that we are going to have a competitive market, that the obligation rests upon the Treasury to finance as cheaply as it can to get the money. But to do it in an atmosphere of complete flexibility.

Mr. KARSTEN. What I suggest, though, would that get you out of your present difficulties for the moment, that is, to take the ceiling off on a short-term securities for a period of 1 year.

Secretary ANDERSON. Well, sir, there is no ceiling, no limit, on what can be paid now for any securities with a maturity of less than 5 years. We can pay any rate of interest.

Mr. KARSTEN. Would it not be more economical to continue to finance that way until interest rates do go down or do you think they are going to continue to go up or stay up?

Secretary ANDERSON. There are a number of things that have to be taken into consideration. Let me point to the first one.

If we do nothing but sit idly by and finance in the shortest area possible, whereas today we have approximately \$76 billion of debt due in 18 months from now we will have something like approximately \$100 billion. This will mean that we have to get \$24 billion out of the short-term market. Now, if we add to that—

Mr. KARSTEN. Mr. Secretary, conceivably your interest rates may not be at the level. They could be somewhat depressed. Maybe you could find some of that on long term.

Secretary ANDERSON. That again comes back to the question of forecasting how long we are going to have this sustained level of high business activity.

Mr. KARSTEN. You have to do a little forecasting, too, to make your plea here, I would think.

Secretary ANDERSON. The point I would like to make is that I would not like to be in the position of trying to say that this is how long we are going to have a high level of business activity and then interest rates will fall, because what we want to maintain in this country is as high a level of business as we can in the future.

Now, the second thing, I would not with propriety be able to make any predictions with reference to interest that could set up a very highly speculative condition in the market. If, on the other hand, Congressman, and I think this is important, I think there are two things there with reference to it, and one of them is if you get a lot of debt crowding in on the short term and you have to go out and borrow in the short-term market many billions of dollars more, then you are forcing up very quickly the total cost of financing the public debt because it is a rise in the short-term rate that has a quick effect on how much does it cost per year. Whether it is \$8 billion, \$8½, or \$9 billion.

The third thing, you put your money in the short-term area which is the next thing to money itself, the next thing to monetary liquidity or to monetization. Then you have created the expectation that you are going to have higher interest rates.

Now, if you create that expectation you have to gage what a man would think if you come to him and say, "I want to borrow money for 15 years." He is going to do one of two things. He is either going to charge a high enough rate of interest that he compensates himself for what he believes is going to be the eroded value which will drive the interest rate up or he will take his money out and buy short-term

securities and simply wait. If he takes his money out then there is less money in the pool out of which long-term loans can be made and that within itself forces up the interest rate.

So the point that I have tried to make here is that it is my judgment that the removal of the 4¼-percent rate will work in the direction of lowering rather than increasing interest rates.

Mr. KARSTEN. Many of us have just the opposite view that that is the signal they are going up. We do not know where they are going to stop. But we know they are going up. That is the impression I get from it. I do not know whether the average person will receive the same impression or not. But that is the view I get of your proposal.

Secretary ANDERSON. Let me again make this statement. If we maintain the 4¼-percent rate it could very well mean that we in the Treasury would not be able to sell a new security.

Mr. KARSTEN. That is long term.

Secretary ANDERSON. Beyond 5 years. But it will not have any effect on what the market will pay for an issue that is already outstanding regardless of its coupon. The rate will continue to go just exactly where it is, wherever it would have gone otherwise. What makes the rate come down?

Mr. KARSTEN. That is what we would like to know. Can you tell us?

Secretary ANDERSON. Yes, sir; I think I can. It is the actions in relationship to supply and demand of funds.

Mr. KARSTEN. What action could we take short of controls that would accomplish this?

Secretary ANDERSON. I think one of the actions you could take is to remove this ceiling which would be a signal to the country saying the Treasury is not required to finance all of its debt in the short-term area. The Treasury is not required by the passage of time to allow an accumulation of additional short-term securities which will have to be put in that area. They will not, therefore, be contributing, have to contribute, to monetization of the debt or to near monetization.

Another action would be that we are going to live within our means so that we are not demanding excess funds for the Government, at the same time that businesses are demanding it and even more than that, that we become a net supplier of funds, because we generate revenues in excess of expenditures and therefore we are supplying funds to the market rather than demanding funds out of it.

Mr. KARSTEN. We have not been in that position for a long time; have we?

Secretary ANDERSON. We were there in 1956 and 1957.

Mr. KARSTEN. For short periods.

Secretary ANDERSON. Yes, sir; for short periods. We had two surpluses.

Mr. KARSTEN. 1956 and 1957?

Secretary ANDERSON. 1956 and 1957.

Mr. KARSTEN. There is one final question. There appears to be some inconsistency in your statement in that you favor a ceiling on the national debt itself but you do not favor a ceiling on the interest, on the securities that finance the debt. Could you enlighten me a little on that?

Secretary ANDERSON. Congressman, as I pointed out in my statement, the existence of a restrictive debt limit serves a useful purpose, in focusing the attention of the country, the Congress, the public, the executive departments and everybody else on the fact that the debt is continuing to rise.

As I pointed out this morning, it would be perfectly appropriate if the Congress wanted to set a normal or what we call a permanent debt limit and then set an additional amount sufficiently large that we could take care of seasonal fluctuations, that we could borrow part of the year and pay off in the other part of the year. But I think this is quite unlike the ceiling on the  $4\frac{1}{4}$ -percent rate because the ceiling on the  $4\frac{1}{4}$ -percent rate is an indication to the people of the country and to the world that given periods of high levels of activities such as that that we are going into now, that you are required to finance in the short term area and your monetization.

So I think it quite different. Now, I fully recognize that there are those who feel there should be no limit to the debt. Again this is purely a matter of honest difference of opinion and judgment as to whether or not it is worthwhile once a year to focus attention on this factor.

One thing is quite sure, that whatever the expenditures of the Government are, whatever we do in order to protect ourselves to carry out the responsibilities which we conceive to be ours, the debt limit will have to be moved up if we spend more than we receive and it can be moved down if we receive more than we spend.

Mr. KARSTEN. It is really not a limitation but a highwater mark. Whenever water washes up high the debt has to go right up with it?

Secretary ANDERSON. Yes, sir.

Mr. KARSTEN. Assume now that we would refuse to authorize this debt increase that you request. Would this be taken as an authorization by the administration to cut out any expenditure programs that they might not favor?

Secretary ANDERSON. You referred to the limitation of the rate or the limitation of the debt?

Mr. KARSTEN. No; the limitation on the debt. Not the rate. The limitation on the debt I was speaking of.

Secretary ANDERSON. I would have to stop selling Treasury bills.

Mr. KARSTEN. Could you tell me, would it be regarded as an authorization or a directive to the administration to discontinue certain programs that cost money?

Secretary ANDERSON. What would be much more important is that you simply could not pay the Government's bills. You would be in default.

Mr. KARSTEN. I realize that would happen.

Secretary ANDERSON. Yes.

Mr. KARSTEN. I wondered if it would also be a direction and authorization for the administration to cut out a lot of expenditures.

Secretary ANDERSON. That, of course, I think would have to be prejudging what the President would decide. I would certainly take it if we were going to default on Government obligations we would be very reluctant to create some more.

Mr. KARSTEN. That is all, Mr. Chairman.

Mr. KING. Mr. Keogh, of New York, will inquire.

Mr. KEOGH. Mr. Secretary, I regret very much my inability to be here for the entire day. I hope that I do not become repetitious with respect to any questions. If I am I wish you would let me know.

Secretary ANDERSON. It is perfectly all right.

Mr. KEOGH. I recall when the committee had under consideration the adjustment upward of the rate of interest on the E- and H-bonds from 2.9 to the 3.26 that I think it now is. During the course of our sessions we had a considerable discussion of the relative place in competing for the savings of the people of the country that those bonds should have. It leads me to this question: Is your suggestion with respect to the increase to  $3\frac{3}{4}$  for the primary objective of maintaining your relative place or of increasing it in the competition for the savings of the country?

Secretary ANDERSON. I am looking for the place in the statement where I—

Mr. KEOGH. 16, 17, 18, and 19.

Secretary ANDERSON. Yes. I, as I pointed out here, what we are trying to do is get back to a relative competitive position. The chart on page 19 is indicative of the relative amounts which are going into savings and loan associations, commercial banks, mutual savings, and E- and H-bonds. It also is applicable to the fact that we feel a trusteeship responsibility to the people who hold these securities. They are not the kind of fellow who rings up his broker in the morning and says, "What is a good investment"? They are not the kind of fellow who gets hold of the financial journal and says, "What is happening today or is likely to happen tomorrow with reference to all kinds of securities"?

He buys these securities because of convenience and because he wants to prepare for the education of his children, to build a new home, the multiple purposes that he might have in mind. And it is not what we would call a financial expert.

Now, we feel that this kind of a buyer is entitled to look to his Government and say that. "We expect from you a square deal. If other rates go up we would expect for you to come along from time to time and treat us with reasonable fairness."

Mr. KEOGH. That leads me to my next question. Have you given consideration with respect to the effect that this increase to 3.75 would have with respect to the competitive position of the mutual savings banks and other thrift institutions who are for the most part dealing with the same types of people as you have described the holders of E and H bonds to be?

Secretary ANDERSON. The mutual savings banks, savings and loan associations, have gone up relatively more than we are now asking. So that if we went back to the same period, when the rate was adjusted to 3.25, and compared the increase that we are now asking for, compared to the increase of other types of securities, the other types of savings have gone up more.

Now, there is an additional factor, and that is this: When you buy a savings bond you usually have a 2-month period before you can come in and cash it at all. When you hold it for a longer period, the increment which you earned goes up gradually by steps. In most of the other types of savings your benefits accrue immediately and even

though some institutions normally require periods of notice before cashing, in actual practice very few of those periods of notice are enforced. So you get your money much more quickly.

Mr. KEOGH. Are you satisfied, therefore, that if this increase on these types of bonds were to be granted that it would not result in requiring the other institutions to make adjustment upwards in their dividend or interest rates?

Secretary ANDERSON. No, sir; I think that they would simply continue to grow.

Mr. KEOGH. I understand, Mr. Secretary, that there have been discussions recently with some representatives of institutional investors looking toward the conversion of some of their presently held  $2\frac{3}{4}$  nonmarketable bonds for Federal Mortgage Association mortgages. Do you know about that?

Secretary ANDERSON. Mr. Baird, if you will agree, will respond to your question.

Mr. BAIRD. Yes. That matter has been under discussion and the President presented that in his message.

Mr. KEOGH. Pardon me.

Mr. BAIRD. The President in his budget message to the Congress did propose that FNMA might offer some of the mortgages held, GI mortgages, 4 percent, in exchange on some equivalent basis for  $2\frac{3}{4}$ -percent nonmarketable Government bonds.

Mr. KEOGH. That is the type of transaction that is contemplated in this second bill mentioned; is it not?

Mr. BAIRD. No; it is not.

Mr. KEOGH. Similar to it; is it not?

Mr. BAIRD. One is Government bond for Government bond. The other was mortgages for Government bonds.

Mr. KEOGH. That is that distinction. It is a conversion of presently held lower interest bearing Government bonds for another type of security with a higher yield.

Secretary ANDERSON. Congressman Keogh, they are quite different. I would like to call your attention—

Mr. KEOGH. I would like to have the differences pointed out to me.

Secretary ANDERSON. All right, sir.

Mr. KEOGH. I am arguing that there are no differences.

Secretary ANDERSON. Yes.

Mr. KEOGH. I am just leading up to wondering why a transaction like that could be under discussion and frankly, I think it is a fine way to handle the difficult situation with which some of those institutional investors are now faced. I am wondering why discussions about a transaction like that can be going on without any necessity for further legislative action and we must consider a legislative proposal with respect to the conversion and exchange of Government securities.

Secretary ANDERSON. Let me say that the technical aspects of this matter, which involve interpretations of the Internal Revenue Code, are going to be presented by Mr. Rose, who is the General Counsel of the Treasury.

As a general proposition, when you today exchange one Federal security for another in a refunding operation, you are required to show the gain or the loss for tax purposes if the value of the old security on

the books of the investor is above or below the market value of the new issue at the time of the exchange.

Now let us assume that somebody had a bond which was issued 25 years ago. It is now a 5-year bond. In order to present or to induce this long bondholder, as you come down closer and closer to maturity, from treating this as a short-term obligation, because it is no longer a long-term obligation, it is due in 5 years, regardless of the fact that it started out as a 20-year bond, we would envision that there would be occasions when we would want to go out 2, or 3 or 4 years before the bonds came due and say to the holder of those bonds, "If you will stay in the Government securities we would offer to exchange the kind of a bond you hold for one which has the same relative market value as your bond now has."

Now if, on the other hand, if that should have occurred at a time when his current bond, which he has, is selling below par, then he would have to write down his surplus in most cases, particularly in savings banks and building and loan associations, they would have to write down their surplus. It would be a tax loss and the tax loss could have been offset against their profit.

But what they are concerned about mostly is not having to write down their surplus account. We would, therefore, say to him that so far as Federal income tax laws are concerned the Secretary of the Treasury could designate this specific exchange to be one in which you would not have to take it into account for the profit or the loss. Therefore, you would take a new bond with the same market value and you would not write down the surplus account.

Now we still have the problem of being sure that this is consistent with the laws of the respective States because we would have to be sure, for example, in New York, that the regulatory bodies of New York, regulating, say, building and loan associations or savings banks, would allow the institution to treat it in that manner.

Now if on the other hand somebody under those circumstances wanted to take the loss they would simply sell their security in the open market and they would buy the new security. It would not be an exchange of one for the other and the loss would take place.

I think, also, I should like to point out here that someone has said to me why could not one, therefore, postpone gain or loss indefinitely, just as often as you replaced one security with the other.

It is for that reason, if you will notice, on page 52 of my statement, this could be done only under rules which we would prescribe for each exchange.

In other words, the mere fact that you did it with reference to one exchange would not mean that you could have the same kind of an exchange without tax consequence in perpetuity. It would be applicable only to each exchange.

Now this is the sort of a mechanism which would give us the opportunity instead of allowing some of the debt that was at one time long term, say 20 years, from just running down until it runs completely out of its 20 years, until it gets down where it is due within a year. As far as we are concerned that is in exactly the same class as a note that we issued a year ago and it is due in a year. Before it gets into that category we would like to put this same long-term real investment back into an investment which would carry for 10, 12, 20 years in the future.

Mr. KEOGH. I appreciate that explanation. I am sure that those who read the record will be delighted to have it.

I would like to finally ask Mr. Baird, Mr. Chairman, if I may, are the negotiation with respect to those FNMA mortgages continuing or are they in process of completion? Would you know?

Mr. BAIRD. I think FNMA is continuing some negotiations. They have not called for any proposals yet. I think largely because some of the Members of Congress have said they wanted to look into it. There was a hearing held last week at which some questions were asked about it.

Mr. KEOGH. I appreciate the motivations for the suggestions, Mr. Secretary, with respect to those E and H bonds. But I wonder if I could have the record show what your opinion is as to the effect of the increase of this on the capital funds that are otherwise available from the thrift institutions. By that I mean to the extent that that type of savings goes into E and H bonds are they not being withdrawn from normal capital markets?

Secretary ANDERSON. I will be glad to furnish a statement but, as a matter of fact, we feel that by those processes we will generate new savings.

Mr. KEOGH. But savings in E and H bonds?

Secretary ANDERSON. Yes, sir.

Mr. KEOGH. To some extent at the expense of the savings that are now going into the established thrift institutions?

Secretary ANDERSON. This will narrow the gap between them, but I would say to the Congressman that I do believe that the other thrift institutions will continue to grow at a very good rate.

Mr. KEOGH. That I would rather leave to them to say as to what their guess on it is before we come back to where we were when we were talking about the increase from 2.9 to 3.26. And that is whether the Government, however desirable it might think the widening of the holdings of E and H bonds might be, how far the Government should go into active competition for that type of savings dollar in the United States. That is not a question, Mr. Secretary. But I will be delighted to have your reaction to it.

Secretary ANDERSON. Of course this, I think, goes to the whole question of whether or not we should have a savings bond program. I believe very strongly that we should. The money which is held in savings bonds is a true type of saving. It is a class of bonds which are normally held for 7 years. It has perhaps the least inflationary effect of any security which we could market. It is a type of saving in which thousands, literally thousands of dedicated people from 1941 to this date have given and are giving their services, in order to develop it.

While, of course, we welcome the acceleration of capital through all of the savings institutions, we believe that a reasonable share of those savings should go into E and H bonds in support of their Government and that they should be treated fairly and reasonably with relationship to other savings institutions.

Mr. KEOGH. My concern about it, and I agree generally with your position, that you should have a share, but whether it should be an increasing share is open to some reasonable discussion.

But my concern about that area springs principally from the breaking in New York of the historic difference between the rates of interest paid on the thrift accounts in commercial banks and the normal thrift institutions and the active and sometimes competitive activity to attract that thrift dollar. I think that it has had some serious effect on the balance between and among the various types of institutions. I hesitate to think that the Government would further complicate that by suggesting an abnormal gap between the interest paid on E- and H-bonds and that paid by the thrifty institutions.

Secretary ANDERSON. I do not believe that we would in any way generate any additional competitive factors or characteristics of the kind which you mentioned between private institutions. I do believe that we do attract into the savings bond program substantial numbers of people who would not otherwise be savers at all. And I think this is very important.

Mr. MASON. Mr. Chairman, I want to clear up one point in the concern of the gentleman from New York.

The proof of the pudding, Mr. Secretary, is in the eating. We raised the interest rate on the E- and H-bonds in order to make them more competitive with these other savings last year. The actual fact was that there were more withdrawn and the percentage of the withdraws from the E- and H-bonds was greater than the percentage of the sales which shows that they are still not in a competitive position.

So I think your concern, judging from the results, is unnecessary.

Mr. KEOGH. Mr. Chairman, the gentleman knows that he would be the last one in the world I would enter into any colloquy with. But the charts on page 19 of the Secretary's statement would seem to indicate that the curve on E- and H-bonds has relatively steadily increased and that leads me to the very point that I am trying to make. Is the Government entitled to increase that beyond its related position or should the Government be willing only to take in E- and H-bonds that which comes into it voluntarily?

Mr. MASON. I will still ask the Secretary if it is not a fact that the ratio of withdrawals last year was greater than the ratio of sales.

Secretary ANDERSON. For the calendar year 1958 sales were approximately \$4,689 million. Redemptions were approximately \$4,856 million, but there was reinvested interest of \$1,178 million, that is, accrued interest.

Mr. KING. Does that conclude your questioning, Mr. Keogh?

Mr. KEOGH. That concludes mine.

Mr. KING. Mr. Curtis.

Mr. CURTIS. Mr. Secretary, I think some of the difficulty that we on this committee experience in explaining these so-called debt limitation increases each time we go before the House and also to the public is so often as a result of semantics.

I made the point in a debate last time we had this up that this would be better described as a Debt Management Act, rather than a Debt Limitation Act. I wonder if you do not agree that that is the more descriptive of what we are talking about here?

Secretary ANDERSON. Debt management?

Mr. CURTIS. Debt management.

Secretary ANDERSON. I think it is a management problem; yes, sir.

Mr. CURTIS. It is a management proposition and the limitation is only on certain types of securities that evidence the debt. In other words, the debt is there.

Secretary ANDERSON. That is correct.

Mr. CURTIS. And we are not going into anything about the debt one way or another. We are trying to find how the Treasury Department manages it.

Secretary ANDERSON. That is correct.

Mr. CURTIS. I am going to suggest we refer to the legislation as the Debt Management Act. because many people think by voting against increasing the ceiling in the debt-management legislation that thereby they are voting to limit the debt and conversely that there are people who vote for increasing the ceiling on these kinds of securities who are voting to actually increase the debt. I think that point needs to be driven home.

I find that it sort of underlies some of the questions that have been asked you, a misunderstanding, that by this act whatever we might do here we might thereby be limiting the debt itself. We are not doing that, are we, limiting the debt itself?

Secretary ANDERSON. No, except to the extent that there is a real limitation if the debt limit should get to a point that prohibited us from raising the cash which we would need to pay the Government's bills, during periods of low revenue income. We would be in a position of having to say to the man that presented his check that we had insufficient funds. This, I think, would be a national catastrophe.

Mr. CURTIS. Yes; I do, too. Because actually what would be happening then, the debt would be there, but we would not be able to get the cash to meet our obligations.

Secretary ANDERSON. We would not be able to pay our bills.

Mr. CURTIS. That is exactly it. There was some reference made by one of the questioners to the debt in 1953 as \$267 billion and the debt of 1960 about \$285 billion. However, that is only an incomplete fiscal picture as I see it. To each column should be added new obligations which in 1953 were \$81 billion, carryover from appropriations \$78.4 billion, carryover from other authorizations of \$24.4 billion, making a total of \$450.8 billion in 1953 and putting a column to the other side for 1960 of \$285 billion debt, \$77 billion new obligations, \$41.5 billion carryover, and a \$30.2 billion carryover from other authorizations, giving us a figure of \$433.7 billion against \$450 billion.

Does that not represent a more accurate fiscal picture of just where we are sitting right now?

Secretary ANDERSON. We are comparing two different things. One is the amount of the debt which is under the ceiling and the other is the amount of commitments which the United States has authorized to be made and for which payment will be made.

Mr. CURTIS. Which is the real debt. That is the real thing we are going to have to meet. That is what you have to anticipate. Those are what your cash needs are.

Secretary ANDERSON. That is correct. We will eventually have to pay them. Of course we will have revenues in between.

Mr. CURTIS. That is correct.

Secretary ANDERSON. I think also, that we have other guaranteed obligations which are not within that.

Mr. CURTIS. I was just going to ask that question, because last time, too, in order to try to get across this concept of what the real debt is, and that is what our outstanding obligations might be, we would have to consider these other contingent liabilities which as I recall run around \$450 billion and that is subject to pretty much of an estimate. It will vary, depending on who is doing the estimating.

Secretary ANDERSON. There are all kinds and shades of contingent obligations, ranging from those which are guaranteed by the United States to those which are simply what we call Government aided which are issued by an agency of the Government beyond which there is no guarantee.

Mr. CURTIS. You pointed out one point, I believe, that really became a factor in this present fiscal picture and that is the Commodity Credit Corporation in our agricultural program.

Secretary ANDERSON. I have a complete list of the long-range commitments and the contingencies.

Mr. CURTIS. I wonder, Mr. Chairman, if we could have those placed in the record.

Mr. KING. No objection, so ordered.

(The information referred to follows) :

LONG-RANGE COMMITMENTS AND CONTINGENCIES OF THE U.S. GOVERNMENT  
AS OF DECEMBER 31, 1958

The attached statement covers the major financial commitments of the U.S. Government, except the public debt outstanding and those involving recurring costs for which funds are regularly appropriated by the Congress and are not yet obligated, such as aid to States for welfare programs and participation in employee-retirement systems. The statement is segregated into four categories, namely, (a) loans guaranteed and insured, etc., by Government agencies; (b) insurance in force; (c) obligations issued on credit of the United States; and (d) undisbursed commitments, etc.

The items appearing in this statement are quite different from the direct debt of the United States. They are programs of a long-range nature that may or may not commit the Government to expend funds at a future time. The extent to which the Government may be called upon to meet these commitments varies widely. The liability of the Government and the ultimate disbursements to be made are of a contingent nature and are dependent upon a variety of factors, including the nature of and value of the assets held as a reserve against the commitments, the trend of prices and employment, and other economic factors.

Caution should be exercised in any attempt to combine the amounts in the statement with the public debt outstanding, for that would involve not only duplication, but would be combining things which are quite dissimilar. As indicated by the enclosed statement, there are \$111.8 billion of public-debt securities held by Government and other agencies as part of the assets that would be available to meet future losses. The following examples illustrate the need for extreme caution in using data on the contingencies and other commitments of the U.S. Government.

(1) The Federal Deposit Insurance Corporation had insurance outstanding as of December 31, 1958, amounting to \$137.7 billion. The experience of the Federal Deposit Insurance Corporation has been most favorable. During the period this Corporation has been in existence, premiums and other income have substantially exceeded losses which has permitted the retirement of Treasury and Federal Reserve capital amounting to \$289.3 million (all repaid to Treasury) and the accumulation of \$2 billion reserve as of December 31, 1958. The Corporation's holdings of public-debt securities as of that date amounted to \$2.1 billion, which already appears in the public-debt total. Out of \$267.7 billion of assets in insured banks as of December 31, \$71 billion are in public-debt securities (also reflected in the public debt). The assets, both of insured banks and the Federal Deposit Insurance Corporation, as well as the continued income of the Corporation from assessments and other sources, stand between insured deposits and the Government's obligation to redeem them.

(2) The face value of life insurance policies issued to veterans and in force as of December 31, 1958, amounted to \$43.3 billion. This does not represent the Government's potential liabilities under these programs, since some of these policies will probably be permitted to lapse, and future premiums, interest, and the invested reserves amounting to \$6.8 billion of public-debt securities should cover the normal mortality risk.

(3) Under the Federal Reserve Act of 1913, as amended, Federal Reserve notes are obligations of the United States which, as of December 31, 1958, amounted to \$26.9 billion. The full faith and credit of the United States is behind the Federal Reserve currency. These notes are a first lien against the \$53.1 billion of assets of the issuing Federal Reserve banks, which includes \$26.3 billion of Government securities already included in the public debt. These notes are specifically secured by collateral deposited with the Federal Reserve agents, which, as of December 31, 1958, amounted to \$18.6 billion in Government securities and \$11.1 billion in gold certificates.

*Long-range commitments and contingencies of the U.S. Government as of Dec. 31, 1958*

[In millions of dollars]

Commitment or contingency and agency	Gross amount of commitment or contingency	Public debt securities held by Government and other agencies
<b>Loans guaranteed, insured, etc., by Government agencies:</b>		
Agriculture Department:		
Commodity Credit Corporation.....	1 803	-----
Farmers Home Administration: Farm tenant mortgage insurance fund.....	2 178	-----
Civil Aeronautics Board.....	5	-----
Commerce Department: Federal Maritime Board and Maritime Administration: Federal ship mortgage insurance revolving fund.....	2 149	-----
Development Loan Fund.....	5	-----
Export-Import Bank of Washington.....	8	-----
Housing and Home Finance Agency:		
Federal Housing Administration:		
Property improvement loans.....	3 320	74
Mortgage loans.....	24, 749	498
Office of the Administrator: Urban renewal fund.....	213	-----
Public Housing Administration:		
Local housing authority bonds and notes (commitment covered by annual contributions).....	2, 345	-----
Local housing authority temporary notes (guaranteed).....	891	-----
International Cooperation Administration: Industrial guarantees.....	4 341	-----
Small Business Administration.....	9	-----
Treasury Department:		
Reconstruction Finance Corporation liquidation fund.....	3	-----
Defense Production Act of 1950, as amended.....	16	-----
Federal Civil Defense Act of 1950, as amended.....	2	-----
U.S. Information Agency: Informational media guarantees.....	8	-----
Veterans' Administration.....	16, 933	-----
Defense Production Act of 1950, as amended.....	236	-----
Total loans guaranteed, insured, etc., by Government agencies.....	47, 214	572
<b>Insurance in force:</b>		
Agriculture Department: Federal Crop Insurance Corporation.....	9 244	-----
Commerce Department: Federal Maritime Board and Maritime Administration: War risk insurance revolving fund.....	62	-----
Export-Import Bank of Washington.....	3	-----
Federal Deposit Insurance Corporation.....	137, 698	2, 053
Held by insured commercial and mutual savings banks.....		71, 004
Federal Home Loan Bank Board: Federal Savings and Loan Insurance Corporation.....	44, 767	289
Held by insured institutions.....		3, 562
Veterans' Administration:		
National service life insurance.....	41, 738	5, 680
U.S. Government life insurance.....	1, 514	1, 120
Total insurance in force.....	226, 026	83, 708

See footnotes at end of table, p. 153.

*Long-range commitments and contingencies of the U.S. Government as of Dec. 31, 1958—Continued*

[In millions of dollars]

Commitment or contingency and agency	Gross amount of commitment or contingency	Public debt securities held by Government and other agencies
<b>Obligations issued on credit of the United States:</b>		
Postal savings certificates:		
U.S. Postal Savings System.....	7 1,134	1,132
Canal Zone Postal Savings System.....	76	6
Total postal savings certificates.....	1,140	1,138
Other obligations: Federal Reserve notes (face amount).....	26,934	26,347
<b>Undisbursed commitments, etc.:</b>		
To make future loans:		
Agriculture Department:		
Commodity Credit Corporation.....	2	
Disaster loans, etc., revolving fund.....	1	
Farmers Home Administration: Loan programs.....	12	
Rural Electrification Administration.....	763	
Development Loan Fund.....	246	
Export-Import Bank of Washington: Regular lending activities.....	1,556	
Housing and Home Finance Agency:		
Office of the Administrator:		
College housing loans.....	302	
Public facility loans.....	33	
Urban renewal fund.....	397	
Public Housing Administration.....	222	
Interior Department:		
Bureau of Commercial Fisheries: Fisheries loan fund.....	6	
Defense Minerals Exploration Administration: Defense Production Act of 1950, as amended.....	3	
International Cooperation Administration: Loans to foreign countries.....	4 1,207	
Small Business Administration.....	81	
Treasury Department:		
Reconstruction Finance Corporation liquidation fund.....	1	
Defense Production Act of 1950, as amended.....	1	
Veterans' Administration (veterans' direct loan program).....	47	
Total undisbursed commitments to make future loans.....	4,880	
To purchase mortgages:		
Agriculture Department: Farmers Home Administration: Farm tenant mortgage insurance fund.....	1	
Housing and Home Finance Agency: Federal National Mortgage Association:		
Secondary market operations.....	80	
Special assistance functions.....	1,498	
Total commitments to purchase mortgages.....	1,579	
To guarantee and insure loans:		
Agriculture Department: Farmers Home Administration: Farm tenant mortgage insurance fund.....	5	
Commerce Department: Federal Maritime Board and Maritime Administration: Federal ship mortgage insurance revolving fund.....	96	
Housing and Home Finance Agency: Federal Housing Administration.....	5,235	
U.S. Information Agency: Information media guarantees.....	1	
Defense Production Act of 1950, as amended.....	117	
Total commitments to guarantee and insure loans.....	5,454	
Unpaid subscriptions: International Bank for Reconstruction and Development.....	2,540	

<sup>1</sup> The Corporation finances part of its activities by issuing certificates of interest to private lending agencies. The outstanding amount of \$734,000,000, as of Dec. 31, 1958, is included in this figure.

<sup>2</sup> Includes accrued interest.

<sup>3</sup> Represents the administration's portion of insurance liability. The estimated amount of insurance in force and loan reports in process, as of Dec. 31, 1958, is \$1,307,000,000. Insurance on loans shall not exceed 10 percent of the total amount of such loans.

<sup>4</sup> The Export-Import Bank of Washington acts as agent in carrying out this program.

<sup>5</sup> Represents deferred participations.

<sup>6</sup> Represents estimated insurance coverage for the 1958 crop year.

<sup>7</sup> Excludes accrued interest.

<sup>8</sup> Includes public debt securities amounting to \$18,615,000,000 that have been deposited with the Federal Reserve agents as specific collateral.

NOTE.—The above figures are subject to the limitations and precautionary remarks, as explained in the note attached to this statement.

Mr. CURTIS. One other point. You did mention this, in looking at our fiscal picture, you said of course items are involved that do not include the fact that you have revenue coming in.

Secretary ANDERSON. Yes.

Mr. CURTIS. Of course revenue coming in to a certain degree is based upon our gross national product, and in 1953 it was \$411 billion, 1959 by now it has gotten up to around \$450 billion. Whether we maintain it this coming year, I do not know.

Secretary ANDERSON. The first quarter GNP was \$467 billion.

Mr. CURTIS. \$467 billion the first quarter. I was taking it off the last figure I had and interpolating.

Now, then, I do not want to get you into a political debate here because that is not the purpose. But just for the clarity of the record, it is the Congress that does the appropriating along with the Executive who signs the appropriations bill. That is what creates the Federal debt, is that not true?

Secretary ANDERSON. It creates the obligations and the obligations generate expenditures. The expenditures are measured against revenues and the difference is either a deficit or a surplus or a balance.

Mr. CURTIS. Of course that can be left in the arena of political argument as to who is responsible for creating these obligations. I personally, of course, take the position it has been the Democratic Party which has controlled the past two Congresses. But I do not want you to become involved in this present discussion of the problem which you have in trying to manage the Federal debt.

You mention in your statement some very interesting history and one thing you pointed out was that Carter Glass when he was Secretary of the Treasury had requested changes in the bond limitations. Congress only granted him one of those requests and not the other. What was the result of that? How did he handle it?

Secretary ANDERSON. During the period 1920-21 the Treasury put out 25 separate short-term issues on which we pay 5 percent or more in interest.

Now, thereafter, while we had a continued level of prosperity we retired about a third of the debt between there and 1929. This is a very good illustration of a period in which you had a level of growing activities, but with the decline in interest rates because the Government was a net contributor of funds through debt retirement. I do think it is rather significant that the Government was forced into as many as 25 issues in the period 1920-21 at an interest rate of 5 or more percent because again we crowded so much into this area.

Mr. CURTIS. In other words, it was an uneconomic operation. In retrospect we now look back and see had he been granted the authority he probably could have managed it better?

Secretary ANDERSON. I am sure Mr. Glass would have done differently if he could.

Mr. CURTIS. Because this committee has the job of carrying this measure to the floor and explaining it to our colleagues the best we can, we must understand it ourselves. I am anxious to present to you some of the arguments that have been going on recently on the floor of the House about the Federal debt management.

There are those who say we are paying entirely too much money in interest on the Federal debt plus the fact we are also increasing the interest rate.

And their proposal has been that the Federal Reserve start pegging the market again. I have taken the floor on occasions when I was there to point out that in 1951 the Treasury and the Federal Reserve reached an accord whereby the Federal Reserve no longer followed that policy and that was the result of, I thought at any rate, some pretty good reason and to prevent the economic damage that was being done otherwise.

I remember Senator Douglas made quite a speech on the floor of the Senate. One of the points he made and this is what I direct your attention to, was that it is true that although the cost of Federal Government may be another \$300 million or \$400 million in interest by having the interest rate go up, the cost of pegging the market before had been several billions of dollars as a result of inflation on the products and services that the Federal Government bought.

In other words, the Senator at that time at any rate was pointing out that the Federal Government actually saved money through this process of unpegging the Government bonds.

Now, is that essentially the theory that you have been trying to present here or are you in accord with that point of view?

Secretary ANDERSON. Congressman Curtis, on page 28 of the supplemental statement which I filed with the committee this morning, there is a discussion of this possibility. I think for the purposes of the statement here this afternoon, it points out that there was a very serious study made of the activities of the Government between during the war and between World War II and 1951. It seems to me, then, that on a bipartisan basis, the conclusion was reached that this was inflationary, that it was without the scope of a responsible central bank, because once market yields rise to a predetermined level the Federal Reserve System during this period could operate in only one direction and that was the direction of creating additional bank reserves through the purchases of securities and whatever amounts that the market holders of these securities wanted to sell.

If we propose to have a flexible monetary system then this takes away that degree of flexibility because it does operate in one way. I think, also, that if we must take into account the fact that in a period of high levels of business activity, such as this, if by the creation of additional bank reserves through the purchase of these securities we generate additional inflationary pressures, which occurred then and which I think would occur again, then those people who have money that they want to lend would be willing to lend it only at rates high enough that they could be compensated for the erosion of their dollar. The people who wanted to borrow would be willing to pay higher rates of interest because they would believe that they were borrowing a currency which would erode in value and allow them to pay an obligation with cheaper dollars.

Consequently, if this occurred, the pressure on interest rates would intensify and if it did intensify you continue to try to maintain the peg, the Federal Reserve could do only one thing and that is to buy more and more Governments from the markets and as they bought more they would create more bank reserves and the process would continue.

Mr. CURTIS. Is it for this same reason as I visualize it, that you feel that a deficit occurring in this prosperous fiscal year, it seems to me, 1960, is so highly inflationary?

Secretary ANDERSON. Yes. You see, I think we ought to take a lesson from past experience in this. However, the deficit is generated, you generate the deficit during the period of the recession. Then you have to raise the money to pay off the deficit as happened this time, largely after the termination of the cycle.

Now, if you could raise the money to pay off the deficit before it was created, or while it was being created, you could contribute to monetization by selling to commercial banks, short-term debt. So that one of the great problems of deficit financing is that all too frequently the deficit has to be paid at the time when the cycle has turned and you are in high levels of business activity.

Mr. CURTIS. One final question, Mr. Secretary.

Of course, this has been a popular saying over a period of years, that it did not make too much difference about how high the Federal debt was because we owed it to ourselves. There are many reasons, of course, economic reasons, why I do not think that is a very good attitude. But beyond that, since World War II has not the United States moved into a position where we are somewhat the banker of the world and therefore do not we have added responsibility in how we look upon our Federal debt and how we manage it?

Secretary ANDERSON. Congressman Curtis, this is an area in which, Mr. Chairman, with your permission, I should like to make limited comment.

I think one has to recognize that you must take the balance of trade, which is generated by normal commercial transactions and which has consistently run in favor of the United States, and you have to add to it the total of all other activities on the part of our country which went into efforts to rebuild the devastated countries of Europe after the war, the increasing volume of what we call invisible payments, which is tourists going abroad, the fact that foreign investments are being made by citizens of the United States at the rate of about \$3 billion per year, the fact that in order to preserve our security and that of other countries we have maintained forces overseas and continue to maintain them, and must continue to maintain them. The fact that we have engaged in many other programs, has resulted in a net accumulation of dollars by foreigners as a result of our total complex of international transactions.

We have come to a point in history when a large number of our neighbors, and we are grateful for it, are not weak and troubled countries, they are sound, highly industrialized countries of Western Europe, they are countries who are actively competing for their historical position in the trade of the world. While there are millions of people in other less-developed, less-privileged countries, who are still looking to us and to other nations of the world for economic aid, that we must reorient our thinking with the knowledge that there are very substantial amounts of dollar balances and outstanding short-term instruments of indebtedness which are held by relatively strong foreign countries and by their citizens.

While we, in turn, hold larger amounts of investments and evidences of indebtedness than they hold, our holdings are mainly long

term. And so we have come to be somewhat in the position of a world banker in the sense that they hold our short-term obligations and we hold longer term investments.

I think, also, that we should remember that we believe that this country became great and strong because of a competitive enterprise system. We believe it became great and strong because of the profit incentive. And we have said to other countries around the world that if you want to raise your standards of living you must save your own money, you must compete for the world's capital, you must assure everybody that it is safe, and safe not only from confiscation but safe from erosion. You must have monetary and fiscal discipline. And I think for us to waver in following the same exacting standards that we have asked of others would weaken the position of financial leadership in the world.

Mr. CURTIS. I thank the gentleman for a splendid answer, and I want to say, which I did not say in the beginning and should have, I thought your presentation and your answers to questions have just been tops. My thinking happens to coincide with most of your thinking on this.

Secretary ANDERSON. Thank you, sir.

Mr. CURTIS. I am very glad to have someone express it better than I can do it.

Secretary ANDERSON. Thank you, sir.

Mr. KING. Mr. Ikard.

Mr. IKARD. Mr. Secretary, I know it is getting late here and I will not prolong this.

I do have two or three questions in my mind, though, that I would like to ask.

One is that we have heard it suggested that, assuming that the legislation that you propose were adopted, that it should be done for a term of years rather than permanently, the thinking being that if it is done on a permanent basis it will be a final movement on the part of Congress going out of this area, the early history of which you very ably outlined in your prepared statement. If you would, please, I would like to have your comments on that, on whether this should be or could be for a term of years, much as we handled the debt limit and as you pointed out has been back and forward periodically and serves primarily the purpose of bringing to focus the fact of what the situation is with respect to the debt. Would it be worth considering if this measure would be adopted to have it for a term of years where the debt management and the interest and all the collateral problems would periodically come up before the Congress and, therefore, in turn be thrown open to public view?

Secretary ANDERSON. Congressman Ikard, I share with you the feeling that this is an area of such importance and magnitude that it always ought to be of great concern, and I am sure it has been and will continue to be of this Congress.

I can appreciate the suggestion that if the ceiling were lifted for a period of years that at the time that there would be a restoration; it would call for a reinvestigation by the Congress of its appropriateness and perhaps an examination of what had been done during the period in which the ceiling did not exist.

To me the really fundamental thing is that what we are trying to do is to finance our debt as cheaply as we can consistent with the basic objectives that I outlined in the opening pages of my statement and which I will not repeat. I am quite sure that any Secretary would want to do it as cheaply as he could. And that he would welcome any review of the Congress from time to time as to whether or not other or more appropriate actions might be taken. The thing that bothers me in putting a period of years with reference to the ceiling on the interest rate as compared to the debt ceiling is this: The debt is actually going to be the difference between what we take in and what we spend. It is going to be affected by the rate at which we accumulate revenues from whatever source.

The review does not make the debt less nor does it make it more. It simply provides a mechanism by which we are required to look.

On the other hand, if we pick out a date and say "during from now until this period we are going to remove the ceiling" it would be very difficult to do so without trying to make some ancillary judgment as to what is going to be the kind of an economic condition which would prevail between now and that time. Are we, in fact, forecasting that there will be such an accumulation of events, whether it be recession or otherwise, that a new ceiling would then be appropriate? Are we attempting to forecast the way in which any economy as complex and as diverse as ours would move over a period of years?

I find it, for example, very difficult indeed to sit down in December of every year and try to estimate what the revenues of the Government are going to be 10 months hence. And when I do it I have a full awareness that I do not have the competence and no one else does to do it with accuracy. We do it. It is a matter of judgment to the best of our ability. But we do it because in the process of budgeting you have to have those kinds of guidelines.

So my reluctance to believe that you would get the same dividend from a review stems from what might be taken as forecasting of predictions in the way in which the economy would move over that period of time.

Mr. IKARD. And it seems to me a very fine statement that there might be conceivably some uncertainty, particularly during the periods when you are coming up to the time. The only way that it would appear that that could be overcome would be the fact that people generally would become conditioned to it much as they are on other items that come to Congress and would assume that the policy would continue.

Secretary ANDERSON. Yes, sir; I think hope that they would come.

Mr. IKARD. Yes. One more question about this, skipping over to another area. I was interested in the question the chairman asked this morning about the auctioning of long-term securities and I heard Mr. Baird's answer in which he said, I believe, or the net effect of his answer was that if you auctioned long-term issues that it necessarily would mean that the professional, so to speak, would be the one that would participate in that market and, for example, an Elks lodge that would want some bonds would not be accustomed and acquainted with that type of operation to the extent that they would participate in it.

Now, is there any other reason—if I may just direct it to Mr. Baird—other than that fact that it would be a strange procedure to where the ordinary purchaser would not participate?

Mr. BAIRD. No, Congressman, I do not think there is. We have been quite willing to use the mechanism just as far as it seemed to be useful. I would not say that in years to come Secretaries of the Treasury might find they can extend it a little further. But once you leave the short-term area which is in the 1- or 2-year area—

Mr. IKARD. Yes, sir, I understand.

Mr. BAIRD. That is where your bond dealers, your banking institutions and your corporation treasurers who invest temporary funds, who are real professionals in the finance market operate and they can learn and get used to this type of a mechanism. They are in the market constantly. They watch it. They are students of it. On the other hand, we have very spasmodic buyers, when you reach out into the long investment area.

Mr. IKARD. As one who knows practically nothing about it, this auction procedure appeals to me. That is the reason I asked the question, Mr. Baird.

Secretary ANDERSON. I think this elaboration might be worthwhile, that even in the normal marketing conditions, small banking institutions very frequently do not buy for themselves but they ask their correspondent banks to buy.

Mr. BAIRD. May I just say this, Congressman? It appeals very much to those of us who are charged with responsibilities of debt management. It is not a pleasant job to have to price an issue. It is much easier for us to say, "Let us put it out and let the market price it."

Mr. IKARD. I would think that would be the case. That is the reason I asked the question. I wondered if there was any other reason other than the fact that it was just one people were not accustomed to and that the average purchaser did not feel qualified to move into that market.

Mr. BAIRD. That is correct.

Mr. IKARD. One more question. It is my understanding from what facts I have been able to get that this is more of an economic question, that during the last 6 years, 5 or 6 years, money supply generally has increased something in the order of 11.8 percent while the gross national product has increased something in the order of 26. My figures may not be exactly right. Maybe Mr. Walker could answer that. Should not the money supply nearer track the growth of the general economy?

Secretary ANDERSON. Congressman, I do not think that you can consider the rate of monetary growth as an isolated factor but that you have to link it with the velocity because important though it is with respect to the growth of the economy, monetary velocity and monetary growth very nearly have to be considered together.

During relatively short periods of time, the velocity of money or the rate at which it turns over can exert significant influences and the money supply may grow relatively slowly but if the velocity increases then total spending expands and I think that the two ought to be considered together. I am sure that when Chairman Martin testifies that he can give you statistics on this.

Mr. IKARD. I better direct that series of questions along that line I had in mind to Mr. Martin and I will save it until that time.

Thank you very much.

Thank you, Mr. Chairman. That is all, Mr. Chairman.

Mr. KING. Are there further questions?

Mr. ALGER. Mr. Secretary, I have endeavored to listen carefully to the other questions and I shall do my best to stick to new fields or things that are troubling me beyond what has been mentioned thus far and also relating to your written testimony which you read earlier to us.

First of all, I recall on page 30 you discussed this matter. The fact that the Treasury already can offer the bonds, can offer bonds under existing law under par so that the net effect is creating a different rate if Congress chooses not to grant the increase that is now being asked.

I commend you for coming to us this way because you said you prefer the direct approach. My question, then, is this:

Is not the position that you state there the result of what you are forced to do, either at this time or if Congress fails to take this responsible action?

Secretary ANDERSON. No; I am not trying to say here that this is a choice of alternatives. While the Treasury has the right to issue securities at a discount, this is a monetary matter of such significance and importance that we would not want to increase the rate without bringing it and securing the permission of Congress. I would not feel that it is appropriate for me to substitute my judgment for the judgment of the Congress.

And neither did I consider it appropriate for me to try to evade the 4 $\frac{1}{4}$ -percent limitation by using it as a coupon rate and selling at additional discount.

Mr. ALGER. Thank you, sir. I appreciate that attitude, Mr. Secretary. That raises another interesting question, obviously, but I will move on.

You mentioned, too, the tax-exempt feature of municipal-type bonds, for example, which are competing with Federal bonds in the marketplace and is very definitely affecting refinancing by the Government. Can you go any further than what you said in your statement, to give us an idea of how much this is hurting Federal bonds competitively? And I think this is partially an answer to earlier statements made when it was alleged that the Government bonds are riskless and therefore might deserve a lower rate of interest, that many people will invest in the municipal bonds in preference regardless of the risk feature. Can you add anything? How tough is the competition now from tax-exempt bonds?

Secretary ANDERSON. I think you cannot isolate one form of competition and say, "Let us measure the effect of the competition of tax-free instruments, which are issued by the municipalities or other political subdivisions." What you can do is to say that you have a substantial number of factors which accumulate. One, you have the capacity on the part of municipalities and others to issue tax-free securities, and these are particularly attractive to people in high-income brackets, because the tax-free quality makes a great deal of difference to them. Secondly, we have a very large number of Government securities issued by agencies which are aided although not guaranteed by the United States.

Then we have a large number of issues of the character of local housing authority bonds which are in effect guaranteed by the United States and which are tax exempt.

You have, as I pointed out earlier the fact that for many years trust funds grew at the rate of \$2½ billion more than they were spending and you had at least a place to put \$2½ billion special issues in the trust funds.

As I pointed out in the statement, for a number of years by reason of statute or otherwise certain kinds of institutions and certain kinds of funds held a large proportion of their portfolio in Government securities. A good example, in the Congressman's State is the funds held by the University of Texas, which they are now able to invest in different kinds of securities that for many years were only in governments.

What you have is a diminishing group of buyers for these various reasons at a time when you are financing very large and expanding debts. This is the kind of problem that we have in this whole competition.

Now, it would be difficult to pick out one segment and say that this is the most important, but I think if you would look on page 9 of the statement you get some idea here of the kind of competition. When you look at individuals, because it is in the hands of individuals, particularly those with high income tax brackets, that the municipals starts to compete.

Mr. ALGER. I am really asking this because we are all aware that later this year we will have tax hearings and will study the entire gamut of taxes. This is a delicate subject, because the municipality would be very uneasy if they thought anything was going to happen to their tax exempt status, but we are talking about a national matter, and I thought possibly you might suggest that we take this up for study along with other tax matters in November.

If I may I will move on here to something else.

On pages 36 and 37, which ends on 38, as far as I am concerned, I think this is the meat of the coconut and will become debatable in Congress, if I understood what you said, you pointed out that the \$13 billion deficit of last year spending was a major factor in the pressure, as I understand, for the increase in interest rates. This was the result of big Federal spending and this will result in inflationary pressure and all of this will be harmful to the people of modest means, and I think I am more or less quoting you, is that correct?

Secretary ANDERSON. I think so.

Mr. ALGER. Secondly, on page 38, I think the language goes, you pointed out that the artificial interest rate limitations actually would foster inflation, and again this inflation would hurt most of all those of modest means—am I paraphrasing this correctly? Therefore, we want to protect those of modest means from asking for these artificial interest rate limitations, is that correct, Mr. Secretary?

Secretary ANDERSON. I think it is correct. All the inflationary problems fall with greater impact on people who are unable to protect themselves.

I think you go down to this: Whether as a nation, whether as a people, whether those of us who are charged with monetary management by the Congress can sit idly by and allow a situation to continue

which can lead to the debasement and erosion of our currency. This is the sort of thing that we would seek to avoid.

Mr. ALGER. I think we all see that, and I think we are all agreed, Mr. Secretary.

The two things I got out of this, and I say, commentators and others are going to go over your statement with a fine-tooth comb, I think we here are aware of the fact that on these two pages you made the statement this \$13 billion deficit has a big part to do in the inflationary impact hurting those of modest means, spending beyond our income, and, secondly, that artificial interest rate limitations will have another inflationary impact.

Secretary ANDERSON. Congressman, I would very strongly commend a study along this line. If you look at the expansion which is taking place over 6- or 7- or an 8-year period, in corporate bonds and notes, in the expansion of State and local government securities, and in bank loans, you will find that there has been in the past year modest increases in a good many instances, smaller increases than took place in the past.

This is also true of consumer credit except in very recent months in which it has gone up very rapidly.

On the other hand, mortgage debt has increased very substantially. Most of this is housing, but the one big thing that has gone up is a rise of almost \$9 billion in publicly held Federal securities. This is in sharp contrast to the moderate increases that took place in 1954 and 1955 and 1956 and the decreases which took place in 2 years, 1956 and 1957.

Mr. ALGER. I believe you pointed out simultaneously that even consumer credit at that point in your statement had not gone up in this same duration.

Secretary ANDERSON. Not except until recently. Now, in order that you would understand the difference between this \$9 billion in publicly held securities and the \$12 to \$13 billion deficit we are talking about, this is simply because we started the year with a relatively high cash position and used up the cash. So that we come out with this net addition to Government securities.

Now, if you contrast a period like this when you have a high level of business activities and a rise in net additions to Government securities with a position like that in the 1920's when you had increasing levels of activity and debt reduction, in this period the interest rate goes up sharply, in that period the interest rate went down. In both periods you had increased growth.

Mr. ALGER. Mr. Secretary, let me quickly go to another field, if I may. I think you deserve a compliment on page 39. No one has mentioned this although I am sure other members have caught this. You said:

Inflationary expectations generate higher rates primarily because borrowers are anxious to obtain funds that they expect to repay in cheaper dollars.

In times past we know and expected this applied also to governments. So your position here is a statesmanlike position, because actually when you deflate the currency you can pay back the debt a little easier, can you not, with cheaper dollars?

Secretary ANDERSON. The thing I think here that we have to remember is that inflation tends to generate recessions, if there is any

great enemy to continued growth in our country, it is recession. This is the thing I think that compels us to try to live with fiscal responsibility.

Mr. ALGER. One other question, if I may, Mr. Secretary.

You mentioned on pages 42 and 43 the fact that you are operating on something like half of the cash balances we used to have. When the budget was half of its present rate you had as much of a cash balance. Then at the bottom of the page and top of the next two pages you pointed out that you felt there were times when somewhat larger cash balances would have given the Treasury much needed flexibility in timing its borrower operations.

From experience, do you feel we actually handicapped ourselves to any degree of losing money because of inflexibility in your hands in this matter of short cash balances?

Secretary ANDERSON. I think in 1957 there were occasions when if we had had larger balances we would have been willing to price more closely and in which the net cost would have been less.

Mr. ALGER. Is this a good enough point for me to ask you, Would you be willing to deliver us additional figures to put in the record to support this point that you ought to have more cash in order to refinance?

Secretary ANDERSON. Yes, sir; I would be delighted to.

Mr. ALGER. Mr. Chairman, I ask unanimous consent that the Secretary be permitted to put in these additional figures to show where if in the past he had additional cash in reserve he could have refinanced at a little better rate to the Government.

The CHAIRMAN. Certainly. Without objection that material will be included at this point.

(The information follows:)

Larger cash balances under a more adequate debt limit would provide considerably more flexibility to the Treasury in its debt management functions. With larger balances the Treasury could ride out periods of market apathy for new issues rather than being forced into the market with a new issue because of a declining cash balance.

More flexibility in management of our cash balance permitted the Treasury in May of this year to sell \$2 billion of 11-month bills in advance of the maturity date of \$2.7 billion of special bills. The flexibility available under the \$288 billion debt ceiling made it possible to carry an increase in the debt of \$2 billion over the period from May 11 to May 15.

The lack of such leeway has on occasions hampered the Treasury in several ways. For example, in the September 1957 cash financing the payment date on a small bond issue had to be delayed until October 1 because there wasn't room for the issue under the debt ceiling until after the attrition had been paid on the October 1 maturities.

On other occasions the Treasury has had to resort to the smaller adjustments possible only through the increase in the regular weekly bill auctions. This was especially true in the period from December 1957 through January 1958.

There have been other occasions where Government agency financing has been in part determined by the problems of a low cash balance and of the debt ceiling. This was part of the reason for the issuance of the Commodity Credit Corporation certificate of interest in a pool of loans back in 1953 and in 1954. The timing of the issuance of the various Federal National Mortgage Association (management and liquidation functions) securities has been affected by the debt limit problem, these issues might have been put out at different times if the Treasury cash position and the debt limit had not been a problem at the time.

But in broader terms, a reasonable margin for contingencies and provision for flexibility in financings is important in the public interest. If the Treasury should go into the market to refund an outstanding issue it must take into consideration the fact that in the normal course of events certain of these securities

will be turned in for cash. Some holders will decide that the terms of the new securities do not meet their particular investment requirements and they, too, may take payment for their maturing securities in cash. When the debt margin is very narrow and the cash balance is low, the Treasury has to estimate carefully what this attrition will be so as not to be in the position where the Treasury could not make payment for all maturing obligations presented. This might mean that the yield on the new securities would have to be more generous than would otherwise be required. If the attrition proved to be greater than anticipated the Treasury would have to go back into the market almost immediately to restore working balances even before the previous issues had been fully distributed. This threat of a new issue hanging over the market creates uncertainty in the minds of investors and when employed would have a tendency to keep the market for U.S. Government securities in a weaker position than otherwise. It also unreasonably handicaps the normal financing operations of States, municipalities, and private businesses.

If, on the other hand, a cash offering is included in the refunding program and the market were to improve between the date of announcement of new U.S. Government financing and the date the books close, the attribution might be substantially less than anticipated. In such an event the Treasury must calculate that it runs the risk of inadvertently exceeding the limit for a short period.

Simple prudence in the management of our fiscal affairs also calls for some additional leeway in the management of cash balances related to opportunities to borrow funds when market rates are favorable and lendable funds are available. There is also the need for leeway in the event of sudden emergencies when Congress might not be in session. However, even with these considerations the Treasury would want to maintain its cash balance at a figure no higher than is consistent with the efficient and orderly management of its affairs.

Secretary ANDERSON. I would only want to say this to the Congressman. This is the sort of thing that you cannot show by arithmetic figures always. It is a matter of judgment.

Mr. ALGER. I do not only realize this, but I know everybody in Congress, men of good will, are interested in trying to learn from our experience. We respect your judgment. We can get a little guidance from our own history; we ought to take advantage of it.

Thank you.

The CHAIRMAN. Mr. Simpson will inquire.

Mr. SIMPSON. Mr. Chairman, I apologize for not finding it possible to stay here the balance of the day.

Secretary ANDERSON. I understand, sir.

Mr. SIMPSON. I know it was my loss.

Mr. Secretary, if you could write the ticket as to the persons who should hold the biggest portion of your debt, in what area would you place that debt?

Secretary ANDERSON. I would place it in the hands of long-term savers.

Mr. SIMPSON. Long-term savers?

Secretary ANDERSON. Yes.

Mr. SIMPSON. Of the nature of series E and H?

Secretary ANDERSON. I would put it in E- and H-bonds. You would put it in savings institutions.

Mr. SIMPSON. My next question is the obvious. Why do not we pay them the highest interest rate? Why do we not make it more attractive for them to buy?

Secretary ANDERSON. You mean sell them at a different rate than to other people?

Mr. SIMPSON. If I understand the plan we envisage the time of paying higher than  $4\frac{1}{4}$  for a long term. Why not offer the individual a long term security to pay  $4\frac{1}{4}$  or more.

Secretary ANDERSON. The individual can buy marketables like anyone else. The individuals can buy E-bonds and of course has a limit on amount of E-bonds he can buy. Because this is a bond that carries special characteristics such as guaranteed redemption values at any time.

Mr. SIMPSON. Why not extend those characteristics and make it more attractive in order to have those people we prefer to have the debt buy more Government securities?

Secretary ANDERSON. I think you would run into a number of problems. One of them would be the problem of discrimination and in tailoring the obligations to the various institutions.

Then I think also we must remember that this might be unfair competition with other types of savings institutions. What we want to do is to finance our debt in such a way that other people who want to borrow, cities, corporations, and utilities and everybody else—

Mr. SIMPSON. Could we pay the same to the persons buying series E and H as we offer to pay to people buying the long term Government securities? It would not seem to me to be unfair competition.

Secretary ANDERSON. The difference in the E- and H-bonds and the other marketables is that the E- and H-bond is a demand obligation and the others are term obligations.

Mr. SIMPSON. Perhaps that is a good and sufficient answer if the necessity ever arose to permit demand on long-term securities. They cannot demand redemption with respect to long terms and ordinary securities in advance of maturity?

Secretary ANDERSON. No, they cannot do it.

The CHAIRMAN. Mr. Byrnes will inquire, Mr. Secretary.

Mr. BYRNES. Mr. Secretary, I apologize for questioning you at this late hour.

Secretary ANDERSON. Perfectly all right, sir.

Mr. BYRNES. I do, however, want to compliment you on the statement that you made here and the detail with which you went into the problem. I recognize that in the beginning you rather apologized for the length, but as one member of the committee, let me express my appreciation that you went to the length you did in discussing some of these problems, particularly in view of the debate that seems to be taking place in some quarters over the issue of interest and monetary policy, and more particularly by some of the self-appointed monetary experts in the other body. I think it was well that you took some time to elaborate on the matter.

There is one aspect that I would like to inquire a little about. I think the point has been raised that your short terms carry a lower interest rate and therefore a lower cost as far as carrying the debt is concerned. The contention is made that that is the case and that your policy now in suggesting that you should be able to move into long term with a higher interest rate will result therefore in a higher cost in carrying the debt.

For instance, the statement made on Monday—"I see no reason why short-term bonds bearing low rates of interest should be converted to long-term bonds bearing higher rates of interest"—the argument seems to be to focus at least to some extent on that aspect. I wondered if you would comment on that part of the picture?

Secretary ANDERSON. Yes. We have recently paid as high as 4.05 percent for 1-year money. As I pointed out earlier in August of 1957 we issued a 1-year, 4-year, and 12-year bond, I mean securities, all of which bore the same rate of interest. Now, if you look at page 29 of the statement you see the market yields of Governments through a 35-year period to maturity. What it really says is that in the longer term you have less pressure than you have in the shorter terms. Now, if your concern gets to be primarily about the cost of debt servicing, the thing that really has the effect on the increased cost of debt servicing is how fast does this short-term rate go up. A year ago we were able to borrow 1-year money for under 1 percent. Now we pay over four. Today we have \$76 billion due in a year or less. If we just sit still and do nothing and allow everything to run out the string by December of 1960, this will be practically \$100 billion and you have to add to it the seasonal borrowing and this will put it over \$100 billion, as I recall, about \$104 billion. If you are paying 4.05 for money today and if the rate of other borrowers, the demand from other borrowers keeps up and you put into the market \$24 to \$28 billion more of the same kind of money then you can see what kind of a pressure you will exert against that interest rate. I think that you were probably not here at the time that one of the members of the committee asked me what happened when Secretary Glass in 1919 asked that there be no artificial ceiling and pointed out that you could very well run into great difficulty. The Congress took all of the limitation off for 5 years or less but they left the 5-year and over limitation. So what happened was that in 1920 and 1921 the Treasury put out 25 issues of short-term securities and paid more than 5 percent on every one of them, that is, 5 percent or more on every one of them.

Mr. BYRNES. In other words, what you are saying, really is that these people that are making this argument are starting on a false premise that your short terms carry a lower rate of interest and will continue to do so?

Secretary ANDERSON. In 1920 and 1921 the short-term rate was higher than the long-term rate.

Mr. BYRNES. In other words, you are saying that these people are starting off on a false assumption that short rate bonds are cheaper to the Government than the long term?

Secretary ANDERSON. That is correct. I do not think that we ought to allow ourselves to believe that the only consequence of this kind of procedure is that you may more quickly pay more to finance the servicing of the debt. Of equal importance or perhaps greater long-range importance is the fact that this is a process which does not stop—because you are not going to stop the clock or the calendar and time will crowd more and more into the short-term area and the shorter you make it the nearer you come to money and the more likely you are to put it in the bank and therefore the more likely the inflation and so you get not only the increased quick-interest cost but you get the inflationary pressures as well.

Mr. BYRNES. I was directing my attention to the arguments that were made within the last day or two in the other body, that they can see no reason why short-term bonds bearing low rates of interest should be exchanged for long-term financing based on the assumption that the interest rates at the present time are substantially less on

short-term obligations than on long-term obligations. I wanted to at least get the facts clear as far as that particular picture was concerned.

Secretary ANDERSON. I would like also to direct your attention, if I may, to page 12 of this supplementary statement, because I think it gives a comprehensive idea of how you distribute the interest on the public debt and of course this again figures into both the revenues and to the impact which it has in the national financial community.

Mr. BYRNES. I would like, if I could, Mr. Secretary, to spend a minute inquiring about the deficit picture, because I think you covered the matter of interest quite thoroughly, although I imagine there will be a lot more discussion about it before this matter has been concluded and finally settled. I understand the debt on June 30, 1959, will be about \$285 billion.

Secretary ANDERSON. That is correct.

Mr. BYRNES. That you expect it will be about \$285 billion on June 30, 1960.

Secretary ANDERSON. Yes.

Mr. BYRNES. Assuming the budgetary picture as outlined by the President, that is what you can anticipate?

Secretary ANDERSON. Yes.

Mr. BYRNES. That within that period you will have a \$7 billion fluctuation, a need to borrow \$7 billion in excess of the \$285 billion and you will need about a \$3 billion flexibility fund or leeway.

Secretary ANDERSON. If you have an operating balance of \$3½ billion and if you have an allowance for contingencies of \$3 billion, in a country of our size it does not seem unreasonable, on December 15, 1959, you will have a total public debt limitation of \$296.5 billion, this is above the request, but we can get along with it, because it is temporary and because we have got these other cushions of the \$3 billion flexibility and \$3½ billion working balance.

Mr. BYRNES. Right. Now, what do you envisage the picture to be as far as your needs during the period from June 30, 1960, to July 1, 1961?

Secretary ANDERSON. It is too early for us to make the calculation.

Mr. BYRNES. Are you not going to be in almost as bad a situation? Do you see anything in the situation which would lead you to believe you are not going to need some place between the \$7 billion and \$10 billion borrowing authority to meet seasonal needs the following year?

Secretary ANDERSON. There will certainly be a seasonal requirement, regardless of how we come out on expenditures.

Mr. BYRNES. Which is what I am getting to, what you are asking for now is really going to take care of the situation only to June 30, 1960?

Secretary ANDERSON. That is correct.

Mr. BYRNES. But you are going to be back here, just as sure as you have been sitting here all day, a year from now suggesting that the permanent limits need not be changed but that you have got to have an extension of temporary authority.

Secretary ANDERSON. That is correct.

Mr. BYRNES. Why, then, should we not explore in a little greater detail the point which you make in your statement, where you suggest that a valid case could be made for a provision that would, for a

longer period of time, control the debt at fiscal year end and yet provide for seasonal requirements within the year?

Secretary ANDERSON. This could be accomplished if the Congress saw fit in its judgment to establish what I would refer to as a permanent debt limit and then provide that within any yearly period you could go above that, on the seasonal basis, to enough billions of dollars, provided it was subsequently repaid. You could operate on it. If you got into a period of deficits as we had in the previous years, where you could not pay it down, then even with that limitation you would have to come back to the Congress and ask for additional.

Mr. BYRNES. You still have to come back so you would have—

Secretary ANDERSON. Surely.

Mr. BYRNES. The ceiling acting as somewhat of restraining influence if it has a restraining influence, I do not know.

Secretary ANDERSON. What you are asking is a high permanent ceiling that we would judge to take care of the yearend debt and then a latitude of going over that ceiling so many billions of dollars in order to take care of seasonal needs, if this would work?

Mr. BYRNES. The same thing you are suggesting except that instead of calling it a temporary ceiling we would call it a seasonal ceiling with the permanent ceiling being the ceiling that shall exist at the fiscal year's end.

Secretary ANDERSON. This would work so long as you did not run into the debt ceiling through deficits.

The CHAIRMAN. Would the gentleman yield to me?

Mr. BYRNES. Glad to.

The CHAIRMAN. Mr. Secretary, I though in terms for a long time of a debt ceiling applying at a specific time without regard to the seasonal variation or anything else, just say that the debt as of the 30th day of June in a year shall not be in excess of such and such amount, whatever it is. Regardless, almost invariably you have a lower debt on the 30th of June, do you not, than probably any other time in the course of the year.

Secretary ANDERSON. It is the low point because it is the end of your high-tax-collection dates.

Mr. BYRNES. The same thing, except I would add, Mr. Chairman, a little restraint on some of their seasonal operations; in other words, let us say as they saw December approaching that they might get their house in a little better order to avoid, if possible, some additional borrowing.

Secretary ANDERSON. Our house gets in order pretty much in proportion to the way we get revenues and the way we accumulate bills.

Mr. BYRNES. I was thinking of this only in terms of the fact that for some time we are going to have to face the need for temporary authority. Let us change the name, Mr. Chairman, and call it a seasonal authority and make the seasonal authority permanent when we know very well that you are going to be back here next year asking for continuation of the temporary authority. You are going to be here the next year and the next year and the next year on this problem unless there are some radical changes made in the spending policies of the Government. Although I do agree that we should review this matter periodically I am not so sure that there would not be a more satisfactory device for providing the congressional review.

There is one question that is raised every time this matter of debt ceiling comes to the floor. It was urged during the debate last year that if the Congress refuses to raise the ceiling that will force the executive branch to reduce expenditures and we will adjust our financial picture; instead of having increased borrowing, we will have reduced expenditures because we just will not give you the authority to borrow.

I know that is just a lot of wishful thinking, but I would like to have your comment on that line of reasoning.

Secretary ANDERSON. The first thing that would occur is that you would be forced to discontinue the sale of Treasury bills. Of course when you discontinue the sale of Treasury bills, if your expenditures ran above your cash you would simply default on the payment and as I expressed earlier I think during your absence, to me this would be a great catastrophe. I would hate to see the date that somebody would put a bill to the window of the Treasury and we say, "We do not have sufficient funds." If this were brought about because we could not borrow it would be almost as deleterious as for any other reason. It would be a very unfortunate occurrence. There is not a week that we do not go to the market, every Monday morning in an auction in order to meet the cash requirements of the Government. And if we got above this debt ceiling to do it, we simply would not go; we could not. And the result would be a default in payments.

Mr. BYRNES. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Betts will inquire, Mr. Secretary.

Mr. BETTS. To what extent, Mr. Secretary, does legislation which might be passed at this session enter into the picture? I suppose when you fix this temporary debt-limit request you assume the debt will reach a limit in December, that is based on certain obligations you are going to have to meet. How much of that obligation will arise from legislation we may pass in this session of Congress? Is that a fair question?

Secretary ANDERSON. I would not be able to separate out the particular items. I will say this as a general matter, that these calculations are based upon the hypothesis that we will not generate in that year expenditures above our receipts.

Now, if we should create an obligation which did that then we would have to readjust our figures. If, on the other hand, you created an obligation which did not have any expenditure impact until sometime in the future, then it would be taken into account in the future in computing the cash needs of the Treasury. But it is based upon the hypothesis that we would have revenues to cover our expenditures.

Mr. BETTS. The reason I asked that, I can see possibly some uncertainty under the present picture.

Secretary ANDERSON. Yes.

Mr. BETTS. Your \$296.5 billion limit is based on your request for gasoline tax, whereas if it is not passed we should shift maybe the excess tax and highway fund, and you are going to have a deficit. Then where is your \$296.5 billion?

Secretary ANDERSON. This, of course, is one of the reasons that we are anxious to have the \$3 billion leeway, what we call the operating balance.

Mr. BETTS. I see.

Secretary ANDERSON. Is because we may run in those periods. If it were not for some latitude which we have in the cash balances we obviously could not have a \$296.5 billion deficit, I mean debt.

Mr. BETTS. I just wondered could Congress maybe cut down the obligation and relieve the necessity or is the debt limit as high as you want to go?

Secretary ANDERSON. My primary problem there is that you have got a large number of outstanding obligations authorized already, then you have certain automatic programs, you take military expenditures, expenditures for all kinds of atomic energy, interest on the public debt, mutual security, items to that effect, you have somewhere in the neighborhood of 80 percent of the money which was spent.

Mr. BETTS. That is the figure that I was looking for. What percentage of your anticipated obligations do you think you can save by the interest?

Secretary ANDERSON. It is hardly correct to say they are fixed because Congress could rescind what is now outstanding obligations, all authority. They could alter the rate at which you—

Mr. BETTS. It has already occurred.

Secretary ANDERSON. You buy or sell hardware for military purposes. If you get these categories and then make an assumption that you are going to have as much or more expenditures for military defense, as much or more for atomic energy, as much or more for interest on the debt, and so forth, then you come down saying this is about 80 percent of your expenditures and of course your flexibility is in the remaining 20.

Mr. BETTS. The 20 percent, you would say that the 20 percent is a range in which this Congress at this session might be able to make up or down adjustments; is that right?

Secretary ANDERSON. In the absence of going to the root of some of the programs which generate expenditures or which arise out of prior authorizations.

Mr. BETTS. I see.

Thank you, Mr. Secretary, and I want to say on the record I want to thank you for your presentation.

Secretary ANDERSON. Thank you.

The CHAIRMAN. Mr. Secretary, I have one further question I wanted to propound. If we should follow your suggestion and take the ceiling off of the interest that you could pay on so-called long-term securities what length securities would you anticipate that you would be able to find a market for that you do not now find sufficient market for? Would it be in securities between 5 and 10 years in length or would they be in securities in excess of 10 years in length?

Secretary ANDERSON. Mr. Chairman, I would not want to try to forecast our offerings because I think it would be speculation. But answering your question on a broad policy basis I would say that there would be a wider market in the 5- to 10-year area than there would be 10 years and beyond. I would say, also, that we would not contemplate doing more than modest amounts of long-term financing, that is, financing beyond 5 years at the present time. And that we would have to base our judgment on market conditions and on the demands of business, individual States and local governments as we judge them at the time because we would not want to unduly affect

the ability of those institutions and government to perform as they should in the economy. But there would be more certainly and there would be a wider area between 5 and 10 than beyond.

The CHAIRMAN. You get very little additional help beyond 10?

Secretary ANDERSON. It might be helpful to you, Mr. Chairman, to take a look since December 1953, we issued \$34 billions, 5- to 10-year bonds, \$2 billions of 10 to 20 and \$6½ billions of over 20. This is looking back.

The CHAIRMAN. What is wrong with this idea of Mr. Byrnes, the thought that I told you that I had in my mind, for viewing the debt as of a certain date? If you cannot hold more than a certain amount on a certain day that serves as a restraint with respect to the entire fiscal year, does it not?

Secretary ANDERSON. Yes, sir.

Mr. BYRNES. Does it not serve just as effectively to control for a fiscal year as it does to have a ceiling at a much higher level every day of the fiscal year?

Secretary ANDERSON. I would think that if Congress would like to work out a formula of that kind we would have no objection.

The CHAIRMAN. Any further questions?

Mr. BYRNES. I do not think it is a matter of whether you would have objection. I would like to know whether it might not be a good idea. You would not have to come up here and spend a whole day. If I were Secretary of the Treasury I do not think I would like to spend a whole day up here.

Secretary ANDERSON. As I pointed out, Congressman Byrnes, the real merit in the debt ceiling is to bring consciousness and awareness of the problem and focus on it. As Chairman Mills pointed out, if you had a debt ceiling at the end of each year you would have to focus on it anyhow. So I think it would be comparable and it would be more comforting; I would say that the Treasury would be just as happy with one as another.

The CHAIRMAN. What you owe at the end of the fiscal year is what I am more concerned about than the fluctuating higher amounts that you may owe at a time when you are not getting your collections.

Secretary ANDERSON. I personally would look with, I think, more favor on having the fiscal yearend ceiling without a fixed limitation of seasonal fluctuations, both because of inability to compute it and because of the fact that you would run into periods perhaps of turns in the economy when you would have small amounts of deficit financing to do.

The CHAIRMAN. Mr. Secretary, let me join others, I am sure, in expressing the feeling of all members of the committee with respect to your appearance today. I know that a few witnesses have been called upon to remain as long before this committee as you have on this occasion. You have from the point of view of the proposal that you have brought us, I think given a very clear and concise and full statement of the problems that are involved and of the reasons that have prompted you to think as you do.

Again I will not only compliment you upon your great ability, and the fine job that you are doing as Secretary of the Treasury, with the very great problem, but also I want to take official notice here in the record of your great spouse.

Secretary ANDERSON. Thank you, sir, and I am very grateful and honored and I should like to express my appreciation to the committee and say I am particularly gratified. I think every member of this committee was present this morning and have been present during most of the day, and I think that this is a sort of problem which is worthy of and has received the most careful consideration of the committee.

The CHAIRMAN. We will see in the morning if we can talk Mr. Martin into our line of thinking and give you some more help.

Secretary ANDERSON. Good, sir.

The CHAIRMAN. Without objection, the committee will adjourn until 10 in the morning.

(Whereupon, at 5:15 p.m., Wednesday, June 10, 1959, the committee adjourned to reconvene at 10 a.m., Thursday, June 11, 1959.)

# PUBLIC DEBT CEILING AND INTEREST RATE CEILING ON BONDS

THURSDAY, JUNE 11, 1959

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in the committee room, New House Office Building, Hon. Wilbur D. Mills (chairman) presiding.

The CHAIRMAN. The committee will please be in order.

Our first witness this morning is the Chairman of the Board of Governors of the Federal Reserve System. We are very pleased this morning to have with us the Honorable William McChesney Martin, Jr.

Mr. Martin, you are recognized to proceed in your own way, sir.

## **STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, FEDERAL RESERVE SYSTEM, BOARD OF GOVERNORS, ACCOMPANIED BY RALPH A. YOUNG, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS**

Mr. MARTIN. Thank you, Mr. Chairman.

The first thing I want to do, Mr. Chairman, is place the Board of Governors of the Federal Reserve System squarely on the record as endorsing the debt management proposals transmitted to you by the President.

In our judgment they are both necessary and desirable and we are urging their favorable consideration.

There are only a few points that I want to make and while this isn't necessary before a group such as this, nonetheless I think it is important to emphasize that I am before you today not as a spokesman for the administration, but as Chairman of the Federal Reserve Board.

We are living today in a country of unprecedented wealth. It is wealthy in part because of abundant natural resources, and in part because of the energy and initiative of our people.

An even more important distinction between the United States and most other countries is the size and quality of the accumulated stock of capital goods in the hands of producers and consumers. Due to past saving—I emphasize the word “saving”—we enjoy the benefits which flow from a reservoir of housing and durable goods in the hands of consumers, of public facilities, such as highways, school buildings, and waterways, and of industrial plant and equipment.

The society in which we live has been popularly characterized as affluent, and despite our proper concern for certain depressed areas, both economic and geographic, I am sure that we can all agree with this characterization.

One consequence of affluence is exposure to instability in the pace of general activity and also in interest rates which rise in periods of boom and decline in periods of recession.

In a primitive economy, where everyone must work as hard as he can to eke out a bare living, additions to stock of capital are largely made by diverting effort directly to production of capital goods. Such borrowing and lending as does take place is effected at interest rates which we would regard as fantastically higher. In this type of economy, there is little threat of instability except from natural causes.

A drought or an unusually good season may produce relative poverty or plenty. But the range of economic fluctuation will tend to be fairly small.

The greater the accumulation of wealth the greater are the possibilities for economic fluctuation. These may stem from shifts in the peoples' preferences among the wide range of expenditure opportunities open to them, from changing attitudes toward saving and investment, from overspeculation which undermines the solvency of financial institutions, or, perhaps on some occasions, simply from the arrival at a point where even a high rate of technical innovation fails to induce investment decisions adequate to sustain capital expansion.

It is not surprising then that, in a free and wealthy economy, we are unable to counterbalance perfectly, through changes in public policy, the wide shifts that can take place. We always have had, and I think always will have, changes in the pace of our economic progress. We can and should work to reduce these fluctuations and strive for the goal of stable growth. At the same time, however, we must recognize that it is highly unlikely that we shall ever achieve perfection.

Fluctuations in our economy express themselves in various ways, and we attempt to gage them by various statistical measures.

If we look at the movements in any of the broad measures or economic activity and compare them with fluctuations in interest rates, the conclusion is inescapable that interest rates tend generally to move upward in periods of prosperity and downward in times of recession or arrested growth. Hence, concerned as we may be about the impact of rising interest rates on the burden of the public debt or on necessitous borrowers, we must recognize that rising interest rates are, in fact, a symptom of broad prosperity and rapid economic growth.

I might insert here, Mr. Chairman, that I have been coming up to the Congress for a number of years now and I would much rather come up to explain high interest rates as a byproduct of prosperity than I would to be up here when interest rates were declining as a result of a deflation.

Since the stabilization of monetary systems in key countries after World War II, interest rates in most other industrial nations of the free world have been higher than in the United States. This has been a period of great economic growth, very active demands for credit, further monetary expansion, and continuing, though perhaps abating,

inflationary pressures. This past year's rise in interest rate levels here, accompanying economic recovery, has been in contrast to some decline in interest rate levels in Western European countries, where a modest recession came somewhat later than in the United States and Canada.

In the United States, the rise in interest rates has affected all types and maturities of debt instruments. Yields on long-term securities have generally risen by about 2 percentage points since the low point reached shortly after the end of the war. Yields now range from 4 to 4½ percent on U.S. Government securities of long- and medium-term, over 4½ percent on many outstanding Aaa corporate bonds, and average over 5 percent on outstanding Baa corporate bonds. New issues necessarily have to be offered to investors at higher rates.

Despite their recent upward movement, interest rates in the United States are still at levels comparable with those prevailing during much of our history.

Long-term rate movements since last summer have been within the range of the period from the early part of this century through 1930. The level is still substantially lower than during most of the 19th century. From a historical viewpoint, the present level of rates can hardly be regarded as "out of line" for a period of wide prosperity and growth.

In comparing present rate levels with those of past periods, one of the most important things sometimes overlooked is the effect of our necessarily high tax structure on the effective rate of interest. For example, if both the borrower and lender are subject to the 52-percent tax on corporate profits, the borrowers' net cost and the lenders' net return is a little less than half of the expressed rate. Thus a market rate of, say 4 percent, implies for both parties a net rate of a little less than 2 percent. On its own taxable bonds, the Federal Government, through the income tax, recaptures a substantial share of the interest it pays. When we look at interest rates in long-term perspective, we must bear in mind that net yields after taxes are lower today than a comparison of market rates would suggest, because of the fact that taxes are higher.

Aggressive demands for financing, which, as I have said, are characteristic of prosperous times, represent efforts to attract resources away from current consumption in return for the payment of interest. In a free economy, no matter how affluent, it follows that, when borrowers attempt to attract a larger share of the total product for their purposes, they will have to pay for doing it.

The presence of strong demands on the credit markets from borrowers of all kinds does create a difficult financial problem. Recently credit demands have been pressing on the banking system, and the banks have been accommodating a growing volume of loans.

As borrowers have sought accommodation, banks have raised their prime rate from 4 to 4½ percent. This is the interest rate that banks charge top-quality customers on short-term loans.

More recently, the discount rate of the Federal Reserve banks has been raised from 3 to 3½ percent. The discount rate, as you know, is the interest rate that is charged by a Federal Reserve bank when a member bank borrows money from it. This money is often called high-powered money. It is high powered because it is credited directly to the reserve account of a member bank, and, unless used to

finance a payment of currency into public circulation or an outflow of gold or some other development which drains the member bank reserve base, it forms the basis for a multiple expansion of bank credit and money.

For some months we have been having rapid expansion of bank credit and money, based largely on borrowed reserve funds. The seasonally adjusted money supply—demand deposits at banks plus currency in circulation—has increased by more than \$2 billion in the last 4 months, an annual rate of growth of about 5 percent. In the face of developing high-level prosperity and the potential threat of inflationary boom, the Federal Reserve should not be in the position of encouraging an undue expansion of bank credit and money. Hence the appropriate discount rate under present circumstances is one that does not encourage member bank borrowing and is generally above current rates on short-term market obligations, such as bills.

It is sometimes asserted that the Federal Reserve System should step in and halt the upward trend of interest rates resulting from active demands for loans by supplying sufficient Federal Reserve credit in one form or another to keep interest rates from rising. This cannot be done without promoting inflation—indeed without converting the Federal Reserve System into what has been called an engine of inflation.

When such a program was adopted during and following the war, it did succeed for a time in actually pegging interest rates on Government obligations. But at the same time it promoted and facilitated the dangerous bank credit and monetary expansion that developed under the harness of direct price, wage, and material controls. The suppressed inflation that resulted, we are now well aware, burst forth eventually in a very rapid depreciation of the dollar and even threatened to destroy our free economy itself.

This experience is very recent and the effects are widely and well remembered. It is now very doubtful whether the Federal Reserve System could, in fact, peg interest rates on Government obligations under today's conditions even if we accepted the inflationary costs, which would be high and would eventually, in my judgment, lead to severe collapse. It is certain that the Federal Reserve could not extend interest rate stability to all markets.

The trouble is that the world has learned from wartime inflationary experience. It now knows that inflation follows any effort to keep interest rates low through money creation as the night follows the day. Any attempt on the part of the Federal Reserve to peg rates today would be shortly followed by an acceleration of the outflow of gold in response to demands from abroad, by further diversion of savings from investment in bonds and other fixed interest obligations into stocks and other equities, and by a mounting of demands for borrowed funds in order to speculate in equities and to beat the higher prices and costs anticipated in the future.

Those familiar with the investment markets will confirm to you that such developments would inevitably follow a Federal Reserve attempt to peg interest rates. A simply tremendous volume of bank reserves would have to be thrown into the market through Federal Reserve open-market purchases in the attempt to stem the upward pressure on interest rates.

As these reserves enhanced inflationary pressures even further, the rush from money and fixed obligations into gold and physical property as well as the mounting demands for credit to reap speculative profits and to hedge against future inflation would overwhelm even the most heroic efforts to hold interest rates down. Ultimately, if the gold reserve requirements to which the Federal Reserve is now subject were eliminated, the System might acquire a large proportion of publicly held Government debt of over \$200 billion in this way.

True, the interest rate on Government obligations might be said in some distorted sense to have been stabilized by such an operation. Interest rates generally, however, would spiral upward as they always have in every major inflation.

People who save will be unwilling to lend their money at low interest rates even when they expect the depreciation in the value of their dollars to be limited. This is understandable. Take for example, a corporate financial institution subject to a 52-percent tax. The aftertax income from a bond yielding  $4\frac{1}{4}$  percent interest would amount to just a little over 2 percent with the dollar stable in value. If this potential investor had reason to fear that the value of the dollar would depreciate even 1 percent a year, his real return would be very low. If the investor had reason to expect a price rise of just over 2 percent a year, his real return would become negative. Investors, I am convinced, are alert today to this way of figuring interest returns.

It might be added that to suggest that holding interest rates down by supplying the banking system with reserves through Federal Reserve open-market purchases of Government securities, on the one hand, and taking them away with higher reserve requirement increases, on the other, represents a fundamental misunderstanding of how the credit system functions. Obviously, if the net effects on the credit base are, in fact, offsetting, they make no net addition to the total supply of bank credit, nor do they reduce the demands of borrowers. If they are not fully offsetting, the net result would be inflationary. We are all acutely aware of the gigantic size of the publicly held debt that is outstanding and available to provide a basis for such monetary inflation. Much as we would like it, there is no magic formula by which we can eat our cake and have it, too.

If the Federal Government should substitute artificially created money for savings in an effort to prevent interest rates from rising, it would have a reverse effect. It would worsen the very situation that the action was intended to relieve.

If you really want to encourage rising interest rates, you have only to follow the prescription of those who argue that interest rates on Government or any other obligations can be pegged by inflating the money supply.

In connection with this discussion, it should be reemphasized that the Federal Reserve System does not "like" high rates of interest. I have testified on many occasions that we would like to see as low interest rates as it is possible to have without producing inflationary pressures. Interest is just a governor on the flywheel of the economy which, if you prevent it working, leads to distortions and maladjustments in the economy from which we all suffer.

We are anxious, always, that interest levels be as low as is consistent with sustained high levels of economic activity, with a steady rise in our national well-being, and with reasonable stability for value for the dollar. We cannot, moreover, put interest rates where we would, whatever our "likes."

Federal Reserve policies can, of course, and do, influence interest rates to some extent through their influence on the rate at which the banking system can add to the credit and money supply. The effectiveness of Federal Reserve policies is always subject, however, to the reaction of borrowers and savers as expressed through the market.

In an economy in which people are alert and sensitive to price changes, the only way to bring about a lower level of interest rates is to increase the flow of real savings or to decrease the amount of borrowing. One important way to do this is to reduce substantially the deficit at which the Government is operating. This will not only relieve immediately some of the demand pressures that are pushing interest rates up in credit markets, it will also reassure savers as to the future value of the money they put in bonds and savings institutions and thus increase the flow of savings into interest-bearing obligations.

The proposals before you do not relate to the levels of rates which will prevail in the market, but rather to whether or not the Government shall be able to use savings bonds and marketable bonds effectively as parts of its program of debt management. The forthright management of the public debt is an essential part of any program to encourage savings and lower interest rates. We should not force the Treasury to resort to undesirable expedients in order to comply with arbitrary ceilings on either the size of the debt or the rate of interest it pays.

International levels of interest rates among industrial countries are now more closely aligned than in earlier postwar years. This realignment, together with removal of most restrictions on the movement of capital, reflects progress toward a closer relationship among international money markets, which is the financial counterpart of progress toward sustained growth in output and trade in the free world generally; exactly what we have been striving to attain for a long time.

It also signifies a state of affairs in which capital demands are becoming international in scope and in which they will converge rapidly on the market that is cheapest and most readily prepared to accommodate them. Under these circumstances, interest rates in this country must increasingly reflect worldwide as well as domestic conditions.

We need to remember that today the dollar is the anchor of international financial stability. That anchor must be solid. Realistic financial policies of Government are essential to that end as well as to the end of a wealthy and strong domestic economy.

At this junction of world development, the least evidence of an irresponsible attitude on the part of the United States toward its financial obligations or of its unwillingness to face squarely the issues which confront it in meeting greater demand pressures on resources and prices, would have very serious repercussions throughout the free world.

That concludes my statement, Mr. Chairman.

The CHAIRMAN. Mr. Martin, we thank you, sir, for coming to the committee and giving us the benefit of your advice with respect to this problem that we have.

Of course, we recognize that you are not here as a spokesman for the administration, but as a spokesman for the Federal Reserve System, the Board of Governors of the Federal Reserve System, and also because we thought from your experience in these matters that you might be able to shed light on different aspects of this problem.

You and I have discussed these matters on other occasions and in other committees. I have always appreciated your frankness and your ability to reduce what to many, including me, is a very complex subject matter into one that is readily understandable.

I have just a few questions, Mr. Martin, that I want to ask and then I am sure other members of the committee will desire to propound questions.

On yesterday, as I understand, Secretary Anderson made it clear that the Treasury proposals are predicated in part on the possible desirability of greater reliance by the Government in the months ahead on long-term obligations. As all of us recognize, there is no limit now on the rate of interest that can be paid on Government securities up to 5 years, and that from 5 years on there is a limit.

He also made it clear that the issuance of long-term obligations by the Treasury will compete with other demands for long-term investment bonds.

What would-be long-term borrowers will the Treasury in fact be competing with?

Mr. MARTIN. They will be competing with life insurance companies, savings institutions, pension funds, individual investors.

The CHAIRMAN. Maybe I didn't make myself clear.

I am thinking in terms of the units of Government, corporations, and individuals that will, during the course of the next months ahead, be in the market with long-term securities trying to borrow on a long-term basis. If we better equip the Secretary of the Treasury to go into those markets of limited credit resources so that he can put more and more of the public debt, say, into long-term securities, he would of necessity be competing in that market with somebody.

Who are these would-be borrowers, not the lenders, but the would-be borrowers, that the Secretary would be competing with?

Mr. MARTIN. With corporations, with Government agencies such as the FHA and the VA that are paying higher interest rates at the present time, State and local governments, generally, almost all of the entities—home buyers, consumers. He just has to compete with all of these forces that are in the market.

The CHAIRMAN. Then do they in turn have to compete with him by proposing to pay more interest themselves for the use of the money that is available in order to get it?

Mr. MARTIN. Or postpone temporarily some of their plans.

The CHAIRMAN. If the Treasury, say, should find it necessary in order to carry out this program of getting more and more of the debt into long-term securities, and State and local governments, for example, have projects that they think they cannot postpone, then in order for those State and local government projects to be carried out,

would they not be in the position of having to agree to a higher interest yield on their securities in order to compete for such funds.

Mr. MARTIN. In some marginal instances, that might be the end result, Mr. Chairman.

The CHAIRMAN. What I am trying to get is your opinion of whether or not what the Treasury is proposing here or what the administration is proposing is merely to enable the Treasury, in the management of its debt, to get itself in a position to compete with an existing situation, or whether in the process of that competition offers made by the Treasury with respect to long-term securities may result in further complications that will set off a further spiral of increases in the interest rates.

Mr. MARTIN. As I tried to point out in my prepared statement, I don't think this relates to the levels of interest rate. This is merely giving the Treasury the ability to tap the market when the market appears appropriate as other people in the market tap it.

At the present time, the mere fact that there is this statutory ceiling on interest rates puts the Treasury at the mercy of the market with respect to that particular level.

I have said repeatedly, and I believe this wholeheartedly, that the level of savings in the country at the present time is adequate to sell long-term bonds at lower than present interest rates if the investing public had confidence that we were going to manage our affairs responsibly and there is not going to be devaluation of the dollar.

Because of the statutory ceiling on interest—this is not something that we are projecting into the future; this is the place that we presently are—I think that we ought to give the Treasury the ability to use all of the debt instruments effectively to get the lowest charge for the public debt.

My own personal conviction is that what will actually happen is that if this ceiling were removed, in the short run the Treasury would benefit almost immediately by it.

I believe that you will have to pay more to finance the Federal debt under the present ceiling than if this ceiling is removed.

I would also like to comment, if I may, on interest rates generally, because this is something that I think is important. People say, "What is the trend of interest rates going to be? Where will they go?"

Well, there is a great misconception about it. My feeling is that we manage or mismanage better or worse at times, but the fact remains that if business continues to improve, interest rates are going to rise. If business stays about where it is, interest rates are going to stabilize and and stay about where they are.

If business declines, interest rates are going to decline.

I don't for a moment mean to imply that I believe in *laissez faire* or a do-nothing economy, but I believe in using principles and forces which we know exist and applying all the new ideas we can to them, but not trying to ignore them.

Some people think that you have to do nothing; you just step by and let all the forces develop.

Now, the Federal Reserve have never tried to do that, but it has tried in its operations to accept the fact that these forces exist and to move with them in the interest of high level employment and

stable prices. That is the best I can do on forecasting interest rates.

I sincerely believe that at the present time a removal of this ceiling and giving the Treasury the flexibility to operate here will make it possible for the public debt to be financed cheaper than it will have to be financed if it does not get this ceiling.

The CHAIRMAN. What I am thinking about is this:

If we are to put the Secretary of the Treasury in a better position of competing in the money market with long-term obligations, with State and local governments relying to a great extent upon long-term obligations versus short-term obligations, and he does not just get himself in the position of meeting the existing rate, but makes an error, as errors have been made in the past and errors will be made in the future, in evaluating the market situation, in order not to have a failure in his issue he goes a little above the prevailing interest rate. The interest rate then applicable to State and local long terms will rise.

I say I fear that as a possibility. Then I look beyond.

If that happens, say we have passed upon whether it will or not, you and I have observed in the last 20 years that State and local governments unable to finance their programs within the locality or within the State have very little hesitancy in coming to Washington for assistance. Would they possibly, in order to avoid these higher rates of interest that they might have to pay, increase their demands upon the Federal Government for financing of services within the locality or within the State?

If that happened, would they not to that extent be further contributing or bringing about at least the primary cause of most of our difficulty today, the amount of Federal spending that is taking place?

What I am getting at, Mr. Martin, is, this thing is not to me as easily resolved as it may appear to some to be.

There are dangers certainly in going along on the basis of existing law from the point of view of debt management, but I want to examine to see whether or not there are dangers in taking the course of action recommended to us that might even be more detrimental in their influence upon the economy.

Mr. MARTIN. I think that is a very sensible approach, and I think what it comes down to is, you have to make judgments at some point on these things.

The CHAIRMAN. We are at that point now.

Mr. MARTIN. Exactly, and I don't have any hesitation in stating the judgment of the Federal Reserve System today, and I think I can speak as the System on this today, that the right course to pursue here is to encourage the flow of savings and not try to supplant savings with artificially created money, and that if we do we are going to create a bubble that will burst in our face in a recession that we won't like at all.

The CHAIRMAN. Is not the whole theory that when interest rates rise they tend to keep people from borrowing money that they would otherwise borrow at low rates of interest and expand and carry on activities that perhaps, on the basis of the economy as we look at it today, ought not to be carried on?

It not that a whole lot of the theory of it, and through this higher charge for use of money there are people who will refrain from using credit, and thus that particular strain on the economy will be eliminated?

If that is the case, who is it in the economy that would otherwise be a borrower at 4 percent who will not be a borrower at 5 percent?

Is it the corporation that intends to expand its activities in recognition of the requirements of the growth in the economy?

Do we want that expansion curtailed?

Mr. MARTIN. We don't want that expansion curtailed. We don't want to avoid it in either sense, but if we get a surplus under conditions that demand pressures, the Treasury will benefit by it on the rate.

Regardless of whether it paid too high on one particular issue or not, it will flow through the whole credit machinery.

The CHAIRMAN. You say you do not like high interest rates, and we do not like high interest rates, but what we are being asked to do here may result in higher interest rates.

Do we have any assurance that those rates are not likely to go to such levels as to so reduce capital investment, dependent upon borrowed money, as to bring about a downturn actually in our rate of growth?

Mr. MARTIN. I think just the reverse. I think that the assurance here is that if we utilize the present techniques and principles which we have, we will have a burgeoning and improving and developing economy that will be sustainable, and I am also convinced that if we try to finance by artificially creating savings, we are going to reap the reward also.

The CHAIRMAN. Maybe I misunderstood you a moment ago, but at least you led me to believe that you were thinking in terms of this statutory ceiling having some effect upon the confidence of savers.

Mr. MARTIN. That is right.

The CHAIRMAN. Let me ask you this: Whether it is the ceiling that has caused the lack of confidence, or whether it is a lot of talk about inflation that all of us perhaps have engaged in that may have made a contribution to the shaking of their confidence.

As evidence of that, and I want you to consider the sharp break in Government bonds last summer to where I think at one point they sold for 83 or some such figure. Did this not serve to shake the confidence of savers a lot more than the ceiling on the interest rate the Government could pay?

Mr. MARTIN. I don't think there is any question about that, Mr. Mills.

You have to put this, however, in perspective. A lot of factors brought us to the condition that we are in today. Let's just take this matter of inflation.

For 10 years or more, 15 years, people have been saying to me, "Where is the inflation? There is no inflation. What are you fighting?"

All right. We all know that the value of the dollar has declined now to such an extent that it is almost immaterial to ask when it declined.

From 1944 on we have had persistent inflation in this country and a lot of factors have contributed to it.

Federal spending has been a major one, but we can't at any particular time say that this brought it about. This matter of talk is one that has very much concerned me. I have tried to be very careful about the talking that I have done on this thing, but when everybody is talking about it, it seems to me that we have to recognize that something is happening and that if the Chairman of the Federal Reserve Board ignores it, among others, he can't be very alive and alert to what is going on.

Actually, what has happened over the last year has been that following the 1957-58 recession, which in my judgment came about because of the preceding inflation that got ahead of us—when gross national product was running a billion dollars a month in value in excess of goods and services being produced, you knew that inflation was well ahead of you in late 1956 and 1957, and some adjustment was going to take place.

Then we went into reverse gear, and I think the monetary authorities did everything they could during that period to stimulate the economy, with due respect to our critics.

I think that when you have a money supply increasing as much as 8 percent, as it was at one point in 1958, it is hard to say that money supply was not doing what it could to contribute to stabilizing the economy and making it possible for the recovery to develop, and this was about the time that the recovery began, which in retrospect we know was April of 1958.

But you suddenly had confronting you in the summer the enormous Federal deficit, nearly \$13 billion, which was the main talking point, and also a conviction that that Federal deficit was not going to be limited at that time, but might even be doubled.

That was the sort of talk that in part led to collapse in the bond market, the sudden realization of it, and also complicated the problem for all of us.

The CHAIRMAN. Mr. Martin, I would not have you or anyone else draw any inference that I am criticizing you. I would not have your job any more than I would have the job of the Secretary of the Treasury, under these circumstances which you both operate. I am trying to get some information because I think there are other points that have not yet been considered that must be considered before we take this step.

Mr. MARTIN. I understand.

The CHAIRMAN. I am always a little bit at a loss to be able to understand and interpret economic conditions as they occur.

As I look back, I think about what happened in the Consumer Price Index between March of 1958, and March of 1959, where there was only about a four-tenths of 1 percent rise in the overall cost of all items that go into it. I do not see much evidence of inflation there, do you?

Mr. MARTIN. Let me just make a comment on that.

That has to do with this process of inflation that I am talking about. All the price movements are explosive in their nature in our economy. I wish they weren't, but that is the way they are.

When I was up here before the Joint Economic Committee in February, I tried to point out the inflationary tinder that was lying around at that time that, in my judgment, can make for an ex-

plosive movement in that cost-of-living index. We have had periods since the inflation started in the 1944-45 period that you can point to these statistical measures that look as if we have everything under control, but the fact remains we have been dealing with a more persistent and insidious problem than that.

I believe a great deal in these statistical measurements and I think they are important, but I don't think we should be slaves to them, and I think the biggest mistake we make at times is to say, "Well, from here to here it was stable and from here to here it was unstable."

What you have to do is to try to interpret those statistics with respect to what is building up. I say that the level of savings is slowly beginning to subside at the present time. The future which I foresee for this country is unlimited. The only thing that limits it is whether we have the responsibility and the courage to manage our affairs in such a way that we don't have catastrophic breaks that come from overexuberance and overebullience.

At the present time, the level of savings has been fairly adequate. In the last 1958-early 1959 period, it has been fairly adequate, but people have preferred stocks, equities, and other types of investment, and while some people say you shouldn't talk about it, when you travel abroad and you talk to a variety of people, you find that they do not have, and I say this publicly, the confidence in the dollar that they had a number of years ago. It is up to us to reestablish that.

The CHAIRMAN. Mr. Martin, over that period of time I agree with you that you cannot judge an entire proposition by looking at any limited period, but over the period of time that we referred to here a moment ago when the price index went up by four-tenths of 1 percent, from March of 1958, to March of 1959, what was the increase in the interest rate?

Do you have any information on that?

Mr. MARTIN. Yes, I could give it to you. I would say it is about 1 to 1½ percent.

The CHAIRMAN. How much?

Mr. MARTIN. 1 to 1½ percent.

I will get the precise figures for the record.

(The information supplied by Mr. Martin is as follows: 9- to 12-month issues, up 1.79 percentage points; 3- to 5-year issues, up 1.38 percentage points; issues maturing in 10 years or more, up 0.67 percentage point.)

The CHAIRMAN. Do you still agree, as you said in February, that much of this inflationary trend is the result of the Government debt?

Mr. MARTIN. Yes, indeed, I do.

The CHAIRMAN. It is still that today?

Mr. MARTIN. It is not to the same extent.

The CHAIRMAN. What I do not understand is this:

When we are in the process of contracting the situation, and I think it is a remarkable feat, if it is accomplished, of reducing from \$12½ billion of deficit, say in 1 fiscal year, to a billion or \$2 billion of deficit, or even a balance in expenditures, when you are going through a situation like that when the economy is just coming out of this downturn and rising interest rates are upon us under conditions of contracting

debt by Government, which may have made a contribution to the rise when we were in the hole \$12½ billion, when all that has happened, and the interest rate continues to go up, I wonder if it is altogether due to the fiscal policy and to the debt itself.

I wonder if there are not other factors that are involved in this increase in interest rates.

Mr. MARTIN. I think that the confidence factor is a broad factor, but I also think that the demand for credit which is beginning to burgeon again is the major factor.

The CHAIRMAN. Could it be this, Mr. Martin :

In spite of the record that the Federal Reserve has made of allowing the money supply to increase by 8 percent when we were in a downturn, much more than you would normally permit an increase in the supply of money and credit, could interest rates be affected as they have been affected since March of 1958, and up to March of 1959, by a policy of the Federal Reserve Board that resulted in less money and credit being made available in a growing economy or an economy coming out of a business downturn ?

I sometimes get lost in this matter of whether or not these demands for money and for credit result from the normal expected growth, the desired growth in the economy, and whether they are altogether the result of pressures that we refer to as inflationary.

Over a period of time when we have had a rate of growth, say, of 3 percent, is it sufficient for the Federal Reserve to follow policies that permit a rate of increase in money in a comparable period of 1½ percent ?

Does not that in and of itself mean that there is less money than there is rate of growth and as a result of that less money and credit, and that somebody is going to have to pay more for it ?

Mr. MARTIN. Let me answer it this way, Mr. Mills, because I think a lot of people have sincere questions on this point.

Some people believe that we shouldn't have any manmade management of this type of thing, that we should just set a measurement and increase the money supply in proportion to gross national product or some ratio figure and automatically increase the money supply or decrease it if it is called for on that basis.

Unfortunately, the nature of this problem doesn't permit that type of measurement. When we talk about the money supply, we have to take the factor of velocity into account just as much as we do the quantity of money. That involves judgments, and they are, to be sure, manmade judgments, and the last thing in the world I am trying to say to this committee or anyone else is that the Federal Reserve has been perfect in its management of the money supply.

But I do want to point out that in 8 years of experience in the Federal Reserve System, I am convinced that our bias, if anything, has been on the side of too much money rather than too little. There have been one or two times when money might be unavailable in individual places, because the money flow is uneven.

That is a serious mistake if that ever happens. We have immediately corrected that just as quickly as we could wherever that has occurred, but the natural human nature tendencies of this thing work in such a direction, and that is one of the most difficult things we have to deal with on this problem of inflation, that it is awful easy to go down and it is awful hard to go up.

We hear a lot about banker influence and banker domination and banker's interest and that type of thing getting into it, but my actual experience is that whether it is bankers or businessmen, generally speaking, they are not pushing for higher interest rates per se. They are on the side of, well, now, just don't run any risk of things developing.

Just taking the recent period as an example, I think that, if anything, we have performed properly. I don't think we were perfect on timing the recession. I don't think we ever will be. If we catch it within several months, I think we are going to do very well.

I have used this phrase "leaning against the wind." I like to think of it in terms of being a rudder and a helmsman. We are not able to make the wind.

If I can throw in just a personal observation there, I had the privilege of knowing Senator Glass fairly well for a short period of time. He told me on a number of occasions—I had no idea I would be ever connected with the Federal Reserve, but I was working on a paper at the Columbia University—"If the Federal Reserve ever gets the idea that they can make the wind, that they can create these forces, it will fail completely of its objective and its purposes."

I want to put that in the broader perspective that I think is important for us to think of, that we don't have a Gosbank here. I am using the Russian phrase here. We have to deal with the conditions that the economy sets for us.

Fundamentally, the problem in the Federal Reserve since I have been with it has been not one of leaning too lightly against the breeze when it is going down. When it is going down you have no difficulty.

I went through it in this last experience, and some people question the way we move, but we had no trouble in going from 3½ percent to 1¾ percent in the discount rate and increasing purchases in the open market and reducing research requirements. We had little or no difficulties with that.

Our problems came when it was perfectly obvious that the wind was stabilizing and beginning to go the other way, not to interfere to say, well, just keep them down a little bit longer if you can.

The CHAIRMAN. I am not disagreeing, I repeat again, and I am not criticizing.

Mr. MARTIN. I want you to.

The CHAIRMAN. I am trying to learn as much about this as I can in this short time. Am I to reach the conclusion from what you have said that the Federal Reserve could not initiate policies if it wanted to, if it decided it could do it, that would have the result of changing the basic trend of interest rates without the result of bringing about pressures for a downturn in our economy, or pressures for inflation within our economy?

Mr. MARTIN. Leave out the question of whether, if we just froze money, which wasn't available at any price. If money weren't available at any price, then interest rates are no longer a factor. You have nothing to price.

But, assuming that interest rates continue to operate, my conviction is that over long periods of time, not short periods of time, neither the Federal Government nor the Treasury nor the Federal Reserve can set an interest rate and make it stick.

We can lead or follow at various times, but the forces are bigger than we are. We may at some point develop a totalitarian—I use that phrase loosely—I mean an overall general management of the economy which would make it more possible to do that, but I don't think that is what we are discussing this morning.

However, as we are set up today, I am convinced that the long-range levels of interest rates are not controllable in that sense. What we are dealing with here are like, and I have used this phrase a number of times, like the tides of the sea, and King Canute can order them to stand back, but you are going to get your feet wet if you try to say they are not there.

The CHAIRMAN. Mr. Martin, on page 5 you call our attention in the second paragraph to the presence of strong demands on the credit markets from borrowers of all kinds. You say:

Recently credit demands have been pressing on the banking system, and the banks have been accommodating a growing volume of loans.

Do you have information with you on how much, aside from the Federal Government, the increase has been over the past year in number of bank loans to these borrowers?

Mr. MARTIN. Mr. Young can give it to you from the bulletin here.

The CHAIRMAN. We did not identify Mr. Young.

Mr. MARTIN. Mr. Young is the head of the Board's Division of Research and Statistics.

Let me point out just in passing while we are waiting that one of the successful things in Federal finance has been the way the Treasury has succeeded with the increase in profits in corporations and the recovery and utilizing even the short-term instruments on going into the hands of corporations rather than otherwise, and that is one of the things that has given us concern, because we know that as a recovery develops and it reaches the stage of growing prosperity, there is going to be more and more demand for capital spending by these corporations, and there is going to be more and more tendency to dump those securities back in the banks, and that is one of the factors in the loan picture.

The CHAIRMAN. What I am getting to is this, while Mr. Young is working: I was under the impression that there had been a considerable increase and that to the extent that we know the composition of the borrowers, it looks like a substantial volume of this recent borrowing is being used to finance business outlays for plant or equipment.

I wanted to know whether or not that is true.

Mr. MARTIN. In April 1958, \$93,450 million; April 1959, \$101,090 million.

The loans of all commercial banks rose from \$93 billion plus to \$101 billion plus.

The CHAIRMAN. Do you know anything about the composition of these borrowings?

Has it gone for plant and equipment outlays, or has it actually gone into inventory?

Mr. YOUNG. We wouldn't know that. It has gone in all directions.

You would judge on the basis of expenditures for plant and equipment, as between the increase in plant and equipment expenditures of

business concerns between the first quarter of last year and the first quarter of this year, that probably only a small part of the increase has gone into plant and equipment, that it has gone mainly into inventory.

There has been quite an increase in mortgage loans at banks. Also, there was some increase in loans on securities.

The CHAIRMAN. There is a limit to business demands for bank credit for plant of equipment purposes and for inventory purposes, is there not?

Mr. MARTIN. There is indeed.

The CHAIRMAN. Are we approaching that limit in the opinion of the Federal Reserve, or are we just beginning?

Mr. MARTIN. That is a pretty hard judgment to make.

The CHAIRMAN. Is it not a factor that will make a contribution to whether interest rates remain stable or interest rates rise?

Mr. MARTIN. It is a factor that will make interest rates rise if we do not increase the level of savings, and I have had the feeling that the level of savings, while quite adequate in the early part of the year, is slowing up at the present time in relation to the growth and development of the economy.

The CHAIRMAN. If we are to get out of this downturn and continue on, I am wondering whether or not our monetary and debt policy should be so arranged as to accommodate their demand for funds rather than put the Treasury in the position of competing with them at this particular time.

Mr. MARTIN. If the savings aren't there, I don't see how our artificially creating them will accommodate them.

The CHAIRMAN. I am not talking about artificially creating or anything. We are talking about the Treasury converting from short-term paper to a greater percentage of long-term paper. These inventory requirements and these capital investments for plant and equipment that are being carried on at the moment are making a contribution to the expansion of the economy and it is a desired expansion at this point.

Is the entry of the Treasury to a greater extent into this field going to impede these businesses in obtaining these required funds, and should we permit that to happen?

Mr. MARTIN. The Treasury has to be financed.

The CHAIRMAN. I understand, but the Treasury, to be financed with short-term obligation, you say costs more.

I agree it probably is not the way to do it, but I am trying to determine whether or not now in the process of getting the Treasury more and more into long terms, we may be doing something on the other side that we do not want to do.

Mr. MARTIN. I don't think so. I think that we are getting too much in the short end of the market and that, reverting again to this confidence factor, that we know that the bills and the short-term securities at some point become almost interest-bearing money and that we just have to recognize that they are inflationary forces in the economy, and we do not want that type of expansion.

The CHAIRMAN. I am sure you are right. I don't yet understand the difference between short-term paper as being this near money and thus being inflationary on the one hand; and Government borrowing

money through long-term obligations not being inflationary. We have said, and you said in February, that the size of the deficit, and I assume you meant the condition of fiscal policy and those things, is the net inflationary influence. If we manage that debt through long-term obligations, you think that is less inflationary or it is not inflationary?

Mr. MARTIN. I certainly do, because if you place the long-term debt that we placed in the hands of corporations or your individuals, they are going to hold it for some time.

The CHAIRMAN. It would not all be in the hands of individuals or corporations, would it?

Mr. MARTIN. So far as its impact on the Treasury is concerned, it is not going to come back for repayment 3 months from now or 6 months from now.

The CHAIRMAN. The fact that the debt has to roll over so fast in these short-term papers is inflationary. Is that your point?

I am merely asking for information.

Mr. MARTIN. That is correct. That is definitely the point.

The CHAIRMAN. That in and of itself is inflationary?

Mr. MARTIN. I think so.

The CHAIRMAN. What makes it inflationary?

Mr. MARTIN. The turnover under conditions of high level activity makes it inflationary because it puts the Treasury in the position of being at the mercy of the market whenever these securities run off.

The CHAIRMAN. You may have to pay a little more interest the next time they roll?

You are not saying that interest rates themselves are inflationary, are you?

Mr. MARTIN. No. I am saying that with the distortion in the level of interest rate, the portfolio has been managed with some relationship to long-term needs and short-term needs.

Most of this money we are talking about is for long-term needs. It is not for repayment in 3 months or 6 months. It is for projects which will require 3, 5, 10 years.

The CHAIRMAN. Most of it is for money already spent—we know that—from which there is no future return. It has already been spent. Projects have been completed. Battleships have been put in mothballs. I just have had some difficulty in understanding why one would be inflationary and the other one not. You helped me. I see your point.

Mr. MARTIN. It is the placement of the issue. You could have all the debt in short-term securities.

The CHAIRMAN. Mr. Martin, I had numerous other questions, but I will not delay you nor the committee to go through all of them.

Thank you, sir, for your continued forthright responses to all of my questions. You have always done that and I appreciate it.

Mr. Mason will inquire.

Mr. MASON. Mr. Martin, all I want to say is this: that I think Uncle Sam is mighty fortunate in having Mr. Martin at the head of the Federal Reserve System in these trying, troublesome times.

That is all.

The CHAIRMAN. Mr. Forand.

Mr. FORAND. Mr. Martin, I was very much interested in all you had to say this morning. I noticed particularly that you, as well as the Secretary yesterday, made considerable reference to the fact that State and municipal obligations were tax-exempt, whereas the Federal obligations are not.

I am wondering, especially in view of the further statement you made when you referred to the interest rate of return being cut down by virtue of the taxes, if you could comment for us on what would happen if we were to make the Federal obligations tax exempt and therefore, perhaps, induce investment in long-term bonds?

Mr. MARTIN. You would make it more difficult for the State and local governments to finance because they would not have the tax-exemption feature exclusively.

I have repeatedly said that I think the tax-exemption feature on State and local securities is a mistake, but we have it.

I think that to make the Federal issues tax exempt complicates the whole general problem. It might be one way of solving it.

You gentlemen are much more versed in the tax problems than I am, but it opens up a whole Pandora's box of troubles with respect to our tax equities.

Mr. FORAND. Maybe this committee is better versed in the taxation than you, but I am sure the committee is not better versed in economics and the general situation in this country than you are, and that is the reason why I have asked for your comment.

Mr. MARTIN. It would have a serious effect on revenues, on the taxes that the Government pays as interest.

Mr. FORAND. However, now the States and local governments, of course, are getting the benefit of the tax exemption and I am sure you are aware of the fact that through the excise tax system the States are taxing the Federal money.

Mr. MARTIN. Yes; I am aware of that, and it is a ring-around-the-rosey.

Mr. FORAND. In other words, I have to assume from your answers that you would not be in favor of making the Federal obligations tax exempt?

Mr. MARTIN. Well, I won't say that I wouldn't be in favor of it, but I would say that it would have to be thought of as a part of a broad problem and not just for the sake of selling Treasury securities at a given time, because I think that these inequities have built up over a period.

Mr. FORAND. You feel the Federal Government would be competing with the State and local groups and that would be the big question so far as the economy is concerned, that we should have to consider.

On the other hand, I think you will agree with me that if the Federal Government is going to try to sell, for instance, its E-bonds and H-bonds, which are 10 years or more, that would be one way to get the money in.

Mr. MARTIN. Yes; I think that is right, and the Treasury has given a lot of thought, as you know, to that problem.

I was in the Treasury once myself, so I have a little background on that, and I think they questioned moving in that direction because of the difficulties that it opens up on the whole picture.

Mr. FORAND. Am I right in the thought that up until about 1941 Federal obligations were tax exempt?

Was it about 1941 that they taxed them?

Mr. MARTIN. There were some that were tax exempt.

Mr. YOUNG. Partially tax exempt.

Mr. FORAND. However, the big impact came in 1941, I believe.

Mr. MARTIN. Right.

Mr. FORAND. Thank you very much.

The CHAIRMAN. Mr. Byrnes will inquire, Mr. Martin.

Mr. BYRNES. Mr. Martin, of course one of the things is if we moved a large area of our debt into tax-exempt status, that would be to the rich man's benefit, would it not?

Mr. MARTIN. That is one of the problems involved in that.

Mr. BYRNES. You would just make a tax refuge for anybody that has any savings.

Mr. MARTIN. That is right, and I shouldn't get started on this, but I think it is a bit inequitable with the present State and local securities that some people who may be very good citizens, but do not work at all, can invest in the tax-exempt securities, whereas the man that has a large salary, and you may think his salary is too large, at least works for it and he has to pay a tax on it.

Mr. BYRNES. The Chairman inquired about with whom the Treasury had to compete in borrowing on long-term. I would like to make an inquiry as to whom the Treasury competes with in the short-term area, because in both cases we are going into a market and probably there is distinction between the two markets.

Mr. MARTIN. The short-term area largely goes to the banks at the present time.

Mr. BYRNES. And that is your inflationary impact?

Mr. MARTIN. That is your inflationary impact.

Mr. BYRNES. There can be no question of the extent of the inflationary impact as between going into the short-term market and the long-term market?

Mr. MARTIN. Not in my judgment, no.

Mr. BYRNES. We have had arguments made relative to this question of short-term versus intermediate and long-term and where the emphasis should be put as far as financing the \$75 billion or the \$100 billion, whichever it happened to be, which is going to have to be refinanced within the next year.

Quite a little emphasis was made in the Senate in the last several days and the argument was made that there was no need to act in raising or limiting the ceiling on the long-term issues because the Treasury had no ceiling on its under-5-year issues; there was no reason at all why there was not an ample short-term market, and that that is where the Government should go for its financing.

I would like, if you would in your capacity, your comment to that point.

Mr. MARTIN. Yes. I touched on that a moment ago and I say that the volume of short-term securities which the banks served as underwriters of and passed on to corporate nonbank investors because of their improving profit situation has been the saving limit in my judgment in the last 9 months, and that as we approach the time when those corporations and nonbank holders have other uses for those funds and turn them back, it is either the Federal Reserve purchasing them or the banks purchasing them, and under those circumstances that can be nothing but inflationary.

Mr. BYRNES. Could you explain also what effect that would have on interest rates generally?

Mr. MARTIN. Well, under present conditions, that is where you get this overall characterization of the economy. I think it would push your interest rates up. I do not think it would stabilize and put interest rates down. I think it will act in the reverse.

Now, what I have tried to state in my prepared statement today, whether I have done it or not, is that the judgment of the Federal Reserve Board on this is that if you were ordered to stabilize interest rates at the present time, if we are given instructions to carry them out, it would not work.

I was in the Treasury at one period when we were coming out of the war, and with the harness of wage and price controls and all the other things we had, we were able, with patriotism and other things, to handle this. We are in a cold war, but we are not in a hot war at the present time. And my judgment is—and most of my associates, I think, concur in this—that at the present time you could not have lower interest rates unless you had a decline in business, which is something that none of us desire. At least I do not.

Mr. BYRNES. The matter has constantly cropped up that, as you increase your interest rates, you freeze some people that need money, or need credit, out of the market, and therefore expansion that you might find desirable does not take place. Is it not also true, though, that as your interest rates go up, and if there can be a feeling of confidence in some kind of a stability of dollar value, you attract additional savings as part of that process? It is not just a matter of freezing out potential borrowers.

Mr. MARTIN. I think that is absolutely right, and I think that we want to do everything that we can to encourage the saving process at the present time.

I believe that the need for savings over the next few years is going to be substantial and that we want to do everything that we can to preserve and develop the process of saving and investment. And one of the things that is being endangered at the present time is this process of saving investment.

Mr. BYRNES. You make reference in your statement to an item that I think might bear repetition. Is it not true that anything that gives concern about the future value of the dollar is bound to increase interest rates because of its discouragement of savings?

Mr. MARTIN. I do not think there is any question of it.

Mr. BYRNES. So that those who worry about interest rates going higher, contending that we must avoid high interest rates, actually encourage higher interest rates if they, at the same time, support spending policies that impair the future value of the dollar?

Mr. MARTIN. No question of it.

The CHAIRMAN. Mr. Keogh will inquire.

Mr. KEOGH. Mr. Martin, I understand that one of the proposals of Treasury is to adjust upward the rate of interest on E- and H-bonds to 3¾ percent.

Mr. MARTIN. That is right.

Mr. KEOGH. I would like to make a statement and see whether you agree with this: that for the most part, and generally speaking, E- and H-bonds compete for the same savings dollar as the thrift institutions of the country look to?

Mr. MARTIN. Yes, sir; I would say that is correct, Mr. Keogh.

Mr. KEOGH. Now, I would like to ask you as to whether you have an opinion, in the present and under the reasonably foreseeable conditions in the future, the increase in the rate of interest on E- and H-bonds to  $3\frac{3}{4}$  percent will have the effect of attracting to them a percentage of those savings dollars that are now going into thrift institutions?

Mr. MARTIN. I think it will take some of them. But I think in the broad sense it will attract others in addition, so that both of them may benefit by it; that is to say, total savings may increase.

Mr. KEOGH. But there will be some shifting of the dollars, the savings dollars, from the thrift institutions to an E- and H-bond paying a return of  $3\frac{3}{4}$  percent?

Mr. MARTIN. I would not deny that, especially as regards new savings.

Mr. KEOGH. Is it not reasonable, therefore, to expect that the thrift institutions of the country will be faced with the necessity of considering an adjustment upward of their present interest or dividend rates?

Mr. MARTIN. They will try to do that. But I just do not think that this is a leapfrog operation that can go on indefinitely. Because competition does work in these things. And, at some level, they would not be able to afford to pay.

Mr. KEOGH. That is right. Now, do you think that it is sound practice for the Government so to attract from established thrift institutions the savings dollars by paying a higher rate of interest, with the effect that you have indicated which will probably occur; namely, the thrift institutions, in an effort to maintain their position, vis-a-vis the savings dollar of the country, will be inclined to raise their interest rates, and some of the existing institutions will be unable to do it?

My point is: Is it really essential that the Government increase its percentage of holdings of that type of savings dollar that goes into E- and H-bonds?

Mr. MARTIN. Well, if it is going to continue its program it is, both on the basis of fairness to present holders and equity with respect to prospective holders. Now, you may question whether that is the right program.

Mr. KEOGH. Well, do you have an opinion as to whether that program is necessary?

Mr. MARTIN. I think it is necessary and desirable; yes, sir. I think it has been developed, and I think it would be a mistake to scrap it. A lot of people disagree with me on that, and thoughtful people; but I think it is one of the really strong things that the Government has done in trying to get America to share in carrying this debt, the smaller savers as well as the larger savers.

Mr. KEOGH. Then that is overlooking the patriotic motives that prompt people to put their savings dollars into E and H, is it not?

Mr. MARTIN. I am considering that as a part of it. But I think that has been of real value to the country, both through the war and in the postwar period.

Mr. KEOGH. And the rate of return on these bonds has been of relatively lesser importance than the patriotic motives?

Mr. MARTIN. I think it has steadily gotten to the point, though, that the patriotic motives do not hold up. You see, the trend has been against that.

Mr. KEOGH. Now, let me ask you this question. Do you have an opinion as to the relative inflationary or antiinflationary effect of a savings dollars going into an established thrift institution or going into an E- or H-bond? Which one is more or less inflationary or anti-inflationary, if either is?

Mr. MARTIN. I do not think there is any real question there. The Government is spending the money in one instance, and the thrift institutions are investing it in the other.

You are placing the debt in the hands of nonbank holders. That is the main point there.

Mr. KEOGH. Do you not agree that, for the most part, the investments made by thrift institutions are in capital assets that produce income rather than just going for consumer goods, that the Government spends so much of its money for?

Mr. MARTIN. Well, the Government does not put all of it into consumer goods.

Mr. KEOGH. No, I appreciate that.

Mr. MARTIN. I think that it is noninflationary in either case.

Mr. KEOGH. In either case. Well, one more, or one less?

Mr. MARTIN. I think that with the program that we have, the savings bond program, as it has been developed, it has been really a major factor in trying to keep the Government debt in a noninflationary way.

Mr. KEOGH. I appreciate that, and I am inclined to agree with you. My only concern is whether that program is so justified as to warrant their coming in now and asking for virtually a half percent increase in the rate of interest paid on those types of bonds. And I am looking for some expert help on it.

Mr. MARTIN. Well, I think we can agree that the present interest rate level is such that a prospective purchaser would feel that he did not have any warrant in buying a series E- or H-bond on any other basis than patriotism or just desire to hold something in the Government. I think that is not a good situation.

The CHAIRMAN. Mr. Baker will inquire.

Mr. BAKER. Let me ask one question, Mr. Martin. In answer to a question of Mr. Forand concerning the advisability of extending tax-exempt status to interest on Government bonds, you stated that one major factor would be a substantial revenue loss. Do you know what that would amount to?

Mr. MARTIN. No; I do not.

Mr. BAKER. I figured it out, and I think I had this figure, from the Treasury, of 1.9 billion. We pay \$8 billion in interest annually, as I understand it. So if you applied the 25-percent effective rate, it would be somewhere in the neighborhood of \$2 billion.

Mr. MARTIN. Right.

The CHAIRMAN. Mr. Boggs will inquire.

Mr. BOGGS. The point has been made to many of us that the Federal Reserve System has tried and is trying to carry out its function almost entirely through increasing the interest rate rather than through such devices as selective credit controls and higher reserve requirements. Would you care to comment on that?

Mr. MARTIN. I will start on the first one first, Mr. Boggs. The only selective control we have is the stock market regulation. Regulation of consumer credit and regulation of real estate credit we do not have at the present time.

On the reserve requirement, as I commented in my statement, I think that it is a difficult tool to deal with, but if you are going to put reserve requirements up you are going to cause sales of Government bonds at the present time, with the demand for credit. Now, that just puts pressure on the Government securities market.

I remember very vividly when I was in the Treasury when reserve requirements were put up to 24 or 26 percent in 1950-51, and we had a pegged Government market. All that happened was that these bonds were dumped in on us at par, and 22/33, where we stood at the present time, and we had not made any net gain at all.

I personally think that requirements—I have testified frequently that reserve requirements for the growth and development of the country that I see ahead of us, are too high, and that I would hope that we would get ultimately lower reserve requirements. Every time I have said that, the press has jumped up and said, "We are going to lower reserve requirements day after tomorrow." But I am talking about a longer range thesis, and I want to see this country always have an adequate money supply, but I do not want to see inflation created, and I do not think it is going to be a substitute to say we will raise reserve requirements at the present time and just force additional sales of Government securities that either we will have to buy or the banks will have to buy. There is no net gain in that.

Mr. BOGGS. Do you feel that a so-called tight-money policy prevents inflation?

Mr. MARTIN. I think it is one of the factors that are very helpful in it.

Mr. BOGGS. In the type of an economy in which we are living, with the tax structure we have, this means that any corporate borrowing—52 percent of it is written off right away for tax purposes. So I do not see how interest rate has any perceptible effect on any large corporate expansion. It seems to me the old law of supply and demand must have the deciding influence. It might have a very definite effect on small businesses that cannot afford these high interest rates, and upon the municipalities and others which are now paying these outrageous rates for money.

Mr. MARTIN. Mr. Boggs, all I can say on this matter of interest rates is that all my life I have had people tell me that interest rates do not make any difference, and at one point, I was on the floor of the stock exchange—

Mr. BOGGS. I did not quite say that, Mr. Martin. But you go ahead.

Mr. MARTIN. I am trying to put it in perspective.

Mr. BOGGS. Right.

Mr. MARTIN. And my experience with it has been that it has much more influence than you realize.

Mr. BOGGS. Where does it have the influence? That is what I am trying to find out.

Mr. MARTIN. It has the influence on forcing people to study their costs at all times, even though they are willing to pay the price. That is one of the important things.

Mr. BOGGS. I am trying to find out. What people?

Mr. MARTIN. All people. You said the wealthy corporation does not pay any attention to it. I think they do.

Mr. BOGGS. Would you say they pay as much attention to it as the fellow who has got to go down to the bank and pay 6 percent and whose business condition may be such that he does not have any tax writeoff at all?

Mr. MARTIN. I will make this observation on that, that I have seen a lot of people sign contracts that were not 6 percent but 12 percent or 15, that they did not understand or did not pay attention to. I have seen a lot of corporations study that contract pretty carefully. When people have got it, you can make that argument either way.

Mr. BOGGS. There is one thing about this I do not understand at all. I want you to understand that I do not understand. I am just asking questions.

I read in this morning's paper that the month of May showed the highest income that we have had in all history, and yet Government securities are the weakest they have ever been. What accounts for that?

Mr. MARTIN. As I tried to point out in my statement, Mr. Boggs, whenever you are having a period of prosperity, there is a tendency for interest rates to rise. That has always been true, on just normal factors.

Now, when the Government ran a deficit of the size that it did a year ago, and interest rates got down to the levels they did a year ago, some adjustment was likely to occur. Now we have had some stabilization, and interest rates have been behaving fairly well in the last few weeks. I do not say they will continue. I do not know. But I mean these adjustments take place. But rising interest rates have never been a sign of weakness in the economy. That does not mean that you are trying to produce them. They have been a sign of growing confidence and of a willingness to use that device.

Mr. BOGGS. You seem to be avoiding my question, if you will pardon me for saying so.

I did not ask you about the rising interest rates on Government securities. I asked you about the declining value of the Government securities, 80, 82. How long has it been since they have been that low?

Mr. MARTIN. Declining prices for Government securities is just the other side of the coin of rising interest rates. A U.S. Government security is the safest security that there is in the world today. When it comes to the payment of interest or the payment of principal at maturity, you do not have any worry there. Your problem is one of depreciation of the value of the currency.

Now, we have gone through a period of the last 10 or 12 years where, as I have said earlier, people have constantly said, "Where is the inflation? Show us the inflation." Yet the end result is that we have a dollar today that is worth 20 or 30 percent less than it was in early postwar years depending on what year you pick for comparison.

Mr. BOGGS. How much has it depreciated in the last 12 months, this dollar?

Mr. YOUNG. Wholesale prices of industrial commodities, sir, have risen since June of 1958 about 21½ percent.

Mr. BOGGS. You did not answer my question.

Mr. YOUNG. That would mean that the dollar in wholesale markets for industrial commodities has depreciated somewhat less than 2½ percent.

In the consumer markets, the cost of living has been relatively stable over this same period. So that, in this period the consumer's dollar has not depreciated in value. If you take a longer period, then the consumer's dollar has depreciated in value.

Mr. BOGGS. In the last 12 months, from the point of view of what the purchaser can buy with his dollar, you had the most stable dollar you have had in how many years? There has been no depreciation at all. You just said that.

Mr. YOUNG. I beg your pardon. I did not say that.

I said the dollar at wholesale in industrial commodity markets has been losing its value.

Mr. BOGGS. And what is the situation from the consumer standpoint?

Mr. YOUNG. The consumer's dollar has maintained its value. Now, a rise in wholesale industrial prices tends to exert upward pressure on retail prices. It takes some time for these matters to work out.

Mr. BOGGS. Well, you are predicting——

Mr. YOUNG. I do not want to be in the position of predicting.

Mr. BOGGS. Then what significance does your statement have?

Mr. YOUNG. Retail prices are in part made by wholesale prices.

Mr. BOGGS. So you are now saying, as I understand, that some time in the predictable future, the consumer's dollar will decrease 2 percent in value?

Mr. YOUNG. I do not want to be in the position of saying that, price trends may change.

Mr. BOGGS. That is what I want to get straight.

Mr. MARTIN. Let me just pick it up and say that that goes back to what I was trying to point out earlier. You can take several periods in the last——

Mr. BOGGS. Wait a minute, Mr. Martin. I want to get right back where I was. I want to stay right there.

I asked a simple question about what had happened to the dollar in the last 12 months, and this gentleman said, on the wholesale index it had declined 2 percent. From the point of view of the consumer, he said it had been stable. So then I said to him, does this mean that the consumer dollar will decline a further 2 percent, and he said he would not make that assumption. That is where we are, as I see it.

Mr. MARTIN. All right. Let us leave it right there.

Mr. BOGGS. So what is the consumer dollar worth today as compared to the last 12 months?

Mr. MARTIN. I think that statistically it is worth about the same as it was 12 months ago.

But it is worth somewhat less in terms of the confidence factor, which I also think is one measure.

Mr. BOGGS. You do not quite agree with your colleague.

Mr. MARTIN. I do not think we are in disagreement.

Mr. BOGGS. I am trying to find out, and I am sure you understand my line of inquiry, where this inflationary thing is coming from. Here you have had this tremendous deficit situation, \$13 billion, which

is the largest peacetime deficit in the history of the United States. And by some strange coincidence, you have this magic thing that everybody sees, a stable dollar. Is there any correlation between the two? Does this mean a \$13 billion deficit gave us a stable dollar?

Mr. MARTIN. No.

Mr. BOGGS. What does it mean?

Mr. MARTIN. It means that the forces which are actually in the economy, many of which had worn themselves out during the period of 1957 and 1958 recession, have, so far as the cost of living index at this particular juncture is concerned, stabilized themselves.

Now, let us take the cost-of-living index, as an example. We had it in 1955 where manufactured items were going up and farm prices were declining. That preceded a period where shortly thereafter you had the combination of both of them going up, and then we were in trouble, and we were not very happy at that time, because the farm prices were declining.

Now, you are having somewhat of that same factor here. You are having some prices that have been moving up, and we have had farm and food prices, on the whole, declining. Now, the composite makes a fairly good picture during this particular period.

But I do not have the slightest hesitation, and I stand on what I said in my statement, in saying that the pricing process as it affects world markets, the lower level of exports, the general pricing of American exports, the stability of our imports, those price factors are things that have given concern to people with respect to the future value of the dollar. And part of the problem we have to deal with is this confidence factor.

Mr. BOGGS. Mr. Martin, if this is inflation, it certainly is not in the traditional sense of excess dollars knocking up against not enough consumer goods. Are there any consumer goods in short supply today?

Mr. MARTIN. There probably are some; at least, some at prices higher than many consumers want to pay, which is what shortage of supply means to them. I am not familiar enough with the picture to pinpoint them. But the big thing here is to return to this process. The process of inflation is what created the temporary overconfidence that we have had in the economy and the slack is now being taken up.

Mr. BOGGS. What do you mean by overconfidence? Is it overcapacity, or underconsumption?

Mr. MARTIN. Overcapacity in the sense of not being able to sell your product at a price that people are willing and able to pay. If you give goods away, you do not have to have a payment factor, and you have a different story. But we built up very rapidly in 1956 and 1957, and part of it was the expectation of meeting higher prices and passing the price on to the consumer. That always ends in a period of, in this country, I am glad to say, temporary overcapacity. We are coming out of a period of temporary overcapacity, and the thing that you saw in the paper this morning on capital spending is one indication that we are coming out of it. We want the development of this, as it goes along, to be sustainable capacity, in the sense that they can produce the product and sell it at a price that people are willing and able to pay.

Mr. BOGGS. We have had no reduction in the debt for a good many years. As a matter of fact, the administration has been in here asking us to increase the ceiling again.

How much more does it cost to finance the national debt now than it cost 8 years ago?

Mr. MARTIN. Several billion dollars.

Mr. BOGGS. How much does it cost to finance the national debt now?

Mr. MARTIN. It is over \$8 billion.

Mr. BOGGS. About \$8½ billion; is it not?

Mr. MARTIN. That is correct.

Mr. BOGGS. If this interest rate continues to go up, with a national debt approaching \$300 billion, how much money do you think it will take us to finance the national debt?

Mr. MARTIN. I am trying to get the interest rate to go down, and I think that this measure will be one of the things that will contribute to it going down.

Mr. BOGGS. You think that the increase in governments will decrease other interest rates?

Mr. MARTIN. I think in relation to the business picture today, if the Government cannot get financed on a sounder basis than it is at the present time, it will make it impossible to finance the Government at a lower rate than at present.

Mr. BOGGS. I really do not understand that at all. Because from what I have been told by the administration, there is great competition for money; with industry seeking to expand, and so on, and looking for money, the building and loan associations looking for money to build houses, and so forth and so on. And now you say if you make governments more attractive and you put more money in governments, you will run the interest rate down. That, I do not understand.

It would seem to me that building and loan association A would say, "Now we must raise our interest rates to 4 percent in order to get Congressman Keogh to deposit his money there."

Mr. MARTIN. I think that is only the short-run implication. My conviction is that with the present state of the Government finances, it is imperative to demonstrate to people that we are going to have fiscal and monetary responsibility, and that, if this is demonstrated, it will do a great deal to lower interest rates in the period ahead.

I think that the only real way you will lower interest rates is by reducing the level of borrowing and increasing the flow of savings. Then I think you will really get lower interest rates.

Mr. BOGGS. Then this means that there is no competition for this money.

Mr. MARTIN. Not a bit of it. Competition for money is always present, but one of the elements in this competition is the factor of confidence in the dollar.

Mr. BOGGS. If you had complete confidence, now, let us say, in governments, would this mean that you would have less confidence in the building and loan associations and the other places competing for this money?

Mr. MARTIN. No, we would have more confidence in all of them.

Mr. BOGGS. So there would be more demand for the money?

Mr. MARTIN. No, more supply.

Mr. BOGGS. What would happen?

Mr. MARTIN. Well, you are talking about borrowed money now?

Mr. BOGGS. Certainly.

Mr. MARTIN. Well, I am talking about savings that come into this picture, not just the fact that people want more money.

Mr. BOGGS. I do not understand the difference. When you are borrowing, it is the result of somebody's saving, is it not?

Mr. MARTIN. That is right.

Mr. BOGGS. So it is the same thing.

Mr. MARTIN. Well, there is only a limited amount of those savings.

Mr. BOGGS. Exactly. So there is competition for it. Is that right?

Mr. MARTIN. That is right.

Mr. BOGGS. So you have stabilized one, and then the other one must go up. Is that not so? And you say it goes down.

Mr. MARTIN. Well, I think the stability comes from the relationship of bona fide savings to the flow of demand for money.

Mr. BOGGS. Has it worked that way in the past?

Mr. MARTIN. I think so.

Mr. BOGGS. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Curtis will inquire.

Mr. CURTIS. First, let me say that I have appreciated your very clear statement.

One thing in response to a question by Congressman Boggs about the effect of the \$13 billion deficit: Would you not agree with me that we have not yet felt the effect of it; that that is what we are coping with right now? So, I doubt if it would show up at this time, at any rate, in either the Consumer Price Index or even the Wholesale Price Index. That is the \$13 billion deficit that has been created this last year. And Congressman Boggs was making the point that in spite of that we have not seen an increase in the Consumer Price Index or the Wholesale Price Index, and as I gather what he is trying to imply, this was not a very great inflationary factor.

And the question asked was: Is not the effect that will come from a \$13 billion deficit something we are beginning to experience about now and we would not in the normal course have experienced it in the past 6 months?

Mr. MARTIN. No question at all about it. I agree.

Mr. CURTIS. I was a little surprised that he made that statement, I might say, inasmuch as he is on the Joint Economic Committee, and in our hearings in January and February on the President's Economic Report, almost all the economists, whatever their shade of belief, said that we would not be able to feel the inflationary pressures probably until around May or June. I think they even predicted a little bit later. But almost all of them said that we would begin to experience the pressures about then.

And I have been quite interested to see how accurate their predictions have been, because I think the May Consumer Price Index did go up a tenth of a percent. That was the first indication.

And I think Mr. Young pointed out that the Wholesale Price Index would precede the Consumer Price Index.

I just thought that was important, because the people were being lulled into the belief that because we were able to maintain price stability in the past 12 months, we do not need to worry about the financing of the \$13 billion deficit and these other inflationary pressures. I am afraid we are going to be badly damaged by the situation. Would you agree with that?

Mr. MARTIN. I would agree with that.

Mr. CURTIS. One other point I want to stress, because—I might say that these questions are necessary because of the job that this committee or any committee has in presenting measures on the floor of the House—our job is to try to explain to our colleagues just what we have learned in these hearings. I find that there is one great misconception about the Federal Reserve Board, and I note in your preliminary remarks you stated that you are appearing here not as spokesmen for the administration but as Chairman of the Board of Governors.

Now, in your capacity as Chairman of the Board of Governors of the Federal Reserve Board, you are not a part of the administration, is that true?

Mr. MARTIN. That is correct.

Mr. CURTIS. And, in fact, there are some who state that the Federal Reserve Board in some respects is an arm of the Congress. I do not know that it is exactly that, either. I doubt if it is. But I wonder if you would just express, if you can, briefly, just what the independence of the Federal Reserve Board means, so that we do not get that in argument when we debate this on the floor.

Mr. MARTIN. I will not go into a lengthy discussion of it. The Federal Reserve Board is clearly an agency of the Government. The Federal Reserve banks are quasi-Government institutions that partake in some sense of the nature of a private connotation. But the independence that we talk of as to the Federal Reserve is independence within the Government but not independence of the Government. We are a creature of the Congress, and the Congress has given us, has bestowed on us, through the Federal Reserve Act, a trust indenture by which we handle the money supply which comes from the power of Congress to coin money and regulate the value thereof, and within the framework of that trust indenture we can exercise the independence of our judgment until such time as the Congress takes that trust indenture away from us.

Mr. CURTIS. That is correct. And the Executive has no control over how you carry on those functions.

Mr. Mason is making the point that you said that you are a governmental agency, but he says that does not mean an administration agency.

Mr. MARTIN. That is right. And it is independence within the Government and not of the Government.

Mr. CURTIS. Now, before what has been referred to as the Federal Reserve accord of 1951, the Federal Reserve Board as a matter of policy has been supporting to some degree the Government bond market; is that correct?

Mr. MARTIN. That is right.

Mr. CURTIS. My colleagues in the House in recent months have been suggesting that the Federal Reserve Board go back, as I understand it, to the policy pursued before the accord. I would ask you: Is there anything different in 1959 that would suggest to you that the reasons why the policy was changed in 1951 to bring about the Federal Reserve Board, which no longer pegs the bond market—is there any difference that should make us change that policy now, in your judgment?

Mr. MARTIN. Well, quite the reverse. My view is that at the present time we do not have any nearness to war that would make possible invoking anything that would help us in the field of control.

Now, prior to the Treasury-Federal Reserve accord, you want to understand clearly that Federal Reserve did this of its own volition.

Mr. CURTIS. That is right.

Mr. MARTIN. It was not forced on it.

Mr. CURTIS. That is right.

Mr. MARTIN. And the reason that it did it of its own volition was that, during the war, we were faced with wartime finance. And then when the Korean war came along we were one step removed from wartime finance, but nevertheless it was a national emergency, and we were still coming out from under the harness of wage and price and materials controls of the war, and we were able to suppress inflation to a large extent through that wartime period.

And it is my view that, today, if the Congress gives us instructions to peg Government securities, we will, of course, do the best we can with that directive, but my guess is that it not only will not be successful but that interest rates will actually rise instead of being stabilized. And that is the judgment that you would have to make.

Mr. CURTIS. I think that a suggestion my colleagues have been making is to go back before the 1951 accord and see the economic forces that brought about the complete change that followed.

I remember Senator Douglas made a very lengthy speech on that subject, pointing it out. And the one thing that he said there in answer to those who said that we would have to pay more interest, that the Federal Government would have to pay more interest, in handling the Federal debt, if we stopped pegging the Government bond market, his answer was "Yes," but that the Federal Government being such a purchaser of goods in the market was paying four times the additional amount they would have to pay in interest through the inflation that resulted in the increased prices for goods and services the Government had to pay.

And I think that was one of the underlying factors in changing the situation into the present accord, which is still in effect, is it not? Is not the 1951 accord largely in effect?

Mr. MARTIN. The 1951 accord is just a milestone.

Mr. CURTIS. But it has not been reversed.

Now, on page 6, you make this statement, in the third paragraph, the last sentence:

The suppressed inflation that resulted, we are now well aware, burst forth eventually in a very rapid depreciation of the dollar and even threatened to destroy our free economy.

Now, the threats to destroy our free economy are borne out, would you not say, in the fact that we went to various credit controls and even to consumer-price controls. Is that an indication of what you mean as to the damage that results from this kind of process, or do you have something else?

Mr. MARTIN. What I had in mind there, really, was that the whole basis of operations in the market was threatened in such a way that we were going to move in the direction of overall Government control.

Mr. CURTIS. Yes, sir. I hope our colleagues in the House will bear that well in mind, that that is what we experienced before 1951, and

it is exactly what we will experience, in my judgment, and as I understand your judgment, if we try through artificial means to change what might be the free market value of money.

One other epithet or shibboleth that is constantly used—and I heard it used again by my colleagues on Friday here—is this “tight-money policy.” It will be used again. But I want to try to pin that down to some degree, if I may.

The tight-money policy, as I understand it, is not a situation created by the Federal Reserve Board, but rather the reaction of the Federal Reserve Board to a money situation. That money situation is where there is an increased demand for money and, in order to react to that economic phenomenon, the Federal Reserve Board then tightens up so that we do not get more money in the economic system than we can handle and maintain price stability.

Is that accurately stated?

Mr. MARTIN. Yes, sir; that is accurately stated. And in the money stream, we are talking about the velocity of money as well as the quantity.

Mr. CURTIS. Exactly. As I remember the old formula, it is not just the amount of money; it is the velocity of money. And I have been a little bit surprised in questioning by some of my colleagues to see so much attention paid to the amount of money without the same regard being paid to money velocity which, I think, you have brought out.

Conversely, the Federal Reserve, when there is a situation where the demand for money has eased considerably, where the regulatory reaction of the reserve is in that regard, so that, as I understand, your objective is to create, if you can do so, the right amount of money in an economy at the right time.

Mr. MARTIN. That is correct. That is correct. We do not ever want a period when there is not an adequate money supply. But we do not want that money supply overflowing.

Mr. CURTIS. Because that damages economic growth, it creates recession. I would hope that when this debate comes up on the floor of the House we do not hear the phrase “tight-money policy” as if it were something that were the creation of the Federal Reserve Board, but rather it is the reaction of the Federal Reserve Board to an economic phenomenon.

Mr. MARTIN. Yes, sir; and it is the money supply that we are trying to regulate. It is not interest rates. The interest rates—some people think it is subtle, but there is just a misconception that you are setting an interest rate.

Mr. CURTIS. Interest rates are set by the demand for money in the free market; is that not right?

Mr. MARTIN. They are influenced. I am not saying that we do not have a managed currency. We do. They are influenced. But I do not think that they can be influenced against these wider forces indefinitely. They may be for periods of time, but not indefinitely. And that is one of the saving graces in Federal Reserve policy, in my judgment, which means that errors will be forced to be corrected from time to time.

Mr. CURTIS. I am like the Chairman. I have lots of questions, but I do not want to trespass on the committee's time.

There is one final point I would like to try to clarify if I can, or bring out.

The Chairman has brought out that probably there might be some competition on the part of the Government going into the money market, where competition would provide for private enterprise's need for these same funds.

There is the matter of going to the banks, for example, for building and equipment, and so forth, that industry needs for its expansion.

But essentially should not industry be financing this kind of expansion through new equity capital rather than through debt financing, particularly bank debt?

Mr. MARTIN. Well, particularly bank debt is bad.

Now, because of the tax problem and others, there has been a tendency to go into debt, when, in my judgment, people would be wiser to go into equity.

Mr. CURTIS. I could not agree with you more. And, of course, to me it is one of the great flaws in our present tax structure, in connection with some of these shibboleths my friends have been using when they were attacking debt credit, which was actually an attempt to shift a lot of this debt financing into equity financing, which, if achieved, would have produced more revenue and not less, because we do get more revenue from equity financing than we do from debt financing.

Mr. MARTIN. One of the dangers in the present picture is that as these pressures for funds develop, the banks are increasingly moving in the direction of the type of loan they ought not to be making.

Mr. CURTIS. I agree with you.

Now, one advantage that has not been expressed of this increase of interest rate, I imagine would be to encourage corporations possibly to finance more of their growth through new equity issues. We are now getting into a situation in the market where we might consider financing new equity issues.

Would you not say that is a proper observation?

Mr. MARTIN. I would say that is a proper observation.

I would also say, as long as you had a wide disparity between the income that you get from common stocks and the return on bonds, at some point you will have to have an equalization of that if our economy is to resume its—

Mr. CURTIS. There was one other thing I did mean to mention that had not been mentioned before. It is just an item, but I noticed in the bill proposed there is a feature of it that would require us to pay into the trust funds, which mean the social security fund, interest which would average out the kind of interest we are paying on other governmental securities. I was happy to see that, because, incidentally, that is going to help us a little bit in our financing and some of these other things.

I would think that that would tend to be deflationary to that extent. I do not think it is a big item, but to the extent it is there, it would seem to me to be deflationary.

Would you agree with me?

Mr. MARTIN. And sound financing.

Mr. CURTIS. And sound financing; yes, sir.

The CHAIRMAN. Mr. Ikard will inquire.

Mr. IKARD. I was very interested in Mr. Curtis' expression of his hope that we would stop using the term "tight money." I have

been operating under the impression for some time now, for instance, that the Guaranty Trust Co. of New York was an organization that has some understanding of fiscal affairs, and I notice in their letter which arrived in my office today, and I assume everybody got it, they refer to further tightness in money conditions. And I have noticed on previous occasions that they have used the phrase "tight money." So there must be some validity to that term, and I do not want to get into any petty argument here about terms. But if we have been using the term "tight money" wrongly, I would like to be informed.

Mr. MARTIN. Well, we get into semantics on this, I think. And I think it means that the demand for money is constantly building up and tending to outrun the supply. And that is a situation that is not brought about by conscious effort to raise interest rates. That is brought about by the flow of money.

Mr. IKARD. But it is a fair descriptive term as to the money market at particular times, is it not?

Mr. MARTIN. I will agree with Mr. Ikard that we have worked like slaves to find other phrases, and that is probably as good as any.

Mr. IKARD. That has been my impression, too.

Mr. CURTIS. Will the gentleman yield?

Mr. IKARD. Yes.

Mr. CURTIS. I was not objecting to the phrase "tight money." I was trying to point out that it was not a phenomenon created by the Federal Reserve Board.

Mr. IKARD. I am sorry. I misunderstood you.

Mr. CURTIS. The Federal Reserve Board was reacting to that phenomenon.

Mr. IKARD. Yesterday, Mr. Martin, I also raised a question that Mr. Curtis alluded to, and that was this matter of there being not so much money available.

If my recollection serves me right, in the last 6 years the amount of money available has increased something like 11.8 percent, while our gross national product has increased roughly 26 percent.

Taking into consideration the velocity during that period, as well as the amount of money available, has the growth in money been about right, or should it have been more or less?

I would like to have your comment on that.

Mr. MARTIN. Well, I will comment. All I can do is give you my judgment on it.

Mr. IKARD. That is what I seek.

Mr. MARTIN. And I also want to say that although money statistics is the main product of the Federal Reserve Board in one sense, I am by no means sure that we have found the right way of handling it. It is our major activity, and we are working on it.

My own judgment, Mr. Ikard, is that it has not only been adequate; it has been slightly more than adequate during that period.

Now that is a judgment on the statistical measurement, both putting quantity as well as velocity into it, and relating it to the whole period.

Mr. IKARD. Your best judgment is, as I take it, that this growth in money, and taking into consideration the velocity, the turnover, has not contributed to the fact that there has been a tendency for interest rates to edge up?

Mr. MARTIN. I will not say that it has not contributed some. I think that the demand-supply relationship and the money supply have at some points contributed.

Mr. IKARD. But I take it from what you previously said that this pressure on interest has been brought about largely through the growth of our economy and a growing demand for money.

Mr. MARTIN. That is right.

Mr. IKARD. I was interested in the questions that Mr. Boggs asked you earlier this morning, too. If I may go back to that a moment, the question I think he put was substantially this: Assuming so many dollars available in the money market, if you make the long-term Government securities attractive to the point where the money moves into that area, would that be inflationary? You would be taking this money out of the market.

Mr. MARTIN. No, I think the inflationary impact comes in the short end of the market, in the bank created money; yes, sir.

Mr. IKARD. I understand that. But as someone else said here, I have no opinion, I am just seeking light.

I do have a question in my mind about what we are really talking about here. I do not think it is whether it would be a desirable situation to have it not all long term or short term. Is it not the matter of balance that we are most concerned with?

Mr. MARTIN. Exactly. That is one of the reasons I think it would be desirable for the Treasury to have the authority, so that when they come up to a situation like this, they could balance it better.

You see, now they are limited by exactly where they stand, and balance, I think, is exactly the right word.

Mr. IKARD. Another question in that area. Let us say I put my money into a savings and loan association, and they lend it to you, let us say, to build a home. Why is that anti-inflationary?

Mr. MARTIN. Well, savings and loan institutions—

Mr. IKARD. Or any other savings.

Mr. MARTIN. Well, just using that as an illustration, it is because that is on a basis of a certain number of years to pay off that loan, and that has come out of savings that they have attracted, which are then placed at a rate of interest; whereas if the banks create the money to do that, you are just adding to the money stream, without tapping the savings flow at all. That is the real weak link here. I am not against bank-created credit when it is being properly used, but if it is being siphoned into long-term housing projects of individuals it is not performing its function of being a commercial bank and adequately protecting the deposits of its customers.

Mr. IKARD. Let me ask you this. It has been suggested to me—this is not my idea, I want to make that clear, but it has been suggested—that in order to solve the dilemma with reference to the E and H bonds, we could adjust them to the cost-of-living index, and make them an anti-inflationary security. The reason would be that people do not now buy them, because they do not have the confidence which you have spoken of several times this morning. If we issued a savings bond that would guarantee at the end of its term the return of the principal plus sufficient interest to take care of any increases in the index during that period, we would have no problem selling it plus the fact that it has been suggested that it might also serve as some stimulus on those of us in Congress to keep the index down.

Mr. MARTIN. I think it would be a tragedy for the Government to accept the necessity of having a bond tied to a cost-of-living index. If we cannot manage our affairs in such a way as to have a currency which people can expect to save and have approximately, not exactly, the same value over a period of years, but have to have some built-in insurance for it, then it seems to me we are just following a policy that ultimately the American people are bound to repudiate. I do not think this is an issue of party lines at all. I think this is just a matter of the unit of currency.

Mr. IKARD. And then will it not be a fact if you tied too many things to this cost-of-living index that every time we moved a point we would have to readjust our own society?

Mr. MARTIN. Exactly.

Mr. IKARD. I believe that is all, Mr. Chairman.

The CHAIRMAN. Mr. Martin, would it be possible for you to be back at 1:30?

Mr. MARTIN. Whatever time you say, sir.

The CHAIRMAN. Without objection, then, the committee will adjourn until 1:30.

(Whereupon, at 12:25 p.m., the hearing was adjourned until 1:30 p.m., this same day.)

#### AFTERNOON SESSION

The CHAIRMAN. The committee will please be in order.

Mr. Alger will inquire, Mr. Martin.

Mr. ALGER. Thank you, Mr. Chairman.

Mr. Martin, I just returned from the floor where they are talking about the wheat bills. I thought we had trouble understanding some of the technical details of debt management, but I think we are in as much trouble in that field and it is as difficult to understand as this one.

Referring to your statement this morning, which I enjoyed very much, I had the privilege of getting it early and studying it before arriving here today, I want to ask you several things relating to your testimony.

On page 2 and again on page 10, you speak about interest rates in periods of boom and recession, and make the general point that interest rates rise in periods of boom and decline in periods of recession.

Yesterday Secretary Anderson spoke to us about the interest rate in relation to deficit spending by the Federal Government as against the period, and the only one he could use as an example was during the twenties, when there was a Government surplus.

My question to you is this: What would be the effect on the interest rate if Government created a sizable surplus and started paying down the debt?

Would this not have a depressing effect on the interest rate or a lowering of interest rate?

Mr. MARTIN. It would have that effect if it went on for any length of time.

I think you have to look at it practically that in a period of boom you have to take your opportunity to build a surplus and to pay down, and then you will reverse that when the boom tapers off and stability occurs, and you resume your open pressures.

It would be one of the adjusting limits in the economy.

Mr. ALGER. Your basic point is, which I certainly do not contest, that the interest rates rise in time of prosperity and decline in times of recession. The rise in times of prosperity, where because of growth and expansion everyone is seeking money, would be offset appreciably if the Government over a sustained period collected more money, in other words, more receipts, than it spent, would have the effect of doing the very thing you are trying to do; stabilize the interest rate.

Mr. MARTIN. That is right, exactly right. There is no question in my mind.

Mr. MASON. Would the gentleman yield?

Mr. ALGER. Yes.

Mr. MASON. \$5 billion taken out of the money market and \$5 billion put into the money market by the Federal Government in paying its debt makes it \$10 billion in the effect upon the interest rate.

Mr. ALGER. You would agree with that?

Mr. ALGER. On page 3 you say in the middle of the page:

Mr. MARTIN. I think in general.

This has been a period of great economic growth, very active demands for credit, further monetary expansion, and continuing, though perhaps abating, inflationary measures.

My question is, Do you feel that the inflationary pressures are abating, in reference to the question of Mr. Curtis earlier, in which he pointed out that the Joint Economic Committee has felt that the impact of the \$13 billion deficit last year has not yet fully been felt, what did you mean?

Would you expand on that "though perhaps abating"?

Mr. MARTIN. Yes. I was referring there to the world, not just to the United States. I start out:

Since the stabilization of monetary systems in key countries \* \* \*.

Recently there has been a tendency for inflation as a problem to abate in a number of countries in Western Europe. One of them has been France that has taken very heroic measures to handle their fiscal and monetary affairs and seems to be making real progress.

I agree completely that the problem in this country has not yet been solved, particularly because of the deficit that you are referring to, and we are frequently getting the comment that I referred to this morning here: Where is the inflation?

I counter that by asking, "Does anyone think there is no danger of inflation at the present time, with a debt of this size having been built up over a period of the last year and the momentum that the economy is currently enjoying?"

Mr. ALGER. There is the possibility, therefore, of the inflationary pressure here, though in the world they might have been abating?

Mr. MARTIN. I only say abating. I don't say that they have been eliminated.

I was pinning that not to the United States, but to the world economies, and that ties in with the latter comments with respect to the price level in the world.

Mr. ALGER. I appreciate that, Mr. Martin.

You bring up another subject which I do not believe has been developed, and I realize it is a very technical one.

On page 4 in the paragraph beginning in the middle of the page, you refer to the effect of our necessarily high tax structure on the effective rate of interest. Then you mention the borrowers' net cost, the lenders' net return, and below you say :

On its own taxable bonds, the Federal Government, through the income tax, recaptures a substantial share of the interest it pays.

Mr. MARTIN, I do not recall ever having heard this argument developed fully, although I am a newcomer on this committee.

Mr. MASON. The effect of our heavy taxes upon the interest rate has never been mentioned before us.

Mr. ALGER. Is there anything further you could add to this?

You just touched on it and left it. Many of us are worrying about the progressive nature of our taxes, not only the high taxes.

What are the effects?

Does it kill the desire to invest?

We know it kills somewhat the desire to earn.

Mr. MARTIN. I think the effects are cumulative. We touched on some of them this morning and the desire to use debt in preference to equity investment on the part of some, but the point I was trying to make here basically was that people say, "Aren't these outrageous levels of interest?"

While we want as low interest rates as we can have, we also want to point out that in perspective they are not exactly the same as they seem because of the tax relationship. They are actually not as high as they appear to be because of the tax relationship. That is not a justification for their rising, but it is something to be concerned about and to consider, and there is a point, and your committee of course is more familiar with this than I am, and I think we have skirted around it, in this country where taxation is progressively destroying the incentives in the economy and therefore impairing the saving and investment process.

I think we ought to have a tax structure as well designed as possible, and this is not meant to be critical of anything in our present tax structure, but our tax objective ought to be to have a system which will provide the incentive for saving and investment, and building the economy in that way instead of tearing the economy down by reversing it.

Mr. ALGER. I certainly appreciate your concern for that and the fact that you even brought it up.

Without taking more time now, could you direct me, or at some other time direct me, to anything that treats of this?

Do you recall any material written on the effect of progressive or high taxation on investment and interest rates?

Mr. MARTIN. We will search our files and see what we have, Mr. Alger, and be glad to give it to you later.

Mr. ALGER. I would certainly appreciate it, if you will, sir.

On page 8 you bring up something else I know very little about, and I only want additional comments if you feel they are appropriate in the way in which you mentioned them.

You said, at the bottom of page 7 :

Ultimately, if the gold reserve requirements to which the Federal Reserve is now subject were eliminated, the System might acquire a large proportion of publicly held Government debt of over \$200 billion in this way.

I do not understand that.

Mr. MARTIN. At the present time the Federal Reserve has to have against its deposit liabilities and currency in circulation 25 percent in gold holdings. That is in the Federal Reserve Act.

The point I was making there was that if that were eliminated as a requirement, we could continue to acquire assets up to what is virtually the limit of the total marketable debt of the United States without violating our reserve requirements, which is written in the Federal Reserve Act.

Mr. ALGER. Does this necessarily imply that when we lose gold through imbalance in trade or whatever other reason such as mutual security, the payout of dollars, which are a foreign claim against our gold unlike our citizens' dollars, your reserves are being cut down all the time as this gold goes out of the country?

Mr. MARTIN. Unless we offset it, there is no question about it.

Mr. ALGER. This weakens the amount of money you have for investment in that sense then?

Mr. MARTIN. That is right.

Mr. ALGER. I want to look into that, too. I may call on you for a little additional material.

Then you mention on the final page the international effect of the value of money. Some of us have heard the expression of soft currency.

Here you make a rather strong statement, which earlier you did not.

Here you say:

Today the dollar is the anchor of international financial stability.

You also express your justifiable concern over the fact that our currency is or could be solid. Do you see any appreciable change in the value of the American dollar in the international situation or in the eyes of world investors recently, or a change within the last year, that should be of great concern to us or not?

Mr. MARTIN. I have already commented on this publicly, Mr. Alger.

I have no doubt that there is some limited speculation against the dollar at the present time. I don't think there are substantial proportions to it, but I think there is enough of it so that it properly should give us some concern, and that is what I am trying to point out here.

As the European currencies have become more convertible, or more nearly convertible, as they have, the temptation to look elsewhere for an anchor has increased.

Mr. ALGER. Is there some justifiable grounds for their being concerned about the United States?

I realize that here sometimes the Government spends money we don't have, for example, \$13 billion last year.

Do foreign nations now fear our fiscal soundness and spending programs?

Is that what they are implying?

Mr. MARTIN. I think that is what they are thinking.

Mr. ALGER. I asked the Secretary about our softening currency. I do not know either; I am seeking information. Quite some time ago he made the statement that he made here yesterday, and it is the only other time I have heard it made. In that vein he said it is natural for

nations that are investing in us to worry about our currency, to make sure we are solvent.

The Secretary pointed out that we are the bank for the world and others are investing in it. With the money they build up in us, like anybody that invests in the bank they want to be sure that bank is solvent and their money is safe.

He said this then is a sign that actually the United States is assuming in the world's eyes more and more the role of the banker. He made it sound like a matter of strength.

I had the idea that maybe it was not that so much as it was other nations fearing that the value of the dollar has declined or will decline because of our own lack of discipline or inability, which we have demonstrated for almost 25, 26, or 27 years now, of living within our means.

Mr. MARTIN. I think the overriding point is your latter point. I think there is that doubt in the world today that we are going to handle our affairs.

Mr. ALGER. I appreciate that and I have suspected this to be true.

Mr. Chairman, just one other question, and I certainly appreciate this opportunity, Mr. Martin, to get your thinking. I have had uneasy feelings as I have listened to these hearings and all of the questions that have been asked. I looked at your statement, and I studied carefully what the Secretary said again last night, and I conclude that there are certain natural economic laws that to the economic world might be likened to gravity in the physical world.

We here will not change natural law.

Could you say that the interest rate is an economic law as the price of the commodity in the marketplace, and it will go up and down with the supply and demand of that commodity just as any other goods might?

Mr. MARTIN. I think it has the elements of that.

I have often thought of it and use the illustration of a thermostat.

When the weather is changing outside, you cannot worry about the cost of the heating material that is required to keep the house at the temperature that you desire. Interest rate is in my thinking then one of the governors that we have on the economy generally. It is the result of those pressures. We do influence those pressures.

I don't want to give the impression that we can do nothing about it. We have a managed currency in the Federal Reserve and we have an overriding responsibility in the Federal Reserve to see that money is available at all times, but not an overriding responsibility to keep the price of that money from having the forces of the marketplace reflected. And I am sure that was the intent of the framers of the act so far as a managed currency was concerned.

If we were to be given the authority to just set an interest rate, which is the misconception that has bothered me so much over the last 10 years, that we could just set an interest rate at some level, then we would have a relatively simple problem, but, unfortunately, that isn't the way it works, unless you have control of all the elements of the economy, and then you have the problem of enforcement.

Let me just carry on one minute on that. Take our totalitarian friends. Some people say they don't have to worry about any of these problems. They get growth. They are not concerned with infla-

tion. They don't have to be concerned about inflation. They just even this thing up at any time that they want.

We cannot operate that way, and I don't think they operate it too successfully that way, but to say that they don't realize that inflation impinges upon the growth is I think a misunderstanding of the economic process.

Mr. ALGER. Mr. Martin, you made another statement on page 1, as I recall, that really just hit me right. You pointed out that the accumulation of wealth and freedom of choice are a couple of rights in our society which to me are examples of the natural laws that we believe don't even come from government. They only are to be preserved by government.

I will not take more of your time on this, though I enjoy your views. As I see it, the problem now is to determine to what extent we have natural economic laws and to find out to what extent the Federal Reserve impinges upon them for good or bad.

If I may, I will conclude by asking you just this, and this came up yesterday with Secretary Anderson. I was very impressed by two points that Secretary Anderson made, and I can give you the page and so forth to be factual.

He pointed out that we have two big dangers. He mentioned the \$13 billion deficit last year, or any deficit spending, for that matter, spending beyond receipts. He said that this is a major factor in the pressures for an increase in interest rate, and this in turn will result in the inflation that hurts most of all people of modest means. That is, the spending beyond income that the Government does.

Then he went to another point, saying that artificial interest rate limitation also fosters inflation, which once again hurts most of all the people of modest means.

Here is the thing which I think a lot of my colleagues in Congress do not grasp, and I am sure as I am sitting here it is going to come out in debate, particularly if anyone should unwisely try to use it for political gain, that by insisting on big spending by the Federal Government, spending beyond income, which fosters inflation, by insisting on artificial interest rates, which again fosters inflation, they are hurting the very little man or the people that they want to help the most.

Would you disagree with that as a matter of principle?

Mr. MARTIN. Not the slightest.

I am convinced that inflation is the bugaboo of the little man. The little man is almost defenseless against it.

I just make the one overall point that to me as an old investment man hits me in the face every day, that I know thousands of trust accounts, and I am not against trust accounts, that have done extremely well in the last 3 or 4 years as opposed to the little man, and his savings and his relative position in the economy has deteriorated.

That is on a relative basis, but that is to me the key of the whole thing.

Mr. ALGER. Mr. Martin, taking what I have just said into account—just think of this—if through inflation we are jeopardizing and hurting, as you have just pointed out, the little man, and if through progressive and high taxation we are lessening the desire of people to reinvest because of the rate of interest they get, which you pointed

out, as 2 percent maybe, if they are in the 52 percent bracket, look what we are doing through Government mandate. That is what scares me and why I for one want to learn my lessons on just what the Federal Reserve is doing relating to these natural laws.

The thing I wanted to ask specifically in this question is this:

Do you feel when we spend beyond Government receipts year after year, spending beyond our income, this is inflationary?

Mr. MARTIN. It is inflation, unless it is financed by selling the debt to nonbank investors, and that is where the flow of savings comes in to us.

Mr. ALGER. Savings naturally then are caught by taxation, and you would say also that the limitations on interest rate through artificial means would have an inflationary effect?

Mr. MARTIN. It causes distortions and maladjustments in the economy which inevitably lead, in my judgment, to a lower standard of living.

Mr. ALGER. And hurt most of all those of modest means?

Mr. MARTIN. That is my absolute conviction.

Mr. ALGER. Thank you, Mr. Martin. I certainly appreciate your statement and any help you can give me relative to these questions I have asked, I hope you will.

The CHAIRMAN. Mr. Metcalf will inquire, Mr. Martin.

Mr. METCALF. Thank you, Mr. Chairman.

I want to pursue a little bit further some of the matters that Mr. Alger was talking about and some of the matters that Mr. Curtis was talking about.

Our main objective here is to find out whether or not we should accept or reject the administration's proposals that we take the present ceiling off of the interest rate on the long-term indebtedness, and on page 8 of your statement you gave us a little bit of an outline and an example of what would happen to a corporation under the present tax system under a 4¼ percent interest rate.

My question is how much do we have to increase the interest rate? Where are interest rates going to attract that corporate investor you are talking about?

Mr. MARTIN. The important point, Mr. Metcalf, I thought was brought out by Mr. Ikard here this morning, of balance in portfolio. We are not talking about saddling everything on the long-term bond market, but the Treasury has to be one of the people that is financed in that way for its long-term credit needs.

Where we are going on the ultimate level of interest depends in part upon the demands that are going to occur for interest in relation to the growth of the economy, and to the extent that we can create bona fide savings we can finance a much higher level of activity than we presently have at lower interest rates in my judgment.

Mr. METCALF. However, you had in mind when you set forth that example on page 8 that there was going to have to be an increase in interest rate to attract this corporate investor.

Mr. MARTIN. What I was really driving at there was the charge of many people that interest levels at the present time are outrageous, and I was pointing out that in relating it to taxation in historical perspective—I am not advocating high interest rates now—actually it was not a very high level in terms of historical perspective when you considered the tax problem.

Mr. METCALF. I will accept that, but my question is: Why do we have to increase the interest rate?

You say if we remove the ceiling it might even go lower, but to attract this corporate investor you must have in mind that the interest rate is going somewhere above the  $4\frac{1}{4}$  percent or you would not be here advocating that the limit be taken off.

Where is it going?

What is the percentage that we are going to have to increase?

We just the other day passed out of the House the bill to maintain the corporate tax rate at 52 percent, so we are going to keep the income tax rate for those corporate investors at the same level.

Where is the interest rate going to go?

Mr. MARTIN. I can't answer it because I don't know.

Mr. METCALF. You must have in mind some place that it is going to go.

Mr. MARTIN. No, absolutely not. It will adjust at some level to an equilibrium rate across the board, and I think the big problem that the Treasury is facing today is this problem of balance in its own portfolio. It has no real choice of how to use its instruments in the whole market.

For example, I was in Spain just recently and a fellow said over there, "Isn't it too bad? I just found out the other day your country can't sell anything but short-term securities."

I said, "How did you just find that out?"

"Well, I just found out that there was a law over there that they can't pay higher than this rate and the rate is now higher than that."

Well, it doesn't prove anything, but it is an interesting commentary of how people sometimes look at us.

Mr. METCALF. Then you are trying to tell me that just because we take the ceiling on interest rates off, these corporate investors that you are talking about on page 8 will continue to come in and buy at the present rate?

Is that what you are suggesting?

Mr. MARTIN. The corporate investors are not coming in at the present time at this rate.

Mr. METCALF. Therefore, it seems to me that you must have some place in your mind to be able to inform us as to where we are going to go and where the interest rate is going to go if we take this ceiling off.

Mr. MARTIN. I wish I could tell you that. It would simplify my problem greatly if I could, but I can't.

Mr. METCALF. It seems to me that if you are going to suggest that we have the balanced portfolio that you were talking about to Mr. Ikard, you are going to have to attract some of these corporate investors that you are talking about that cannot afford to invest in Government bonds at the present  $4\frac{1}{4}$ -percent interest rate.

What I am asking you is how much do we raise the rate so they can afford to invest to get that balanced portfolio?

Mr. MARTIN. If we could give you a precise rate, we would give it to you, but this is not a case of that. You are talking now about the adjusting forces in the market, and I for one happen to believe that they would balance out at lower rates than some other associates of mine would think they would balance out.

I believe that the adjustments in interest rate do not have to be as dramatic as some people think they have to be, and I use as my background for that the Treasury-Federal Reserve accord. I was told at that time by dozens of people that if the Fed starts pegging Government bonds, they will just fall out of bed, that any adjustment at all will create a sensation.

As a matter of fact, a very minor adjustment produced for a temporary period of time at least an equilibrium in a market that had become clogged, disjoined, and unable to handle itself.

Mr. METCALF. You cannot tell me then where in your experience rates may go if we take this ceiling off?

Mr. MARTIN. No; I cannot. I wish I could.

Mr. METCALF. Thank you.

Thank you very much.

The CHAIRMAN. Mr. KNOX will inquire, Mr. Martin.

Mr. KNOX. Mr. Martin, first I want to commend you upon the great knowledge you have of the fiscal affairs of our Nation and the way that you have responded to the questions which have been propounded to you here today.

Take the \$1,800 million which came due in the month of May of Federal securities, and the Treasury of course had no funds to pay off the securities, but asked that the same holders once against purchase new securities on I think 1-year debentures, and that one-third of the holders of those securities which were purchased at one and a quarter percent delined to purchase them at  $4\frac{1}{4}$  percent.

We have \$76 billion, I understand, of securities coming due next year; is that correct?

Mr. MARTIN. Yes.

Mr. KNOX. Of course, if we are unable to refinance through long-term bonds, then of course naturally the Treasury would have to go into short-term bonds. Treasury could offer short terms at any rate of interest which they could sell them at; is that correct?

There is no ceiling.

Mr. MARTIN. Yes.

Mr. KNOX. What would this do to the interest rate in your opinion, if all of the \$76 million has now to be financed on short debentures?

Mr. MARTIN. It will drive the rate up very substantially.

Mr. KNOX. Is there a possible chance that a great majority or some of the \$76 billion may have to go into short-term securities if the ceiling is not removed from the long-term bonds?

Mr. MARTIN. I think that is right.

Mr. KNOX. It presents a serious problem, not only on the part of the Treasury, but on the financial solvency of the Nation; does it not?

Mr. MARTIN. I think it does.

Mr. KNOX. Most of these short-term securities would be purchased by the banks of the Nation?

Mr. MARTIN. They would be purchased by the banks and I think you put your finger on it, Mr. Knox.

We are talking here about the public credit of the United States. That is really fundamentally what we are talking about.

Mr. KNOX. I listened to Mr. Anderson and to the statement he made in his prepared document yesterday. Although the Treasury does have the option to sell bonds at  $4\frac{1}{4}$  percent, and it also has the

right to discount those bonds, but the Treasury does not look favorably upon it.

If the Congress does not act, there may be a possibility—I hope it never occurs—that the Treasury may have to discount these bonds in order to sell them?

Mr. MARTIN. It is possible.

I think the Treasury has been very wise in not pursuing that course before presenting the problem to the Congress, and I hope that the time will never come when they have to do that.

Mr. KNOX. I think the Treasury has been very explicit in their remarks and statements to the committee here, at least that they do have and have had this right under the law since 1942, but do not want to have to exercise that right.

Mr. MARTIN. That is right.

Mr. KNOX. They come here now asking that the ceiling be lifted so we may give the Treasury some flexibility in order to operate in the bond market.

Mr. MARTIN. That is right.

Mr. KNOX. That is all I have.

The CHAIRMAN. Are there any further questions of Mr. Martin?

Mr. Martin, again we thank you, sir, for coming to the committee and giving us the information you have about this matter. Thank you very much.

Our next witness is the Director of the Bureau of the Budget, the Honorable Maurice H. Stans.

Mr. Stans, we appreciate having you before the committee on this occasion. You are recognized, sir. You may proceed in your own way.

#### STATEMENT OF MAURICE H. STANS, DIRECTOR, BUREAU OF THE BUDGET

Mr. STANS. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, in support of the President's recommendation on the statutory debt limit, I should like to review the budgetary situation briefly as it now stands.

As you know, first of all, we ended fiscal year 1958 with a budget deficit of \$2.8 billion and with a public debt of \$276.3 billion.

The revised budget figures for the fiscal year 1959, which ends this June 30, as estimated in January, showed expenditures of \$80.9 billion, and a deficit of nearly \$13 billion. While there is the possibility that the budget deficit may be as much as one-half billion dollars less, the January estimates will not be very far from the mark.

In view of the size of the expected 1959 deficit, it will not be possible to come within the debt limit of \$283 billion that becomes effective on June 30 under existing law.

With respect to fiscal 1960, I pointed out to this committee on June 3 that as of now the only change in the January estimate of budget expenditures which seems definite is for interest on the public debt. Because of currently higher interest rates, this expenditure may be about one-half billion dollars more than originally estimated.

As the President stated in his message on Monday, the strength of economic recovery and growth beyond our earlier expectations is now expected to increase revenues by enough to offset this one-half billion dollars of increased interest cost on the public debt.

There are, however, other factors, still not definite, which might affect the total of 1960 expenditures. Here are some important enough to deserve special mention.

Most of the regular appropriation bills for fiscal 1960 are still pending in Congress. The same is true of major substantive legislative bills that could have important effects on the total expenditures for the coming fiscal year.

For example, major bills approved by one or both Houses of Congress include authorizations for housing, airports, and area assistance in excess of the amounts recommended in the budget.

While congressional action to date on appropriation bills alone indicates the possibility of some expenditure reductions, taken altogether action on all bills thus far would, if they were enacted in present form, result in larger increases than decreases in the budget.

Other factors which should be kept in mind in appraising the budget outlook for 1960 are the recommendations of the President to raise postal rates and to increase taxes on motor and aviation fuels. If these are not enacted, the expenditures for 1960 will increase by more than \$600 million, and the estimated surplus affected accordingly.

Finally, this committee is well aware of the difficulty of predicting expenditures very far into the future for certain largely uncontrollable items such as the amount of surplus farm crops which must be acquired under existing laws.

In addition, there are always uncertainties about the international situation.

Considering all these factors, I hope we can manage to hold to the slim margin of balance estimated in the January budget. A \$70 million surplus in a budget of \$77 billion does not afford much leeway.

Assuming that revenues do cover expenditures for the fiscal year 1960, as estimated, the slim surplus could not effect any significant decrease in the public debt. It therefore seems reasonable to set the permanent debt limit at \$288 billion, which is \$13 billion higher than the permanent limit before the recession-induced deficits of 1958 and 1959 occurred.

As the President and the Secretary of the Treasury explained, such a limit would provide about \$3 billion of leeway to protect the Government in case of unforeseen emergencies and to provide needed flexibility for debt management.

I assure you, and I think the record shows, that the administration, while determined to meet our national responsibilities, will do everything in its power to achieve a balanced budget for fiscal 1960. Nevertheless, the debt limit should take into account the closeness of the estimated budget balance and the necessity for some margin of safety.

In addition to the budgetary situation, the debt limit should also take into account the Treasury's requirements for sound debt management, for flexibility in the timing of resort to the securities markets, and for adequate cash balances.

According to the best estimates of the Treasury, this requires a temporary increase of \$7 billion above the proposed permanent debt limit of \$288 billion.

The CHAIRMAN. Mr. Stans, we thank you, sir, for your appearance and this information that you have just given the committee.

Mr. Stans, what would be your reaction to fixing the ceiling on the public debt as of a given time rather than with respect to each day of the fiscal year?

Say that we look at the Government's business somewhat like a business looks at its own operations and we decide that we can have outstanding so much debt as of a given day, June 30 of each year.

Do you see any harm in such procedure rather than having a ceiling with respect to every day's operation of the Treasury?

Mr. STANS. Mr. Chairman, I should think the Secretary of the Treasury's opinion on this might be perhaps more helpful than mine, but I would see no reason in the world why it would not be adequate to have a yearend debt limit and allow the Treasury to have whatever flexibility it needs in the course of the year.

I think the figures presented by the Secretary of the Treasury show that there is quite an unevenness in the collection of taxes and some unevenness in expenditures, and those sometimes are very hard to predict, so that I believe the Congress would have all the controls it wants if it had a yearend debt limit alone.

The CHAIRMAN. I wanted to get your judgment. I have great respect for your thinking in this field.

Are there any further questions?

Mr. ALGER. Mr. Chairman.

The CHAIRMAN. Mr. Stans, Mr. Alger will inquire.

Mr. ALGER. This is elementary, but supposing, through existing programs already in law to expend money, that for a fraction of time the payroll of the Federal Government exceeded our cash on hand, is it possible that we might not have the money on hand to pay Federal employees?

Is it possible we could fall short and not even meet the payroll?

Mr. STANS. I think that is quite unlikely, Mr. Alger. I believe the Treasury's plans always take into account the contingency of some irregularity in receipts or in disbursements, and of course they do have access to the bill market for temporary borrowings.

I think the situation you describe would be an extremely unfortunate one, but I believe we can trust Treasury to see that does not happen, so long as the debt ceiling is adequate.

The CHAIRMAN. Are you through, Mr. Alger?

Mr. ALGER. Yes.

The CHAIRMAN. Mr. Knox will inquire, Mr. Stans.

Mr. KNOX. Mr. Stans, there is something that has concerned me for some time and that is relative to the annual trip that the Treasury, the Bureau of the Budget, and other agencies that have to do with it make to the Congress and ask for an increase in the temporary debt limit.

Why is it necessary that we are confronted with this problem each year?

Mr. STANS. I think one of the difficulties, Mr. Knox, is, it is pretty hard to predict more than a year ahead how the finances of the Gov-

ernment are going to come out. In other words, whether we are going to have a balanced budget or a surplus or a deficit.

I think our experience a year ago is a pretty good illustration of the problem of predicting the budget situation for any extended period.

At the present time, we are reasonably confident that the 1960 budget will either be in balance or will show a small deficit, but I think we all have to recognize that if we start to project into 1961, there are a tremendous number of uncertainties that would be almost impossible to evaluate, and I would hesitate at the moment to give any estimate of what the budgetary situation will be for 1961, particularly until the Congress has completed its action on the 1960 appropriation bills and on substantive legislation.

Mr. KNOX. Would you feel that there would be any objection if the committee should recommend to the Congress, and it was approved, to put the temporary debt ceiling at \$295 billion until June 30, 1961, instead of 1960, and then if it was necessary that the temporary possibly be made permanent, that the administration could come forth and ask the Congress for further consideration of the increase?

Mr. STANS. Again, the Secretary of the Treasury might have a view on this that would be more valuable than mine. I would not see anything objectionable certainly in making a 2-year debt limit because if circumstances appeared to be such a year from now that it was unworkable, we would have to come back and ask for another change in it.

Mr. KNOX. It is not also true that with the vast amount of legislative effort that the Congress has made for certain programs which the money has not been allocated for, there is a possibility that it would continue at about the same level as it is today?

Mr. STANS. I think that is a pretty good possibility.

I think it is unlikely that we can expect that the fiscal year 1961 would show any very substantial surplus.

Mr. KNOX. That would just be automatic would it not?

It would just naturally go back?

Mr. STANS. In that case you would need about the same debt limit as you would need for 1960; that is correct.

Mr. KNOX. That is all.

The CHAIRMAN. Are there any further questions?

Mr. KARSTEN. I have a question.

The CHAIRMAN. Mr. Karsten will inquire.

Mr. KARSTEN. Mr. Stans, I wonder if you could tell us the difference in interest on the national debt in the 1959 budget as distinguished from the 1960 current budget?

How much more interest will we pay in 1960 than will be paid in 1959?

Mr. STANS. There is a difference of under a hundred million dollars between 1958 and 1959.

Mr. KARSTEN. Is that at the increased rate we have been talking about, this 4½ percent, or is that something that came along before we were talking about increasing the rate and taking off the 4½-percent ceiling?

Mr. STANS. I thought you asked the difference between 1958 and 1959.

Mr. KARSTEN. No, 1959 to 1960, Mr. Stans.

Mr. STANS. I am sorry.

There will be an increase in 1960 over 1959 of about a billion dollars in our interest cost.

Mr. KARSTEN. A billion dollars?

Mr. STANS. Yes.

Mr. KARSTEN. Many of us were under the impression it was \$500 million. Can you break that down for us?

Mr. STANS. I can explain it to you in this sense; that the original budget estimate that we submitted last January estimated that interest costs would be about \$500 million higher in 1960 than in 1959.

Mr. KARSTEN. That was the budget that came down in January; is that right?

Mr. STANS. That is correct.

Since then the market situation has been such that, coupled with the effect of this legislation, it now appears as though the interest cost will be another \$500 million higher than it was in 1959.

Mr. KARSTEN. Then we are about a half-billion dollars wrong in our January guess?

Mr. STANS. We were \$500 million low.

Offsetting that, it is the administration's present estimate that our revenues will increase by about the same amount, that our budget posture is still unchanged in showing a very small surplus.

Mr. KARSTEN. However, we are still in the end paying out about a billion dollars more interest this year than we will have paid out last year?

Mr. STANS. Yes, sir; 1960 over 1959.

Mr. KARSTEN. Do you anticipate that this legislation we are talking about which would take off this ceiling on the Government interest on bonds would result in any further increases in the carrying charge on the debt, or do you think this is the top?

Mr. STANS. We don't expect that this legislation will involve any significant increases in 1960 and we do expect that, whatever the increases will be, the increases will be nominal and will be within the \$500 million figure that I have given you.

Mr. KARSTEN. That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions of Mr. Stans?

Mr. ALGER. Mr. Chairman.

The CHAIRMAN. Mr. Alger.

Mr. ALGER. Mr. Stans, I thought someone else would bring this up, and I for one want to commend you for your statement on page 2.

The House has done most of its appropriation work and we know the other body many times ups our bills, I know that is implicit in your statement. You are concerned that this may upset the balance, but you mention something else, Mr. Stans, that I do not believe some members have faced up to, namely, the pending spending bills—housing, airports, and area assistance, and other bills that will provide additional spending, including those which we have been calling the back-door method where money will be taken directly from the Treasury, actually going around the Appropriations Committee.

Am I correctly interpreting what you say here in your concern that this slim surplus you mention on page 3 may turn into a deficit?

Is that the reason you mention these other spending bills there?

Mr. STANS. That is one of the things that I am concerned about, yes, that this type of substantive legislation which Congress is now considering would provide for heavier amounts of authorization and expenditure than the budget contains for them. If that is the case, then not only do we face the risk of eliminating any potential surplus for 1960, but we take on increased burdens in 1961 and subsequent years as well.

Mr. ALGER. Thank you, Mr. Chairman.

The CHAIRMAN. Are there any further questions of Mr. Stans?

If not, again, Mr. Stans, we thank you, sir, for coming to the committee and giving us the information you have.

Thank you.

Mr. STANS. Thank you.

The CHAIRMAN. Our next witness is our colleague from Texas, Hon. Wright Patman.

Mr. Patman, we are pleased to have you with us today to discuss this matter that you have discussed with us before in part and this new feature which we have not considered in several years in this committee. We appreciate having you.

#### STATEMENT OF HON. WRIGHT PATMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. PATMAN. Thank you, Mr. Chairman. It is good of the committee to hear me.

After I finish my prepared statement, I would like to document the answers to some questions that have been raised here, particularly about:

One, do we have a free market in Government securities? I want to document the point that we do not.

And, two, I want to show by citing good authorities that if you raise the interest rates on U.S. Government securities, that will raise all other interest rates.

Furthermore, I will show that the independence of the Federal Reserve System which has been claimed is the principal cause of our troubles in regard to the national debt and interest rates; that when we raise the national debt and then raise interest rates, that, in turn, necessitates increasing the national debt again.

Mr. Chairman, I am opposed to increasing the legal debt limit. I am also opposed to repealing, or even raising, the interest rate ceiling which was enacted during Woodrow Wilson's administration in 1918, and I am opposed to increasing interest rates on the series E and H bonds.

As to the proposal to raise the debt ceiling, it is unnecessary for this reason: The Federal Government is now holding \$25 billion of its own interest-bearing debt obligations. At least \$15 billion of these obligations can and should be canceled immediately so as to reduce the present debt by that amount.

The fact is, as you may know, Congress is now considering a bill which will give away to the private banks about \$15 billion of these securities, which will be the biggest giveaway in all history.

This legislation, the so-called vault-cash bill, was recommended by the administration and by the Federal Reserve Board. It has already passed the Senate; it has been approved by the House Com-

mittee on Banking and Currency and by the Rules Committee of the House, and we may expect the House will pass it within the next few days.

The \$25 billion of interest-bearing obligations that I refer to are held by the Federal Reserve System. They have been purchased in the open market and paid for with Government funds. They are owned by the Government and not by the private banks. The private banks have no claim to them whatever.

In purchasing these securities the Federal Reserve System has not used any reserves deposited by the private banks, or any other funds of the private banks. The fact is that most of these bonds were purchased from the private banks.

These statements of mine about the ownership of the \$25 billion of obligations are not in dispute. They have been agreed to many times by all authorities, including the present Chairman of the Federal Reserve Board and the past Chairmen of the Federal Reserve Board.

Now as to the question of what amount of these securities the vault-cash bill will give away, this is in dispute.

The bill gives the Federal Reserve System authority to reduce bank reserves by about \$12 billion immediately, which authority could be used only by either :

(a) Setting off the biggest inflation in history, or

(b) By transferring ownership of an equal amount of the Fed's securities, without cost to the banks.

Some of my colleagues on the Committee on Banking and Currency would no doubt tell you, however, that they are unaware of anything in the legislative history of this bill which indicates the Federal Reserve will use this authority for either of the two purposes for which it could be used. I think the legislative history is clear and unmistakable, but I will not impose on this committee a question which is in dispute in another committee.

I simply call the committee's attention to the fact that the Federal Reserve Board has reported to Congress that its present holdings of \$25 billion of bonds and other interest-bearing obligations of the United States are a great deal more than it needs for all purposes and all possible contingencies. Consequently, there is no reason why \$15 billion of those obligations should not be canceled immediately, and thus remove any need for increasing the debt ceiling.

I might add also that if \$15 billion of these securities are canceled, this will remove any possibility that this amount of securities will be given away. If these securities are given away, the Government will have to pay for them again when they become due, and in the meantime the Government will have to pay interest on the securities, which interest will go into bank profits.

At the present time the interest on these securities is paid back into the Federal Treasury. The Federal Reserve System meets its operating expenses out of these interest payments, sets aside some money in a so-called surplus fund, and returns the balance to the Treasury.

There is an added point about which there is also no dispute.

The \$25 billion of Government securities which the Federal Reserve System is holding have, in the last analysis, been paid for by the issuance of non-interest-bearing obligations; namely, Federal Reserve

notes. Federal Reserve notes are, of course, currency in the pockets of individuals and in the cash registers of business firms. They are obligations of the United States, as is plainly stated on the face of them. They are signed by the Secretary of the Treasury, just like any other Government obligation, whether they draw interest or not—they are signed by the Secretary of the Treasury and the Treasurer of the United States and not by the Chairman of the Board of Governors of the Federal Reserve System. They are obligations of the United States—it is so stated in the law—but they are not obligations which are subject to the legal debt limit.

They are not expected to be redeemed. They will remain in circulation for the convenience of business and consumers in carrying on trade and commerce.

Now let me read from a report which the Board of Governors of the Federal Reserve System submitted to the Committees on Banking and Currency of the Senate and House with reference to the vault-cash bill. This is the Board's position as of April 7, 1959, about 2 months ago, with reference to the amount of its \$25 billion of interest-bearing securities which it feels it needs to keep :

To the extent necessary to avoid undue credit expansion, reserves released by any reduction in requirements could be absorbed by Federal Reserve sales of securities in the market. This would in effect shift earning assets from Federal Reserve banks to member banks. The present System portfolio is adequate to permit a substantial reduction and still leave enough to provide sufficient earnings to cover necessary expenses, as well as for current purposes of policy.

Any decrease in requirements, however, should leave the Federal Reserve with a portfolio adequate to cover possible future contingencies, such as a large inflow of gold or economies in the use of currency that might add reserves in excess of appropriate needs. (U.S. Congress, House of Representatives, Subcommittee No. 2, Committee on Banking and Currency, hearings, "Member Bank Reserve Requirements," 86th Cong., 1st sess. (1959), p. 28.)

May I suggest an estimate of the amount which the Federal Reserve would need to keep in its portfolio for the purposes which it has specified?

Six billion dollars of securities would provide the Federal Reserve System with an income sufficient to meet expenses.

In 1957, which is the latest year for which we have a report, the Fed's interest income on its holdings of Government securities amounted to 3.15 percent. Six billion dollars, yielding an annual interest income of 3.15 percent would give the Fed an income of \$189 million. Its expenses in 1957 came to \$169 million, including amounts set aside for various reserves. For its retirement systems, and including some very plush luxuries.

As to the amount of securities which the Fed would need to hold, to sell at a later time to meet the contingencies which it has mentioned, actually it does not need any amount. These contingencies could be met by raising reserve requirements.

One contingency is a possible large gold inflow from abroad, which would increase bank reserves and which would be inflationary unless offset by Federal Reserve action.

The other possible event is a decline in the public's preference for currency, as opposed to bank deposits, in which case bank reserves would also be increased.

In either case, the Fed would no doubt prefer, however, to meet such contingencies by selling securities from its portfolio rather than by raising required reserves of the member banks.

The experience record of the past 40 years would indicate that \$2 billion would cover both of these contingencies. In other words, an \$8 billion portfolio of Government securities would be more than adequate to give the Fed a luxurious expense income and leave it in a comfortable position to meet the contingencies it envisions and in the manner in which it would prefer to meet them.

But, to be extra generous, so there could be no possibility of objection, I have proposed leaving the Fed with a portfolio of \$10 billion of Government securities and canceling immediately \$15 billion. This will make the proposed increase in the debt ceiling completely unnecessary.

Now, if the committee should wish to cancel other amounts of unnecessary debt, there are two other suggestions it might consider.

First, the Federal Reserve System is holding approximately \$1 billion in a so-called surplus fund, for which no conceivable need could ever arise. If this \$1 billion were paid promptly into the Treasury, the present Federal debt could be reduced by that amount.

Second, it is really not necessary, and I cannot imagine by what reasoning it is appropriate, for the Federal Reserve System to hold interest-bearing obligations of the United States for the purposes of having an interest income to meet its expenses.

The \$6 billion of debt which I have suggested leaving with the Fed for this purpose should be canceled, and the Federal Reserve Board should come to Congress for annual appropriations, just as other Government agencies do. This would reduce the present debt by another \$6 billion.

When the vault-cash bill comes to the floor of the House for debate, I expect to offer an amendment to the bill which will require the Federal Reserve Board to turn over to the Treasury immediately for cancellation \$15 billion of the securities it is now holding.

If the Congress and the President accept this amendment, the administration's proposal to increase the Federal debt by \$12 billion will be completely unnecessary.

Removing the 1918 ceiling on interest rates is unwise and unwarranted.

I come now to the administration's chronic problem, interest rates.

Like most people today, I accept and believe in the collective-bargaining processes. Furthermore, there is no question that when the bankers and moneylenders want a wage increase, they must come to the Government to get it. There is no place else to go. In this, I am assuming, of course, that the Federal Reserve System is still in reality a part of the Government.

It is true that it has, under this administration, assumed the posture of a fourth nonelected branch of the Government, exercising powers to overrule or reverse economic policies decided upon by Congress and the President through constitutional lawmaking processes.

Furthermore, the President has repeatedly ratified this posture so that we would seem to have a super government of bankers sitting over and above the constitutional Government.

It is hardly reasonable to assume, however, that the President would agree to this independent government position of the Federal Reserve System if there were any serious policy differences between the administration and the Federal Reserve.

We should be fair and openminded on the question whether there is really any need to give the bankers and moneylenders a larger share of the national income. We should expect, however, that some reasonable argument would be advanced for such a proposal.

There is no claim, however, that the moneylenders are entitled to a cost-of-living increase, that their productivity has increased, or that there is a hardship which should be met. Rather, the arguments which Secretary Anderson made to the committee yesterday are these:

One, the Federal debt is now at an alltime high, having reached \$1,600 for each man, woman, and child in the country.

Two, the demand for savings has increased and the Federal Government cannot compete with the demands of State and local governments, private industry, or the stock market; in fact, cannot even compete with itself.

Three, the main problem is that interest rates have been pushed up by a growing belief that there will be inflation, an inflation which Secretary Anderson says has not materialized and a belief which he says is mistaken. I share his views.

The only inflation we have today is inflation caused by high interest. In other words, if the interest rate had not been increased since January 20, 1953, the Eisenhower administration would not have had to come to the Congress at any time in the past or now in order to get a debt limit increase. It is all caused by high interest, and if you increase it again, again we will be called upon to increase the debt limit, just as we have in the past.

Four, monetary policy is an all-controlling factor in times of recession and becomes what is called one of aggressive case. But at times when interest rates are being raised, all the Government instruments of monetary policy disappear into the thin air of flexibility and interest rates are made by something called a free play of market forces.

Five, we have demonstrated the ability of a free economy to come out of an economic recession and the high interest rates have been caused by the \$13 billion deficit, which it is suggested to be a product of Congress "fiscal irresponsibility."

Six, the same old saw that this administration inherited a short-term Federal debt and wants to lengthen the maturity of the debt.

And finally, Democratic administrations financed the tremendous debt of World War II, while holding the bond rate at 2½ percent, and the consequences were horrible.

Let us give a little examination to these arguments.

First, the Federal debt is at an alltime high, and it does average \$1,600 for each man, woman, and child in the country. But in past years it has averaged a great deal more when the country was presumably less rich, and when interest rates were a great deal lower.

In 1946, the debt was \$1,908 per capita, and in 1950, it was \$1,650 per capita. In 1954, it was \$1,670 per capita, and in 1956, it was \$1,622 per capita. In all of these years interest rates were lower than now, so we can hardly blame interest rates on the high per capita debt.

Let us come now to this question of the total demand for savings. If we add up the figures on pages 139 and 157 of the President's Economic Report for 1959, we can see what the total demand for savings has been in the years 1951 through 1958. This includes total private domestic investment, consumer debt, the surplus or deficit of State and local governments, the Federal surplus or deficit, and the net export of capital abroad.

We find that the total demand for savings amounted to 15.3 percent of the gross national product in 1951, and 15.4 percent in 1952. In none of the subsequent years has it been as high. It has ranged from 15.2 percent in 1953 down to 14.5 percent in 1958. (See table 2, following my testimony.)

Why then the increase in interest rates?

Let us make some comparisons.

In 1953 total demand for savings was a smaller percentage of the gross national product than in either 1951 or 1952. But the rate on 91-day Treasury bills was raised by 25 percent, from 1951; the yield on long-term Government bonds was raised by 14 percent; and the rate on prime commercial paper was raised by 17 percent.

Then, in 1957, we had what the Federal Reserve Board thought was a "runaway" investment boom. Yet the demand for savings in that year was only 15.2 percent of the gross national product. But, compared to 1951, interest rates on 91-day Treasury bills were raised by 111 percent; interest yields on long-term governments was raised by 27 percent, and the rate on prime commercial paper was raised by 76 percent.

In this span of years, the gross national product was going up, the country was becoming more affluent, and we would normally expect that a larger percentage of the national income would go into savings, since people presumably had more money left over after meeting the cost of food, clothing, and shelter.

Let me make one other point.

Since 1951 there have been years of low interest rates, medium interest rates, and extortionate interest rates. But the evidence is that neither the high nor the extortionate interest rates caused people to save any larger percentage of their incomes.

On the contrary, people saved the highest percentage of their disposable personal incomes in 1951, 1952, and 1953, when interest yields on long-term governments ranged between 2.57 and 2.94 percent.

In 1956 and 1957 interest yields on long-term governments were 3.08 and 3.47 percent, respectively, yet people saved only 7.2 and 6.8 percent of their disposable personal incomes in those years.

Now this I admit: The administration does have quite a problem with this belief that inflation is coming and that anyone who puts his savings into fixed-return securities will be repaid with cheap dollars. This has been the subject of one of the greatest propaganda crusades of all times. "Inflation" has been made a household word in every home in the land.

I was here in the great depression, in the depression that was named for Mr. Hoover. Mr. Hoover could have had the most prosperous time in his history named for him just as well, if he had only permitted the people to have had adequate money which he refused. This word "inflation" was used more during the Great Depression,

when we had 10 and 12 and 13 million people unemployed, even than it is used now. "Inflation" has been the scare word.

In the lowest point of depression or in the highest point of prosperity, that scare word "inflation" is used.

Now, over the past year particularly, the President has taken to television and to numerous press conferences to carry on a tremendous word battle against the coming "inflation" which seemed clearly visible to him. The National Advertising Council has cooperated. Substantially all big-business firms that profit from high interest rates or from a rising stock market have cooperated, with newspaper and magazine ads and so on.

Altogether, \$4 billion of new money was poured into the stock market last year, and stock prices were driven up by 25 times that amount, or an increase of 40 percent within 12 months. The big-money boys on Wall Street have made millions and paid taxes at capital gains rates, and the banks and money lenders have enjoyed a fat increase in interest rates.

You know, the banks, of course, have a very fine tax provision for profits on Government securities and for the returns on Government securities. They are in a tax category different from any other corporation or individual—in a more favorable position.

So, my suggestion to Secretary Anderson for the cure to his problem is not to come to Congress and ask Congress to ratify what he calls a "mistaken belief" in inflation, but go back to the opinion makers in his own administration and have them correct this belief about a coming inflation which he thinks to be erroneous.

Now on this matter of the Government's monetary policy, I do not believe it is quite fair of the Secretary to try to have it both ways—to have it that monetary policy makes low interest rates to help the people in a time of recession, but that monetary policy disappears when interest rates are being raised. The fact is that somebody in the Government decides every day, and every hour of the day, what the money supply will be and what interest rates will be. The Government's money managers have now put us back in a condition of tight money and high interest.

There is one point to which I desire to invite your attention, Mr. Chairman.

A few years ago there was no such timidity about admitting to tight money and high interest policies. These policies were then boasted about. They were presented to the public as being a cure-all for all of our economic problems.

In 1955 the money managers instituted tight money and high interest to fight what they thought was a boom in consumer installment purchases. In 1956 and 1957, the money managers squeezed money and raised interest for the purpose of dampening what they thought was a runaway investment boom. They finally choked off investment and brought on a recession. Then they sat back and counseled that we all wait for "adjustments to take place in the market," saying they were hopeful that the level of investment would soon increase again and everything would be all right.

We came out of the depression, Mr. Chairman, despite the Federal Reserve. Three things pulled us out.

These are the three things that brought us out of the depression:

- (1) The raising of the debt limit which permitted an increase in defense spending;
- (2) The retroactive pay increase for Federal employees—this is a big factor; and
- (3) The unusually large farm crops.

These three things brought us out of the depression. We came out despite the Federal Reserve.

Earlier this year Chairman Martin testified that the Fed made available enough money last year for the banks to extend credit amounting to about \$10,500 million. Mr. Martin did not know himself that the banks had not used that money for the purpose of making loans to business and for the purpose of bringing the country out of the recession. The banks made investments instead in U.S. Government bonds to the tune of \$10,400 million, which they received absolutely free by reason of the free reserves given to them by the Federal Reserve System.

Now, then, instead of the freed reserves being used to help bring our country out of the recession, the banks used these for the opposite purpose. Instead of the banks actually increasing business loans after getting these free reserves, they actually called in business loans and reduced them a billion and a half dollars during that same period. I say we came out of the recession principally because of actions initiated by Congress.

Now the Secretary of the Treasury comes forward and says that the reason for the new high interest rates is the \$13 billion deficit. The fact of the matter is the deficit came about in the first place because of the recession brought on by the high-interest, tight money policies of 1956 and 1957.

When the administration first embarked on a program to raise interest rates, with its first issue in February 1953, it said then that its purpose was to lengthen the maturity of the debt. That has been said repeatedly since, and it has also been said repeatedly that this administration inherited a debt of short maturity.

When they increased that the interest rate on Government bonds from the traditional 2½ percent (an exception was the issue of 2¾ percent bonds under Secretary of the Treasury Mr. Snyder in 1938, which was the highest rate) to 3¼ percent in May of 1953, just arbitrarily to increase the interest rate structure in this country—this was done without rhyme or reason and not needed—that was a terrible mistake. Mr. Martin, who is Chairman of the Federal Reserve Board, admitted to me the next year when I was interrogating him—and his testimony is printed—in answer to my questions that it was a mistake; it should not have been done.

The fact is that on December 31, 1952, 75 percent of the debt was in Treasury bonds and nonmarketable securities, and it has not been as high since as in December 31, 1952, nor has the average maturity of the debt been raised.

On June 30, 1952, the marketable debt had an average maturity of 5 years and 8 months. By mid-1953, it had an average maturity of 5 years and 4 months. By mid-1954, it had an average maturity of 5 years and 6 months. By January of this year, it was down to 4 years and 9 months. (See table 5 following my testimony.)

It seems to me that after 7 years of hearing about raising interest rates so as to lengthen the maturity of the debt, everybody would be weary of it. We have now had some clear demonstrations on the way to manage the Federal debt and on the way not to manage it.

We financed the unprecedented burden of World War II without having the bond rate go above 2½ percent—and may it be said here that under President Truman interest rates never went beyond 2½ percent, and bonds never went below par, as long as Mr. Truman had control—and we had the least inflation that any country has ever had during a major war.

Maintaining low interest left the Treasury in a good position to make substantial reductions in the national debt after the war. Between 1945 and 1950 the debt, including guaranteed issues, was decreased by \$22 billion.

Furthermore, the Government was in a good position to make savings in other ways. In 1948, bank profits were high so the Federal Reserve Board increased its contribution to the money supply and decreased the private banks' contribution, thus acquiring \$2 billion of the debt so that the interest payments went back into the Treasury. Interest rates on the obligations were not high then so the bankers did not object too much.

Today, of course, just the reverse is true. The interest rates are high and the bankers are demanding a transfer of the Federal Reserve securities over to them free of charge. We will have to pay them twice. We will have to pay the interest during that time until they mature.

In contrast, we have seen two disastrous consequences of trying to impose high interest and tight money on the country. Certainly by now everyone should know that these policies will not work.

Now, as to the proposal to raise the interest rates on the series E and H bonds, we have been playing this kind of ring-around-the-rosy for a long time, raising one rate to make it competitive with the others, and at the same time raising the others. This is a fruitless exercise. I am opposed to raising any of them.

May I close with an example we may take from the business firms of the country? In 1956 and 1957, many of the big corporations believed that the high interest rates that had been imposed could not be sustained. Consequently, instead of going to the bond market for long-term financing at high interest rates, they went to the commercial banks and got temporary short-term financing, and it squeezed out thousands and thousands of small businessmen from getting financing because small business people had been going to the banks to get short-term loans, but when the big people moved in, the small people did not have a chance. They were squeezed out of business instead.

Then, in 1958, when there was a change in policy, and interest rates were brought down, the corporations paid off their bank loans and went to the bond market for long-term financing.

There is no limit to the rate which the Treasury can pay for short-term obligations.

I would suggest that in this period of high interest rates, the Government not be committed to any long-term contracts. There could be, in the next administration, another change in policy to low interest rates.

Now, then, I want to invite your attention to something that has been said here about the competitive and free market. I first want to read you something. I do not think it has ever been in the record before.

Mr. W. Randolph Burgess was Deputy Secretary of the Treasury. He made arrangements for the appointment of those to pursue the monetary policy of the Eisenhower administration after the election, of course, in 1952. On June 12, 1953, Mr. Burgess made a speech delivered before the student body of the graduate school of banking at its 19th residential session at Rutgers University, New Brunswick, N.J., in which he said:

What has happened since—

remember this is June 12, 1953, after Mr. Eisenhower had taken office on January 20—

then is simply that we have assured the Reserve System that it is the boss on monetary controls.

That is before President Eisenhower ever answered the question at a press conference explaining that the monetary controls were turned over to the Federal Reserve System.

I think that was a commencement of the real mess that we are in today, because when President Eisenhower did that, he then made the Treasury the captive of the Federal Reserve System, and the Federal Reserve System is the captive of the New York Federal Reserve Bank. The New York Federal Reserve Bank, in turn, is a captive of six of the nine directors that are elected by the private banks in New York City area. That is what caused this mess to commence, and the trouble we are in today, that so-called independence, in defiance, I say—of course I know people have different opinions about this and I respect other people's opinion as I expect them to respect mine, and I am at least honest and conscientious in asserting them—to the Constitution, which says that the President "shall take care that the laws be faithfully executed."

Is not the Federal Reserve Act the law? Was it not passed by the House of Representatives after the Democrats had a caucus lasting almost a week—John N. Garner of Texas was chairman of that Caucus—and they agreed to it and then was it not passed in the Senate, and sent to President Woodrow Wilson who signed it and it became a law?

It is a law just like any other law and it is the President's duty to see that that law be faithfully executed just the same as any other law.

Mr. Chairman, I ask consent to extend my remarks and include some material that I did not state.

The CHAIRMAN. Without objection, you may have that privilege. (The information referred to follows Mr. Patman's testimony.)

Mr. PATMAN. By reason of turning the Federal Reserve loose, just footloose and fancy-free, and they are doing everything that they want to do. Last year in 1958—now, this is a shocking statement—the commercial banks in dealing and speculating in Government securities received in net profits \$681 million. That is in 1958. That was just after the depression year of 1957, when they bought the bonds at a low point.

I do not know who ran them down, but they were down low, and then I do not know who caused them to go up, but they went up, and by reason of that the private banks made \$681 million.

Now, then, 50 banks in the country make \$300 million of that and 20 of the largest banks—now listen to this, Mr. Chairman, in this crap-shooting speculative activity that they were engaged in, made \$220 million. Twenty banks averaged \$11 million each last year speculating on Government securities in this kind of a market which they say is a free competitive market.

Is not that prima facie evidence that it is not a free competitive market when banks can make a million dollars a month speculating in that market?

The Government bond market has no controls. No one is supervising it. The onion market is regulated, but the Government bond market is not.

There are many things that are regulated, but the Government bond market is not. By reason of that lack of regulation, the private banks make exorbitant profits, clearly against conscience. And do you know how much that amounts to in comparison to the amount of their actual voting capital stock?

It is between 12 and 15 percent of their paid-in voting capital stock.

I am not including the surplus and undivided profits. I am talking about the voting capital stock. That profit on Government bonds in 1 year is between 12 and 15 percent of their common stock.

And then follow that back to 1953 when we had a similar year to 1957, when bonds went down again.

Why did they go down in this free competitive market?

For some reason they took a nosedive and just at the low point, for some reason unknown to us, the banks bought up the bonds again, and then the bonds started up again.

In 1954 they sold them and they made \$426 million that year, which was several times as much as was made in all history on speculations of that kind, and then in 1957 they have exactly the same dip again. Bond prices go down real low. The banks buy up the bonds again. The prices go up in early 1958 and they sell the bonds and make \$681 million.

How long are we going to say that that is a free market?

Oh, we have a wonderful free competitive market. It adjusts itself? It didn't do it there. Something is wrong. Mr. Martin and Mr. Anderson have recognized that something is wrong about it and they have started an investigation of their own.

Here is the announcement in the Washington Post and Times Herald of Monday, March 9, 1959:

U.S. bond market speculation probed. The Treasury Department and the Federal Reserve System—

this is in an article by Mr. Joseph R. Slevin—

said they have begun a joint investigation of the multibillion-dollar Government bond market. The two agencies declared they want to prevent "excessive speculation" and to improve the functioning of the market. They said that the inquiry will be factual.

The investigation is a direct outgrowth of a speculative buying spree and a subsequent market collapse in 1958. The agencies said their study will focus on those developments. The Treasury and the Federal Reserve said they expect to complete their joint study in time to make it public by midyear.

When is midyear?

A month and a half from now. And here it is just before that deadline when they are going to make their report on what happened last year in this bad speculation, and so bad they had to take notice of it, that they are asking you to believe them that there is nothing wrong with the market, that it is a free competitive market, and that people are protected by it. [Continuing.]

A number of banks violated the precepts of sound banking by lending money to speculators.

It says here :

Herald Tribune News Service investigation last summer disclosed that loose corporate bank and Government bond dealers lending practices made it possible for speculators to obtain huge quantities of Government bonds without making a downpayment and without paying interest. Some of the Nation's biggest corporations, banks, and speculators simply speculated heavily on their own.

This \$681 million includes only profits of the commercial banks. It does not include those of all the corporations, brokers, and the other speculators that were not speculating for the commercial banks, but on their own account, so evidently there was an additional billion or \$2 billion made on these gyrations up and down of the Government bond market—this market is now said to be a very stable market that is a competitive and free market.

I have another statement from the New York Times, Sunday, March 15, 1959 :

U.S. bond study called overdue. Scrutiny by Reserve and Treasury may go beyond most recent abuses. The study of the Government's securities market about to be undertaken by the Treasury and the Federal Reserve System is the first effort of this kind in a number of years. It has not stated limitation of scope. Conceivably it could go far beyond the problem that touched it off, the abuse of speculative credit in the market, and lay the foundation for a broad and more flexible market structure, but there are many touchy reasons why the study should not limit itself unduly to the spectacular price gyrations of the 1958 market.

Many disinterested observers feel that the sponsors of the study, the Treasury and the Federal Reserve, themselves cannot avoid a share of the blame.

Here are reports from people that really know, pointing out that the investigation is being made by people who are partly responsible for the evils which require investigation. Those who are making a study and an investigation and are going to report in a month and a half are asking this committee and Congress to take their word for it that there is nothing wrong, that we have a very free and competitive market.

I think that is asking too much of the Congress.

I heard the chairman of this committee ask the question of the witnesses, and he bore down on them :

Now, will this bill raise other interest rates if you raise Government rates?

The answers I heard were that they would not raise other rates. However, this is not borne out by statements of Allen Sproul. He was president of the New York Federal Reserve Bank longer than any other person I think, and the New York Federal Reserve Bank entirely runs the Federal Reserve System. The other Reserve banks do not even touch the bonds. The Federal Reserve Bank of New York buys all bonds. They just send the other Federal Reserve banks their P-check every year. You know, back in the 1930's, when

the farmer received subsidy checks from the Government, they referred to them as P-checks. All they do is receive a P-check every year from the New York banks to keep them going. They do not make any of their money locally to amount to anything. They get their money from the interest on the bonds that the Federal Reserve Bank of New York has purchased for them.

Mr. Sproul had complete charge of that bank for a longer period than any other person. I asked him one time, "What were the results that you anticipated from the removal of the support price of the Government bonds by the open-market committee?"

Here is the testimony which was taken in 1951 at the time of the so-called Treasury-Federal Reserve accord.

Mr. SPROUL. At the time we removed these support prices, my anticipation, I hope I can say it without too much hindsight, was just about what we had, no great disturbance of the market, certainly no calamity, no chaos, a market which pretty quickly found its own bottom and has maintained itself then throughout without much offense on our part.

Representative PATMAN. Specifically with reference to interest rates, you expected Government rates to increase?

Mr. SPROUL. Yes.

Representative PATMAN. Did you not also expect other rates to increase?

Mr. SPROUL. Yes.

You can find testimony like that from any of these officials because they know it is the truth. You cannot raise Government rates and not raise other rates. It just does not work that way.

It occurs to me that to my Republican friends this should be a challenge, that they should not want to raise these rates, that the Democrats over a long period of time borrowed more money than was ever borrowed before in the history of any nation on earth, more than all nations in the aggregate, and then fought the biggest war in all history and yet at a time when it was the hardest and most difficult time to keep interest rates down and keep prices down, the rate was maintained at less than 2½ percent and bonds never went below par; never went below par.

This is a challenge to our Republican friends, to beat that record. It is true that during that time we told the people, "Now, we are not going to pay the servicemen as much money, and the people who furnish them money are going to make a sacrifice. It is going to be at a lower price and the men who serve in the Army, Navy, Marine Corps, and the Air Force are going to serve for a smaller amount because this is the business of all to sacrifice together."

But then after the war was over, they commenced raising these rates on the war debt. Well, the people who bought these bonds and who have bought these bonds since 1933 have a right to expect our Government not to break faith with them. But we have broken faith with them on every issue.

The Government would issue bonds and then they would go down. Whatever is done in the future, there should be an understanding with this servant of ours, this fourth branch of the Government, the Federal Reserve, which feels like it is footloose and fancy free and has assumed many arrogant attitudes, that hereafter it must support this Government bond market; they must support it.

If you have to pay 4½ percent, support it. "If you bought these bonds at 4½ percent, we will never see you lose on them in the market. They will yield 4½ percent."

That should certainly be assured on all new issues that are sold.

I have another question here that I want to bring up and I will be through, Mr. Chairman. I want to quote Mr. Martin. I show in this statement that these bonds were paid off, just as I said in this statement, with the use of Federal Reserve notes.

Now, then, Mr. Martin is on the witness stand. I happened to be chairman of this committee, the Joint Economic Committee, on December 11, 1956. It is only 2 years ago.

I asked Mr. Martin this question :

Do you really believe we have a free market in Government bonds, Mr. Martin?

Mr. MARTIN. Well, all freedom is relative, but I say there are forces in the marketplace, as I repeatedly said to you, that are stronger than both the Federal Reserve and the Treasury together. Some people question that, but I think that is where the law of supply and demand comes in.

And then I asked him this question :

You would not positively and without reservation say that there is a free market at all times in Government bonds?

Mr. MARTIN. I would say that there is some intervention, as was provided in the Federal Reserve Act, in the market, but that generally speaking the market forces are permitted to operate.

Then Senator O'Mahoney asked :

Mr. Chairman, may I ask a question on that point?

He is granted the request.

Now, this is Senator O'Mahoney asking Chairman Martin of the Federal Reserve Board, after he did not positively and categorically answer my question, as to whether there is a free market in Government bonds.

Senator O'MAHONEY. Your answer is a qualified one, is it not, Mr. Martin?

Mr. MARTIN. Yes, it is qualified.

Senator O'MAHONEY. You do not want this committee or anybody who reads or hears this testimony to believe that you are saying that there is a free market in Government securities?

There is not, is there? Am I not right?

Now listen to this reply by Mr. Martin. This was only 2 years ago.

Mr. MARTIN. There is not a completely free market in Government securities. We are touching over it from time to time.

Now, this is the person who has charge of monetary affairs in this country telling you that there is no free market in Government securities—something we all know. Secretary Snyder said the same thing a number of times. Chairman Eccles, of the Federal Reserve Board, said so a number of times. I do not know of anyone, any unbiased person, who even claims that there is a free market in Government bonds. There is not.

Now, then, I want to bring out the points that I feel this committee should consider. I feel you should go into this open market situation. You should investigate this free market. I think this committee is the one to do it. If you pass this bill out, either prong of it, interest rates or debt limit, so much depends on the free market. And I think we should have the assurance from this committee that there is a free market. And therefore I believe this committee should investigate that question.

Now, in Mr. Anderson's testimony, all throughout, he says, "if we have a free, competitive market." Mr. Martin here this morning

kept talking about a free competitive market. But when there is testimony introduced, like these bonds being sold last year in such a fashion that banks would make a million dollars a month on them, that excites your curiosity. And when the banks make \$681 million, and that is just part of what is made, on the market going up and down, that is enough to excite our curiosity about a free market. Furthermore, when we have the chairman of the Federal Reserve Board himself saying that we do not have a free market, I think that is enough to cause this committee to give consideration to investigating whether or not we have a free market before this bill or these bills are reported out.

I would recommend, Mr. Chairman, that before you vote these bills out you have some unbiased witnesses. The Secretary of the Treasury and the Chairman of the Federal Reserve Board are not unbiased witnesses.

The CHAIRMAN. If the gentleman will not mind the interruption, I thought we had one here right now.

Mr. PATMAN. I am trying to be unbiased. But I am suggesting witnesses from outside Government—college professors, people who know more about these matters than I do. I appreciate the opportunity of being heard, but I am just a country lawyer from down in the piney woods of east Texas. There are plenty of people in this country whom you can get to testify who know the score and know it expertly, and who are unbiased. I hope you consider hearing some of them before you report something out that would take the bridle off interest rates and raise the debt ceiling again.

Personally, I would love to see this committee consider rolling back interest rates.

Now, when we had a crisis during the war, we did not hesitate to roll back prices. We have a crisis now, and we are paying interest on interest. Had it not been for increased interest, we would not have this request to raise the debt limit. We are in a crisis. And I think it is time to consider a definite, permanent, stable, interest policy for this Government in reference to both Government securities and tax-exempt bonds.

Now, I share the views of Mr. Martin about tax-exempt bonds. I would not permit any more of them to be issued if I could help it. I realize it will be a difficult thing to do away with them. And Mr. Roosevelt started that practice when he was a very popular person. And it only resulted in the tax exemption being removed from the Federal Government obligations and not removed from the States, counties, cities, and political subdivisions.

Just after that was done, Mr. Daniel Bell was testifying before a committee that I was on, in 1941, and I asked Mr. Bell this question: "Have interest rates stiffened any since the removal of Government securities from the payment of the tax on income from Federal securities?" And his answer to that, without reading all of that colloquy, was: "One-eighth of 1 percent." That is a very small difference, Mr. Chairman, in tax-exempt bonds and taxable bonds. It is not enough to justify the loss in Federal revenue, that one-eighth of 1 percent.

The alternative, if you cannot remove the tax exemption, I think, is that we ought to have an agency of our Government here representing the people, in cooperation with the bankers if they want to cooperate,

something like the RFC, that gave a market for all these tax-exempt bonds. They bought them up. They permitted the building of roads and school buildings and things like that. They sold them out when the market was ripe to take them. The RFC did not lose money. They made money. And they helped the people that way.

Right now, it is against conscience and a disgrace that some of our people are voting bonds and paying 5½ percent interest on tax-exempt bonds to build highways and schools and for sanitary purposes and things like that. It is the hardest tax on earth, because the people who are paying these taxes are paying taxes on what they owe instead of what they own. Many of them own farms and homes that they have not bought and paid for, but that they have bought and owe for. And they pay taxes on them as if they own them when they just owe for them. So they pay taxes on what they owe rather than on what they own—the hardest tax on earth. And Congress should not sit idly by and see them robbed in broad daylight by being required to pay 5½ percent on tax-exempt bonds. Now, that is a disgrace, and it is a reflection on Congress, including every Member of Congress. It should not be allowed, and I wish this committee would give consideration to it.

Now, the last point I make is this: Over years, I have asked a lot of questions of a lot of witnesses—Mr. Eccles and Mr. Martin and all the different members of the Federal Reserve Board whom we have had before our committee at different times, as well as every member of the Open Market Committee. We have heard every member of the Federal Reserve Board, and I have interrogated them about fixing interest rates. We had a gentleman before our committee one time—the Committee on Banking and Currency—testifying on the Housing Act of 1954. His name was Clark. He represented the mortgage dealers of America. He was president of the Mortgage Bankers Association of America, and was accompanied by Mr. Massey, president of the People's Bond Mortgage Co. of Philadelphia, and Mr. Neal of the General Mortgage Bank of America. And with those gentlemen sitting there, I asked them these questions. This is really, I think, something worthy of your consideration, because it comes not from a Government witness, but from people who are, you know, in the private enterprise system themselves.

Mr. Clark, since by reason of your experience in not only the mortgage banking field but in the insurance field, in the financial field, you evidently know a great deal about the interest rates on long-term Government's and how the interest rates are fixed. Don't you think that the Federal Open Market Committee has more influence on the fixing of the rates, both short and long term, than any one factor in the United States?

Mr. CLARK. They certainly seem to me to have it.

Mr. PATMAN. Well, don't they have complete authority? In other words, they have unlimited power to buy bonds and sell bonds and even to create the money to do it, manufacture the money to do it?

Mr. CLARK. That is correct.

Mr. PATMAN. Without reference to what they have, they have just got it. They just do it on the Government's credit.

Mr. CLARK. That is right.

Mr. PATMAN. At one time Mr. Monroney, who sat here next to me before he went to the Senate in 1947, at a hearing before this committee, interrogated Mr. Eccles, and Mr. Eccles I guess was longer with the Federal Reserve Board than any other one person and was Chairman at that time. Mr. Monroney said, "Do you mean to say that with your present Open Market Committee and the operation of the Federal Reserve as it now stands, that regardless of what the

national income is or other economic factors, that you can guarantee to us that our interest rate will remain around 2.06 percent?" Mr. Eccles said: "We certainly can. We can guarantee that the interest rate so far as the public debt is concerned is where the Open Market Committee of the Federal Reserve desires to put it."

You agree with that statement; do you not?

Mr. CLARK. I do; yes, sir.

Mr. PATMAN. A hundred percent?

Mr. CLARK. Yes, sir.

Now, that is from people who should know something about this. And they say it is possible to have interest rates low or high, however, you want to fix them.

So in conclusion, Mr. Chairman, I want to express my thanks to you for the privilege of being heard, and for your consideration. I know you will give great consideration to this matter. And I hope you can see your way clear to not increase these interest rates but to investigate this so-called free and competitive market and look into this matter very carefully.

The CHAIRMAN. Mr. Patman, we thank you, sir, for bringing to the committee your views on this matter.

Are there any questions of Mr. Patman?

Mr. Baker will inquire of Mr. Patman.

Mr. BAKER. Mr. Patman, you stated a while ago that Mr. Martin stated that it was a mistake to increase the interest rate on series E- and series H-bonds from 3 to 3¼ percent. And I understood you to say that is in the testimony before your committee.

Would you please read that?

Mr. PATMAN. Yes, sir; I have it right here. This is before the Committee on Banking and Currency, May the 26 and 27, 1954, on H.R. 8729, page 22 of the hearings.

Mr. PATMAN. Were you consulted about the issuance of these 3- and 4-percent bonds last April?

Mr. MARTIN. Yes, sir; I was.

Mr. PATMAN. Did you agree to it?

Mr. MARTIN. I agreed that it was in line with Federal Reserve policy; yes.

Mr. PATMAN. Aren't you sorry that you did?

Mr. MARTIN. No, sir.

Mr. PATMAN. Well, there has been a difference within 1 year's time in the high and low on these particular bonds of 11½ points. In other words, \$11½ on a hundred dollars, and then with the 3¼-percent interest for that 1 year, that makes 14¾-percent in 1 year on a riskless Government bond.

Mr. MARTIN. I regret that fluctuation. I wish it had not happened.

Mr. PATMAN. Well, don't you think it had something to do with managing money that caused it?

Mr. MARTIN. I have already testified, Mr. Patman, that we made a miscalculation in the spring.

Mr. PATMAN. In other words, you made a mistake.

Mr. MARTIN. All right. A mistake. Yes; I do not apologize for making a mistake.

Mr. BAKER. You do not construe that to mean he made a mistake in raising the interest rate from 3 to 3¼?

Mr. PATMAN. That is the way I construe it.

Mr. BAKER. I construe it that he made a mistake in calculation, because you just read above there: You asked him if he was not sorry they raised the interest rate, and he said he was not sorry.

Now let us go back to the time we raised that interest rate on E- and H-bonds. It was developed before this committee, through very complete charts, over a period of months, that more of these so-called

savings bonds were being cashed each month than we were selling. Had you been Secretary of the Treasury, faced with that curve of more being cashed than we were selling, what would you have done?

Mr. PATMAN. I would have made a recommendation to this Congress that, just as during the war, we should have financed our debt to permit him to sell all the bonds that he can at the rates allowed by law to every person or corporation having money to purchase those bonds. And then, after all had been sold that it was possible to sell, by using any high pressure or other method to sell them, and there was remaining a large amount of bonds to be sold that could not be sold except to sell them to the commercial banks, which create money on the books of the bank, on the credit of the Nation to buy those bonds, then permit him to sell those bonds to the Federal Reserve banks. And then when the interest was paid on those bonds, it would flow back into the Treasury, and the taxpayers would get the benefit of it. That is what I would have done as Secretary of the Treasury.

Mr. BAKER. How would that have prevented the holders of these series E- and H-bonds from cashing them in?

Mr. PATMAN. It would not. Some of them would have cashed them in. But it would have stopped them eventually, because they would have been satisfied with the interest rate they were receiving.

Mr. BAKER. All right. Then the next question: Under today's market, most savings banks now, at least in the South, are paying 3 percent interest. You can get your money any time you want it. And you do not have to wait a year for a series H-bond. You have to wait 6 months before you can get anything back. And building and loan associations right here in Washington—first, of course, the savings accounts are insured by the FDIC. The building and loan associations are insured by another Federal agency. In most places they are paying  $3\frac{1}{2}$ , a lot of them are going to 4 percent, and even here in Washington I read in the paper 4 percent. With these two lines of savings depositors paying from 3 to 4 percent, why would anybody buy these bonds today, series E and H, at  $3\frac{1}{4}$ , at maturity, without much liquidity to start with, when you guarantee up to \$10,000? It seems to me that is what we are faced with, and that is all there is to the question.

Mr. PATMAN. I recognize that problem, Mr. Baker. But I do not want to encourage interest rates going higher. If we go up to 4, then some of building and loans will go up to  $4\frac{1}{2}$ . Shall we follow them? I think there is a limit. Some people desire to do business with their Government, you know, and they would take less. I do not want to encourage higher interest rates. If you are in favor of giving higher interest rates to the others, I am in favor of giving them to the E-bondholders, not to the commercial banks which are paying 3 percent on deposits. Do you know how many times they can expand those deposits? Twenty times.

Mr. BAKER. I am talking about the standpoint of the investor.

Mr. PATMAN. That is right. From the standpoint of the investor.

Mr. BAKER. The lender fixes the interest rate. It is true that the Congress fixes the maximum on Government securities. But the Government cannot make anybody buy any bonds.

Mr. PATMAN. Mr. Baker, you are mistaken about the Fed not fixing the interest rates, on the commercial banks. They have an application in right now to increase the time deposits interest rate in New York.

Mr. BAKER. I understand it has to be approved. But in the last analysis, if you are going to get the money that you want to borrow, the debtor, the applicant, the fellow that is applying for credit, does not fix the interest rate. In the final analysis the fellow who loans the money fixes the interest rate, or else he says, "I won't let you have my money." That is an indisputable premise.

We have not had any charts submitted so far to the committee, because these hearings only started a day or two ago. I do not know whether we are in the same fix today that we were in 2 years ago. If we are, and as I said frankly I do not know whether we are or are not, they are cashing in more than they are selling, or that point is rapidly approaching. Then, with the \$50-odd billion in E and H, or whatever the figure is, what in the world is the Government going to do?

Mr. PATMAN. We are not dependent on those E- and H-bonds. Of course, they are a major source of financing, or they have been, over the years, and they are very helpful. I am in favor of keeping them uniform, along with other rates. But I am against increasing any of them. If one of your constituents, Mr. Baker, asked you the question: "How do you justify the Government's paying interest on its own money?" I do not know whether you could answer that right off.

And the question is: If the Government is going to permit itself to be charged for the use of its own money, it should have something to say about how much that charge should be. And it should not be necessary to keep on going into the market and increasing the rates. The Government itself should fix that rate.

Mr. BAKER. Well, would you advocate having the Federal Government saying to its citizens, "You must loan me a thousand dollars apiece, interest free?"

Mr. PATMAN. No. I would just offer them the bond at a certain rate. If they did not want to take it, that is all right.

Mr. BAKER. And then if they did not provide that money, what would you do?

Mr. PATMAN. In the past we did not pay but about 40 percent of the cost of the war as we went along. We should have paid more, but at least we paid that much. And we borrowed a portion from the books of the banks that just created the money to buy these bonds. I say that is wrong. That is where the Government is paying interest on its own credit.

Now what ought to have been done? When all the bonds that were sold that could possibly be sold to people who had the money to buy the bonds, then, instead of offering them to the commercial banks just to create the money by a fountain pen operation, a flick of the pen, it would have been well to sell them to the Federal Reserve and let the Federal Reserve banks hold the bonds, and then the interest would go back into the Treasury.

Mr. BAKER. The United States goes into the open market. They go into the market and say, "I want a billion dollars in money. I am willing to pay 2½ percent."

Well, the people with that billion dollars are getting 3½ and 4 percent. They say, "No, I don't want to loan a billion dollars at 2½ percent, because I can get 3½ percent with practically equal safety."

If there is just one alternative, when the United States has to have a billion dollars, if they cannot borrow it, they have to start up the printing presses and print that amount of money.

Mr. PATMAN. You see, you have the printing presses in the commercial banks. All money is printing press money. There is no other way. All witnesses testify to that. There is no dispute about it. You create printing press money whenever you permit the banks to create money on the credit of the Nation.

Mr. BAKER. Let us put it on the basis of economics and not politics. From what little I have learned, the only difference between a State, a municipality, or a county issuing securities, going into the market to try to borrow money, is that the U.S. Government has one additional remedy, which is to print money.

Mr. PATMAN. The United States is sovereign.

Mr. BAKER. Solvent?

Mr. PATMAN. Sovereign. The States are not sovereign for money-issuing purposes. They would have to pay a 10-percent tax on every dollar.

Mr. BAKER. The only sovereignty in this area the United States of America has which the States do not have is the constitutional power to print money and issue currency; is that right?

Mr. PATMAN. Well, the Congress has given that power to the Federal Reserve. Congress did it. So the Federal Reserve people are responsible to you. They are your agent, Mr. Baker, and you are responsible for their acts. Everything they do—in tightening money and raising interest rates—you are a little bit responsible, because you are a Member of Congress, as I am. Now there is only one difference between us. You want to stabilize interest rates upward. I want to stabilize them downward. That is the only difference between us.

Mr. BAKER. Well, in all seriousness, and this certainly is serious, and I know you know it is serious the same as I do: If, as I said awhile ago, the situation is facing us, and I do not know whether it is or not, we cannot borrow this money, we of the United States of America, without paying higher interest, then what in the world are we going to do to meet our obligations?

Mr. PATMAN. Borrow whose money? Only the Government can issue money. Only the Government makes money that is any good. We borrow our own money. The Government should have something to say about what it will pay for the use of its own money.

Mr. BAKER. I am not talking about printing press money.

Mr. PATMAN. All money is printing press money.

Mr. BAKER. The United States as a borrower goes to you, Wright Patman, and says, "I want to borrow a million dollars. I want to get 2½ or 3 percent interest. I won't pay you 4." And you say, "I won't loan you a dime unless you give me 4." What are you going to do?

Mr. PATMAN. Just do not make a loan. If you are going to have money created anyway, after you have sold all the bonds you can—

Mr. BAKER. You mean issue printing press money?

Mr. PATMAN. The same kind the commercial banks issue.

Mr. BAKER. If there is no other way to get money, borrowing it, you have to issue printing press money. I believe that is rather fundamental.

Mr. PATMAN. Sure it is. Therefore, we should have something to say about what we pay for the use of our own money.

The CHAIRMAN. Any further questions of Mr. Patman?

Mr. Alger will inquire.

Mr. ALGER. Mr. Patman, why not just monetize the entire debt and pay it off?

Mr. PATMAN. Oh, we should not do that. You have to have debts. If you did not have debts, you would not have any money. That is our system.

Mr. ALGER. Let me ask you something else you did not mention in your statement, although you covered a lot of ground. What explanation do you give for the devaluation of money between, say, the mid-thirties and 1950?

Mr. PATMAN. Oh, I think it was all right. You mean the gold revaluation?

Mr. ALGER. I am talking about the purchasing power of the dollar bill.

Mr. PATMAN. Well, of course, it has gone down.

Mr. ALGER. The reason I specify these years: This takes it out of politics.

Mr. PATMAN. That is right. I am going to take it out of politics, too. I will show you. You take a dollar now that is used to pay interest on short-term U.S. Government obligations. That dollar in comparison to the dollar that was used to pay the same kind of interest on short-term obligations, say, in 1945, 1946, and 1947, is worth 10 cents now. That has been quite a nosedive.

Mr. ALGER. I listened to your speech the other day on the floor on this subject. I did not understand it then either. And I am afraid I have opened too big a field of inquiry. I asked you this question, because you had an answer for everything else. I do not believe you are giving me the answer.

I asked you about the devaluation of the dollar bill in 15 years, between 1935 and 1950, or take any other time you like between that period, thus removed from politics. Why was there a devaluation of the dollar bill, economically?

Mr. PATMAN. You are not talking about the gold devaluation? You are talking about the devaluation or decay in the value of the dollar?

Mr. ALGER. The purchasing power of the dollar.

Mr. PATMAN. Well, the dollar has gone down with reference to lots of things, like the 10-cent dollar on interest. That is the greatest devaluation. But on a lot of things, such as farm products, the dollar buys a hundred cents on the dollar, and more. It has gone down more to buy certain things than for other things. But to buy interest, it has gone down most.

Mr. ALGER. Mr. Patman, perhaps I am not coming through to you, because you are not coming through to me. I asked you a question, and you are not answering.

Mr. PATMAN. I certainly know the gentleman is asking me a question sincerely, and I am trying to give you an earnest answer. My answer is that for some things the dollar is worth more than it was, and to buy other things less. It all depends on what you are buying. The value of the dollar is relative.

Mr. ALGER. Mr. Patman, I will not pursue this any further at this point. As far as I am concerned, it is my understanding that the

dollar bill was reduced drastically in value, 50 percent of purchasing power, during that period.

Mr. PATMAN. Let us say you are correct. If the workingman had four times as many dollars, would he be better off, or worse off?

Mr. ALGER. If he had what?

Mr. PATMAN. Four times as many dollars in comparison to the period you are talking about.

Mr. ALGER. This is all in terms of purchasing power.

Mr. PATMAN. That is what I am talking about. In other words, from the time you started 15 years ago, suppose the dollar is worth 50 percent less now, but individuals have four times as many dollars with which to buy. And, therefore, they can enjoy more comforts and conveniences and even luxuries of life.

Mr. ALGER. Maybe we do not understand each other at all.

Mr. PATMAN. Maybe I do not understand you. I am ignorant on this thing. I am glad to get information from the gentleman. If he will teach me something, I will be greatly appreciative.

Mr. ALGER. I might say to the chairman that this is my maiden experience in hearing Mr. Patman testify. And there is very little in your testimony, sir, that I even understand.

Mr. PATMAN. Well, I am sorry about that, because if a country boy from down in east Texas can make a statement that a person so well informed and so highly educated and cultured as yourself cannot understand, I think there must be something wrong with myself. I would have to reevaluate myself.

Mr. ALGER. Maybe we both need to learn, Mr. Patman.

But, you see, I come from the school of what we used to call hard knocks. And economically I do not understand these things that apparently others have acquired while they were in Government service.

Mr. PATMAN. May I reply to that sincerely?

You know, I have been in Congress—this is my 16th term. I am serving my 31st year. And I am not only disappointed, I am almost disillusioned, and almost on the verge of being disgusted, about some things, for the same reason you mentioned. Now it is not the fault of the Members of Congress. I have a very high regard and great respect for Members of Congress. I do not think I could have served with finer and better people. They are sincere and honest. And I am not talking along party lines—I am talking about all of the Members. But there is one weakness, and you have put your finger on it. The Members are not equipped to do their job. We run errands all the time for our constituents. We are pressed, and we do things that are the most urgent to take care of ourselves and take care of ourselves politically, too. That is part of the job. We are expected to do that. And by that time we do that and answer our correspondence and attend meetings of the committees we are on, we have no time to look into any other questions.

And these big questions involving taxes and appropriations and monetary matters and things like that. We have nobody that is close to us, that we hire and fire ourselves, to do this research for us and keep us informed as to what is going on. That is the weakness in our system today. I think every member of this committee should have one or two administrative assistants or research assistants, and every Member of the House should have at least one. This is a weakness in our democracy. We are not equipped to do the job. And things happen here in broad daylight that years after we will regret, because we do not understand them. We are not equipped to do the job.

Mr. ALGER. Mr. Patman, you and I are on the same side of that argument, because I feel very definitely we should give more thought to our legislative chores.

Did not Mr. Lumer do some work for you?

Mr. PATMAN. No, he never worked for me.

Mr. ALGER. Thank you, Mr. Chairman.

The CHAIRMAN. Any further questions?

Again we thank you, Mr. Patman, for coming to the committee and giving us the benefit of your thinking.

(The information referred to on pp. 225-226 is as follows:)

TABLE 1.—Gross Federal debt <sup>1</sup> per capita <sup>2</sup> 1939-58

June 30:		June 30—Continued	
1939.....	\$350.63	1949.....	\$1,694.93
1940.....	367.08	1950.....	1,696.81
1941.....	414.85	1951.....	1,653.61
1942.....	571.02	1952.....	1,650.35
1943.....	1,029.82	1953.....	1,667.06
1944.....	1,464.17	1954.....	1,670.64
1945.....	1,851.70	1955.....	1,660.42
1946.....	1,908.79	1956.....	1,622.28
1947.....	1,792.67	1957.....	1,580.54
1948.....	1,721.21	1958.....	* 1,588.18

<sup>1</sup> Includes obligations guaranteed by the U.S. Government.

<sup>2</sup> Based on Bureau of the Census estimated population for continental United States.

\* Subject to revision.

Source: Annual Report of the Secretary of the Treasury, 1958.

TABLE 2.—Demand for private savings as related to gross national product, 1951-58

[Dollar amounts in billions]

Year	Gross national product	Gross private domestic and net foreign investment	Government surplus or deficit (Federal, State, and local)	Demand for private savings	Demand for private savings as related to gross national product (percent)
1951.....	\$329.0	\$56.6	\$6.1	\$50.5	15.3
1952.....	347.0	49.7	-3.9	53.6	15.4
1953.....	365.4	48.3	-7.1	55.4	15.2
1954.....	363.1	48.5	-6.7	55.2	15.2
1955.....	397.5	63.4	2.9	60.5	15.2
1956.....	419.2	69.6	6.3	63.3	15.1
1957.....	440.3	68.8	1.7	67.1	15.2
1958.....	437.7	53.6	-10.0	63.6	14.5

Source: Computed from data in Economic Report of the President, 1959, pp. 139, 157.

TABLE 3.—Rate of personal savings compared with interest rates, 1951-58

(Dollar amounts in billions)

Year	Disposable personal income	Personal savings as related to disposable personal income	Average interest rates per year		
			Yield on 3-month Treasury bills	Yield on taxable U.S. Government bonds (long term) <sup>1</sup>	Prime commercial paper, 4 to 6 months <sup>2</sup>
		<i>Percent</i>	<i>Percent</i>	<i>Percent</i>	
1951.....	\$227.5	7.8	1.55	2.57	2.16
1952.....	238.7	7.9	1.77	2.68	2.33
1953.....	252.5	7.9	1.93	2.94	2.52
1954.....	256.9	7.3	.95	2.55	1.58
1955.....	274.4	6.4	1.75	2.84	2.18
1956.....	290.5	7.2	2.66	3.08	3.31
1957.....	305.1	6.8	3.27	3.47	3.81
1958.....	311.6	6.7	1.84	3.43	2.48
June 5, 1959.....			3.18	4.11	3.38

<sup>1</sup> Series includes: 1951 through March 1952, bonds due or callable after 15 years; April 1952-March 1953, after 12 years; April 1953 to date, 10 years and after.

<sup>2</sup> Averages of daily prevailing rates.

Sources: U.S. Department of Commerce and Federal Reserve Bulletins.

TABLE 4.—Changes in interest rates compared with changes in rate of personal savings

Year	Percent change from previous year		
	Interest yield on 91-day Treasury bills	Interest yield on long-term Government bonds	Rate of personal savings
1952.....	+14	+4	+1
1953.....	+9	+10	0
1954.....	-51	-13	-8
1955.....	+84	+11	-12
1956.....	+52	+8	+12
1957.....	+23	+13	-6
1958.....	-44	-12	-6

TABLE 5.—Average maturity of marketable interest-bearing public debt

Year as of June 30:	Average length
1951.....	6 years, 7 months
1952.....	5 years, 8 months
1953.....	5 years, 4 months
1954.....	5 years, 6 months
1955.....	5 years, 10 months
1956.....	5 years, 4 months
1957.....	4 years, 9 months
1958.....	5 years, 3 months
1959—January.....	4 years, 9 months

Source: Treasury Bulletin, March 1959, p. 21.

TABLE 6.—Business loans of member banks, 1955 and 1957, by size of borrower

Size of borrower (total assets, in thousands)	Amount of loans					Number of loans					Average size of loan		
	Millions of dollars		Percentage change, 1955-57	Percentage distribution		Thousands		Percentage change, 1955-57	Percentage distribution		Thousands of dollars		Percentage change, 1955-57
	1955	1957		1955	1957	1955	1957		1955	1957	1955	1957	
All sizes.....	30,805	40,618	31.9	100.0	100.0	1,185.2	1,280.6	8.0	100.0	100.0	26.0	31.7	22.0
Less than \$50.....	1,501	1,456	-3.0	4.9	3.6	503.1	504.7	.3	42.5	39.4	3.0	2.9	-3.3
\$50 to \$250.....	4,505	5,256	16.7	14.6	12.9	414.9	494.3	19.1	35.0	38.6	10.9	10.6	-2.1
\$250 to \$1,000.....	5,051	6,302	24.8	16.4	15.5	125.8	157.6	25.3	10.6	12.3	40.2	40.0	-.4
\$1,000 to \$5,000.....	5,586	6,775	21.3	18.1	16.7	37.9	48.2	27.2	3.2	3.8	147.3	140.5	-4.6
\$5,000 to \$25,000.....	4,742	5,912	24.7	15.4	14.6	11.0	13.3	21.1	.9	1.0	432.8	445.7	3.0
\$25,000 to \$100,000.....	3,240	4,893	51.1	10.5	12.0	4.4	5.4	22.7	.4	.4	732.6	901.6	23.1
\$100,000 or more.....	5,297	8,815	66.4	17.2	21.7	6.0	6.5	7.3	.5	.5	878.8	1,363.5	55.1
Not ascertained.....	883	1,207	36.7	2.9	3.0	82.0	50.7	-38.2	6.9	4.0	10.8	23.8	121.3

NOTE.—Details may not add to totals because of rounding.

Source: "Financing Small Business," Report to the Committees on Banking and Currency and the Select Committees on Small Business, U.S. Congress, by the Federal Reserve System, Apr. 11, 1958.

TABLE 7.—Change in amount of business loans of member banks, 1955-57, by business and size of borrower

[Increase, or decrease (-). In percent unless otherwise noted]

Business of borrower	Amount outstanding Oct. 16, 1957 (in millions of dollars)	Size of borrower (total assets, in thousands of dollars)							
		All borrowers <sup>1</sup>	Less than \$50	\$50 to \$250	\$250 to \$1,000	\$1,000 to \$5,000	\$5,000 to \$25,000	\$25,000 to \$100,000	\$100,000 or more
All business.....	40,618	31.9	-3.0	16.7	24.8	21.3	24.7	51.1	66.4
Manufacturing and mining:									
Food, liquor, and tobacco.....	2,392	28.0	-33.5	7.1	23.7	5.4	-4.6	8.5	104.5
Textiles, apparel, and leather.....	1,685	-3.0	-38.7	-20.7	-7.8	-4.0	-9.5	3.6	47.7
Metals and metal products.....	5,526	70.5	-18.2	20.1	20.2	46.7	35.1	106.1	151.2
Petroleum, coal, chemicals, and rubber.....	3,750	44.1	-16.2	2.2	40.3	18.3	7.2	20.4	138.1
All other.....	2,793	47.2	-7.2	8.4	20.1	46.1	76.1	82.7	119.2
Trade:									
Retail trade.....	4,588	33.2	3.4	28.3	51.4	48.7	32.3	36.6	33.7
Wholesale trade.....	2,982	24.7	-10.6	21.8	23.7	17.9	31.0	105.2	134.7
Commodity dealers.....	816	10.7	-18.8	13.4	44.2	-22.1	-2.4	61.2	20.2
Other:									
Sales finance companies.....	3,096	9.3	-32.5	-24.0	20.2	-6.6	7.5	36.3	5.9
Transportation, communication, and other public utilities.....	4,168	47.0	31.2	13.0	10.5	44.6	56.1	84.0	40.0
Construction.....	1,981	17.1	-7.7	9.4	9.3	23.6	-5.5	101.2	310.0
Real estate.....	2,976	22.5	-24.9	9.9	23.3	17.1	27.6	109.3	19.9
Service firms.....	2,263	28.3	4.6	29.5	36.2	42.1	79.8	29.7	9.3
All other nonfinancial.....	1,606	20.4	6.0	18.0	26.9	-1.3	25.1	30.4	96.1

<sup>1</sup> Based on data that include a small amount of loans for borrowers whose size was not ascertained.

Note.—Details may not add to totals because of rounding.

Source: "Financing Small Business," Report to the Committees on Banking and Currency and the Select Committees on Small Business, U.S. Congress, by the Federal Reserve System, Apr. 11, 1958.

TABLE 8.—Business loans of member banks, 1955-57, by business and relative size of borrowers <sup>1</sup>

Business of borrower	Loans outstanding Oct. 5, 1955				Increase, or decrease (-), 1955-57						
	Millions of dollars	Percentage of industry total, by size of borrower <sup>2</sup>			Millions of dollars	Percentage of industry total, by size of borrower <sup>2</sup>			Percentage change, by size of borrower		
		Small	Medium	Large		Small	Medium	Large	Small	Medium	Large
All businesses.....	30,805	20.5	44.9	31.7	9,813	6.9	39.5	50.4	10.6	28.0	50.7
Manufacturing and mining:											
Food, liquor, and tobacco.....	1,869	21.4	55.4	22.4	523	10.0	6.2	83.7	13.0	3.1	104.5
Textiles, apparel, and leather.....	1,736	33.0	47.2	18.2	-53	<sup>3</sup> -154.4	<sup>3</sup> -95.3	<sup>3</sup> 157.1	-14.3	-6.2	26.3
Metals and metal products.....	3,241	38.7	36.1	24.0	2,285	16.6	32.0	51.4	30.2	62.5	151.2
Petroleum, coal, chemicals, and rubber.....	2,603	28.7	44.7	21.7	1,147	13.0	14.5	68.0	20.0	14.3	138.1
All other.....	1,896	18.6	61.8	18.4	895	2.1	58.9	38.0	5.4	45.0	97.5
Trade:											
Retail trade.....	3,445	13.8	51.0	33.1	1,144	1.4	56.9	38.9	3.4	37.1	39.0
Wholesale trade.....	2,392	23.9	56.5	17.8	590	16.0	48.4	37.2	16.5	21.1	51.5
Commodity dealers.....	736	8.9	36.5	52.3	79	7.4	12.7	78.7	8.9	3.7	16.2
Other:											
Sales finance companies.....	2,832	25.1	32.1	42.5	263	-2.7	74.9	27.1	-1.0	21.8	5.9
Transportation, communication, and public utilities.....	2,835	1.7	49.0	46.6	1,334	1.1	53.6	39.7	31.2	51.5	40.0
Construction.....	1,692	7.8	51.1	38.0	289	-3.5	27.9	62.8	-7.7	9.3	28.2
Real estate.....	2,430	24.4	22.7	44.7	546	4.1	23.5	52.6	3.7	23.3	26.4
Service firms.....	1,763	17.4	50.1	27.0	499	2.8	56.7	41.4	4.6	32.0	43.3
All other nonfinancial business.....	1,333	7.1	37.5	48.8	272	2.1	41.7	46.5	6.0	22.7	19.4

<sup>1</sup> For classification of borrower by relative size, see appendix A.

<sup>2</sup> Figures do not add to 100 percent because some loans were made to borrowers whose size was not ascertained.

<sup>3</sup> Net change for industry was a decrease; sign indicates direction of change for size group.

Source: "Financing Small Business," Report to the Committees on Banking and Currency and the Select Committees on Small Business, U.S. Congress, by the Federal Reserve System, Apr. 11, 1958.

[From the New York Times, Mar. 15, 1959]

U.S. BOND STUDY CALLED OVERDUE—SCRUTINY BY RESERVE AND TREASURY MAY  
Go BEYOND MOST RECENT ABUSES

(By Paul Heffernan)

The study of the Government securities market about to be undertaken by the Treasury and the Federal Reserve System is the first effort of its kind in a number of years.

It has no stated limitation of scope. Conceivably, it could go far beyond the problem that touched it off—the abuse of speculative credit in the market—and lay the foundation for a broader and more flexible market structure.

Such a reform would be long overdue. In many ways the structure and practices of the market still smack over much of the attitudes and concepts inspired by the psychology of depression and war.

But there are more touchy reasons why the study should not limit itself unduly to the spectacular price gyrations of the 1958 market. Many disinterested observers feel that the sponsors of the study—the Treasury and the Federal Reserve—themselves cannot avoid a share of the blame.

After all, was it not the acts of the money and debt managers that egged on the reckless and, as it turned out, naive speculators? The Reserve System saw fit to impart dramatic emphasis to public declarations of credit policy change. And the Treasury was ingenious in devising securities having speculative appeal. Further, both reputable financial and nonfinancial corporations not only extended questionable credits but joined in the revelry themselves.

INQUIRY TERMED DESIRABLE

It is reasonable to assume that the chagrined parties to this unhappy adventure have learned a lesson and that an official white paper on the subject will do little, perhaps, except to instruct and appease the public.

But a full inquiry into the structure of the Government market and the Government debt—one that would seek to bind Government securities more closely into the economic consciousness of the everyday citizen—would be of lasting social and economic benefit.

Every U.S. citizen should want to own Treasury bonds, not out of patriotism but out of a deeply held feeling of prudence. Such a feeling must be wanting in the stock-crazed period of today. And a lack of it is more deplorable than the occasional market excesses of professional speculators.

Much of the current coolness of the investment community to Government securities must be a revulsion from the profligacy of a public legislative body that keeps spending more money than it is willing to cover by taxes.

Some of the indifference must be due, too, to the tax shelter appeal of the equity market, a refuge where punitive income tax liabilities can be converted into less onerous and postponable capital gains liabilities. Of course, much of the equity craze is inspired by the growing shortage of blue-chip common stock, a phenomenon unquestionably related to the tax structure's encouragement of debt capital financing and discouragement of equity financing.

A Federal Reserve-Treasury white paper can do little to dismantle the tax and budget policy barriers that now keep the investment public from buying Government securities. Congress will undertake this job in due course, probably when the going rate of interest on Government bonds gets so high as to spur the Treasury and Federal Reserve to write another white paper. The going rates today—3 and 4 percent—are still low, historically.

LAST STUDY IN 1952

The last official study of the Government market was a Reserve Board undertaking in 1952. Coming in the wake of the restoration of the long-term part of the Treasury market to a free basis, the study at the time seemed pointed and fruitful.

It confirmed the Reserve's resolution to shun intervention in the long-term market and it brought to an end the concept of "officially recognized dealers," an arbitrary expedient invoked by the Federal Reserve during the war finance period to prevent the market's high places from being usurped by opportunistic financial adventurers from outside.

Experiences of subsequent years have shown, however, that the reforms of 1950 and 1952 fell far short of "reconverting" the Government securities market to the needs of peacetime. Despite the worthy changes, official Washington is still conditioned by states of mind born during the great depression as a consequence of the worldwide economic collapse. Some of these are:

Low interest rates are an economic boon. Even if brought on by disaster, they should be credited to political sagacity and maintained at all costs, even at the risk of debauching the currency.

There is something wrong about any profit obtained from a financial service.

The man in the street should be shielded from the dangers of the free marketplace. He should be discouraged from buying debt contracts whose prices fluctuate in the market, and should be encouraged to buy nonmarketable Government bonds cashable at any time without loss of principal.

Securities should be sold not to suit the Government's needs but to suit the needs of investors. Investors will always have more money to invest than places to invest it.

It is against public policy for the Government to sell tax-exempt bonds because wealthy persons will have in such investments a selfish sanctuary for preserving their estates.

Not until the public authorities are further disabused of these holdover, anti-capitalist notions can the Government securities market be expected to realize its full potential, both as a professional market for high-grade basic yields and as an active part of the everyday life of the citizenry.

Moves such as the following might rid the Government market of most of the problems besetting it:

Congressional efforts to restore balance or surpluses to budgets and to reform taxation.

Restoration of income tax exemption to selected new issues of Treasury bonds.

Aggressive sales campaigns to discourage the man in the street from the hazards of stock speculation and to encourage buying of marketable Government securities of short or long term, according to his needs.

Payment of special compensation to distribute Government securities on a wide scale. Otherwise it cannot be expected that the Nation's thousands of investment dealers and banks otherwise occupied will risk joining the 16 dealers now handling the Government bond business.

Recurring sales of interest-bearing or non-interest-bearing Treasury bonds of the capital appreciation type, with the date of call selected at designated quarterly or semiannual dates by lot. The gambling aspect of such lossproof bonds would have wide appeal.

---

[From Washington Post and Times Herald, Mar. 9, 1959]

#### U.S. BOND MARKET SPECULATION PROBED

(By Joseph R. Slevin, Herald Tribune News Service)

The Treasury Department and the Federal Reserve System said yesterday they have begun a joint investigation of the multibillion-dollar Government bond market.

The two agencies declared they want to prevent excessive speculation and to improve the functioning of the market. They said that the inquiry will be factual.

The investigation is a direct outgrowth of a speculative buying spree and subsequent market collapse in 1958. The agencies said their study will focus on those developments.

The 1958 fiasco was the worst debacle in the history of U.S. free market public finance. Thousands of investors lost money. The Government bond market became demoralized and has not yet regained public confidence.

The Treasury and the Federal Reserve said they expect to complete their joint study in time to make it public about midyear. The findings presumably will be laid before congressional committees.

A Herald Tribune News Service investigation last summer disclosed that loose corporate, bank, and Government bond dealer lending practices made it possible for speculators to obtain huge quantities of Government bonds without making a downpayment and without paying interest. Some of the Nation's biggest corporations and banks financed the speculators and simultaneously speculated heavily on their own.

The Treasury and Federal Reserve made it plain that the plungers' credit deals will be a prime target of their probe.

They said they will ask for data from major lenders and participants in the Government bond market including banks, corporations, dealers, and brokers.

The news service investigation revealed that banks and corporations financed hundreds of millions of dollars of speculative activity by buying securities that they then agreed to resell at a future date to a speculator or to a money broker who acted as the speculator's middleman. These arrangements were called repurchase agreements and buybacks.

A number of banks violated the precepts of sound banking by lending money to speculators they didn't know. Direct loans were often granted without margin.

The bubble burst in mid-June after the plungers had joined with legitimate investors in buying more than \$7 billion of new 2½ percent 7-year Government bonds. The bond market faltered with signs that the recession was ending. It broke sharply when speculators began to dump huge holdings of Government obligations.

The CHAIRMAN. Our next witness is our colleague from Florida, Hon. Charles E. Bennett.

Mr. Bennett, we are pleased to have you with us today, and you are recognized, sir, to proceed in your own way.

#### STATEMENT OF HON. CHARLES E. BENNETT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. BENNETT. Thank you very much, Mr. Chairman.

Mr. Chairman, I appreciate this opportunity to testify on the national debt. You have heard in these hearings the testimony from a great Secretary of the Treasury. I know it pains him to be forced to ask for an increase in the national debt limit. If there were any other way of financing our Government economically and wisely under present laws, I am certain he would not ask for this increase. His having to come before Congress periodically to ask for debt limit increases points up the need for stronger laws to keep the national debt down and, if possible, to roll it back. In an effort to make a contribution toward such laws, I have introduced several bills which are now pending before this committee. With your permission I would like to say a few words on these proposals and how I believe they would help make it unnecessary for the Secretary to request further debt increases.

Enactment of my bill, H.R. 6292, would be a significant first step toward exploiting gifts as a means of reducing the national debt. At present gifts to reduce the debt are negligible. With proper legislative changes, many Americans who are concerned over the national debt can be interested in making such gifts. H.R. 6292 would authorize acceptance of gifts earmarked to reduce the national debt. Such gifts can now be treated only as unconditional gifts to be deposited in the general fund of the Treasury. No assurance can be given that they will be used to reduce the debt. The donor cannot be certain that the net effect will not be to increase spending on programs with which he is not in sympathy. H.R. 6292 makes possible the giving of that assurance. It provides that such gifts are to be placed in a special fund to be used only for retiring obligations constituting part of the national debt. The Treasury has not yet rendered a report on this bill, but it reported favorably upon a similar bill in the 85th Congress, and I believe it will render a favorable report on this bill as well.

An even more important step in my opinion is that proposed by my bill, H.R. 6348. This bill is needed as a companion measure to H.R. 6292, discussed above, to give the strongest possible assurance that gifts to reduce the national debt are used for that purpose and not for swelling current receipts. This it does by dividing the public debt into the "1949 national debt" and the "post-World War II national debt." The "1949 national debt" would consist of obligations totaling the amount of the public debt on April 30, 1949, when the debt was at its lowest point since World War II, to wit: \$251,530,463,254.82. All gifts made for debt reduction would be used to reduce this figure. This would have the advantage not only of insulating from current expenditures the debt to which gifts are applied, but also of maintaining a definite figure which would be affected only by gifts and other receipts specified for reducing the national public debt. Thus, every gift would result in reducing the debt by an easily determined precise amount, and no current expenditure could change this result. I believe that insulating the debt to be reduced in this way is an indispensable step in any program to reduce the national debt. Otherwise, wars, depressions, and deficits will upset the debt reduction program.

My third debt-reduction bill is H.R. 7457, which is identical with Congressman Wright's H.R. 4588. Since he is taking the leadership on this measure, I believe I should permit him to make the major presentation on it. Suffice it to say, I wholeheartedly agree with him when he says, "It's cheaper to pay than to owe," and I hope his bill can be enacted.

My last debt-reduction bill before this committee is H.R. 6293, which would require proceeds from sales of Federal surplus property to be used for reducing the national debt. If passed together with H.R. 6348, such proceeds would be applied to the "1949 national debt." This would mean that such proceeds would not show up in current receipts and would not determine whether a current year's budget is balanced. Applying proceeds of surplus property sales to the national debt in this way would provide a substantial means of reducing the debt.

Mr. Chairman, the American people have come to have a defeatist attitude toward the national debt. As long as nothing is done this problem they will continue to have such an attitude, and the debt will continue to rise in good years as well as in bad. But if we enact some or all of these bills, we will be showing them that something can be done about the national debt and that we are doing it. These bills might not result in a fast payoff, but they would be a beginning, and that would be a monumental accomplishment.

Thank you again, Mr. Chairman, for permitting me to express these views.

The CHAIRMAN. Thank you, Mr. Bennett, for bringing this discussion of your bills to the committee. We appreciate your doing so. Are there any questions?

Thank you, sir.

Mr. BENNETT. Thank you.

The CHAIRMAN. Our next witness is also from Florida, the Honorable D. R. Mathews. Without objection, Mr. Matthews may extend his remarks at this point in the record.

**STATEMENT OF REPRESENTATIVE D. R. (BILLY) MATTHEWS,  
OF FLORIDA**

Mr. MATTHEWS. Mr. Chairman, I appreciate very much the privilege of appearing before this great committee on behalf of H.R. 5317, and similar legislation which I think would provide a practicable means for the retirement of the public debt.

The language of the bill is simple. It simply says that "There shall be included in each budget hereafter submitted to the Congress by the President under the Budget and Accounting Act, 1921, an item requesting an appropriation equal to 1 percent of the aggregate face amount of such obligations (not including those held by the Secretary of the Treasury) outstanding on July 1 of the year in which this sentence is enacted, which item shall be used exclusively for the retirement of such obligations. No such budget for any fiscal year shall be considered as balanced, or as providing for estimated receipts equal to or in excess of estimated expenditures unless such item is taken into account, and considered as an estimated expenditure for such fiscal year."

Mr. Chairman, I realize there is no painless way of retiring our national debt. I do believe, however, we should determine now to have set aside in the budget a certain amount that will enable us to begin that retirement. If such a bill as the one I have introduced were passed, it would mean it would take about a hundred years to pay off the national debt, provided we could continue in the future to hold expenditures in line with receipts.

I believe the American people would be willing to sacrifice some if they felt that we were really making progress in balancing the budget and paying off the debt. Such a bill as I am proposing, if it were passed, would be of great moral incentive to Members of Congress to take a more personal interest in holding down expenditures. Many times as new Federal programs would be proposed we would have facing us two alternatives—either we could vote for the new spending program, or we could decline to vote for it on what might be the logical grounds of saving the money of this program so that we could retire the portion of the national debt that we are supposed to retire in any fiscal year.

I, of course, am not proposing that by means of this legislation we shall forestall any new Federal programs. I am very much concerned, however, with the attempt each year to straddle on the Federal Government certain obligations and responsibilities that I think belong to the States and to the municipalities of America. It doesn't take much courage many times to vote for new appropriations in Congress because we are not faced with the immediate prospect of assessing new taxes to take care of these appropriations. We must, however, pay the fiddler sometime, and I propose that we begin those payments beginning with fiscal year 1961.

I think the passage of such a bill as H.R. 5317 would have a great moral effect on the people of America. It would say to them that surely in this great and powerful country of ours, in order to preserve the private enterprise system, we are going to fight for the fiscal solvency of the Nation, which in turn, of course, means the fiscal solvency of every one of the millions of individuals who go to make up this beloved country of ours.

Thank you very much, Mr. Chairman, for this opportunity of testifying.

The CHAIRMAN. Our next witness is our colleague from Wisconsin, the Honorable Henry S. Reuss.

Mr. Reuss, we appreciate having you before the committee, and you are recognized to proceed in your own way.

#### STATEMENT OF REPRESENTATIVE HENRY S. REUSS, OF WISCONSIN

Mr. REUSS. Thank you, Mr. Chairman.

I have a prepared statement, which has been handed to the clerk, and with the Chair's consent, I would like to offer that statement for the record and then proceed briefly to summarize what I have to say.

The CHAIRMAN. Without objection, your entire statement may be printed in the record.

(The statement of Hon. Henry S. Reuss is as follows:)

#### STATEMENT OF REPRESENTATIVE HENRY S. REUSS, OF WISCONSIN

Proposed amendment: Add a new section 8, as follows:

"SEC. 8. It is the sense of Congress that the Federal Reserve System, while pursuing its primary mission of administering a sound monetary policy, should, to the maximum extent consistent therewith, utilize such means as will assist in the economical and efficient management of the public debt; that the System, to the greatest extent possible, should bring about needed future monetary expansion by purchasing United States securities, of varying maturities, rather than by further lowering bank reserve requirements; and that the System should promptly and fully explore methods whereby use of the power to raise reserve requirements may become a more usable and effective anti-inflationary tool."

The House Committee on Ways and Means is considering a bill to remove the present interest ceilings on savings bonds and on Treasury bonds, and to raise the public debt limit from \$283 billion to \$288 billion, with a temporary increase to \$295 billion.

The bill to accomplish this is called "A bill to facilitate management of the public debt." It has been brought about by the crisis in our debt management—higher and higher interest rates, lower and lower market prices for U.S. securities, less and less investor interest in the national debt.

If the bill merely removes the ceilings on the interest rate and on the amount of the national debt, it might better be entitled "A bill to facilitate mismanagement of the public debt." For it will encourage our monetary managers to continue on the deadend course on which they are embarked.

Merely raising the interest paid on the national debt is not going to solve anything. The \$8.5 billion carrying charge on the national debt for fiscal 1960 is already the largest single nondefense item in the budget. Further increases in the interest rate are not merely going to increase the burden on the taxpayer. As high interest rates communicate themselves throughout the entire economy, economic activity everywhere, but particularly in housing, local government activities, public utilities, and small business is going to be hurt.

The amendment I propose would express the sense of Congress that the Federal Reserve System should not continue to turn its back on the management of the national debt, as it has been doing for some years. Of course the Federal Reserve's sole mission should be a sound monetary policy. But there is no reason why a sound monetary policy cannot be used to help, rather than to hurt, debt management. The proposed amendment involves no backtracking on the Treasury-Federal Reserve accord of 1951, no commitments to peg the U.S. security market at par, no support measures at a time when monetary expansion would be inflationary.

The principal directive of the amendment would be that the Federal Reserve "should bring about needed future monetary expansion by purchasing U.S. securities, of varying maturities, rather than by further lowering bank reserve requirements."

Consistently since 1953, the Fed has expanded the money supply, where it has expanded it at all, by lowering reserve requirements of member banks. In the case of central Reserve city banks (New York and Chicago), reserve require-

ments have been lowered from 24 in 1953 to 18 today. In the case of Reserve city banks, requirements have been lowered from 20 in 1953 to 16½ today. In the case of country banks, reserve requirements have been lowered from 14 in 1953 to 11 today.

About \$4.3 billion of reserves has been added to the banking system by this method—enough to create six times as much credit, or almost \$26 billion worth.

Never once since 1953 has the Federal Reserve, when it was pursuing anti-inflationary policies, tightened reserve requirements. Instead, it has tightened money solely by raising the rediscount rate and by selling U.S. securities from its portfolio.

What is more, the Federal Reserve System has recently stated very clearly its continuing intention of adding to the money supply by purchasing U.S. securities for its portfolio. I recently collected these policy statements from the Federal Reserve System and set them forth in the Congressional Record for June 4, 1959, at pages 8963-8964.

The proposed congressional directive to the Federal Reserve to use purchases of U.S. securities as its principal method of expanding the money supply would help the cause of debt management in three major ways:

(1) It would raise somewhat the price of U.S. securities, and thus lower somewhat the going interest rate, not only on U.S. securities, but on all debt, public or private. Cushioning fluctuations on the downward side would make Governments more attractive to investors. Even if the additions to the money supply in the future need to be only the modest 3 percent currently recommended by the Federal Reserve (I think 4 or 5 percent would be more like it), this requires an addition to the money supply of close to \$6 billion annually, or close to \$1 billion in new reserves. If the Federal Reserves achieves this expansion in reserves by purchases of U.S. securities, it will have assured the maximum amount of support for U.S. securities, consistent with sound monetary policy (assuming reserve requirements remain unchanged). It should be noted that the proposed congressional directive to the Federal Reserves speaks of purchasing U.S. securities "of varying maturities." The Fed presently restricts itself to a bills-only policy which needlessly deprives the U.S. security market of the maximum support per dollar that it ought to have.

(2) It would save many millions of dollars annually for the taxpayers, because the interest charge on the national debt owned by the Fed comes back to the Treasury. For example, if the Fed had purchased \$4.3 billion of U.S. securities in recent years, instead of achieving this increase in outstanding reserves by lowering reserve requirements, at current interest rates something in the neighborhood of \$160 million would be saved for U.S. taxpayers. For the future, if the Fed's net purchases of U.S. securities average only \$1 billion a year, in 10 years this would amount to \$10 billion worth of national debt. The savings on this sum could be close to \$400 million a year, at current interest rates.

(3) It would at least partially protect the Treasury against the frequent embarrassment of attrition, whereby holders of maturing national debt suddenly elect to take cash, rather than a refunding security. In May, for example, one-third of the holders of a maturing 1-year note suddenly demanded cash, rather than to take another 1-year refunding note.

So far we have been discussing solely decreases in the Reserve requirement, and making the point that this method of increasing the money supply does not help in the management of the national debt, as does the method of purchasing, or at least retaining in the Federal portfolio, U.S. securities. However, there may well be occasions when the Federal Reserve, from the standpoint of both sound monetary policy and sound debt management policy, may wish to, and in fact should, raise Reserve requirements. The Federal gives as its reason for not having done so, and for proclaiming its intention of not doing so in the future, that the reserve-raising power is a clumsy weapon, in that it may operate harshly upon certain member banks.

There is strong reason to believe that the Federal Reserve, if it really wanted to smooth off the rough edges of its debt management policy, could do so by a series of very simple amendments. A number of sound and sensible ways of doing this, recommended by the late E. A. Goldenweiser, former Director of Research for the Federal Reserve System, and published by the Committee for Economic Development, are set forth in my remarks on the floor on June 4, 1959 (Congressional Record, p. 8965).

The House Committee on Banking and Currency on May 28, 1959, formally requested the Federal Reserve to explore methods of making the Reserve-raising power a usable and effective method. The committee said:

"Your committee firmly believes that the Board's monetary tools must be as efficient as possible. We are concerned over indications that increases in Reserve requirements may be considered too blunt a weapon to use effectively. Accordingly, the Federal Reserve Board is requested to give further study to this problem, and to report to the committee as soon as practicable concerning possible improvements in the techniques of employing Reserve requirements as an anti-inflationary tool, together with recommendations for any remedial legislation that may be necessary to put these improvements into effect" (committee report, p. 6).

The entire Congress should express the same wish as did the House Committee on Banking and Currency—that the Federal should refurbish its Reserve-raising powers, both to fight inflation when inflation threatens, and to permit a decent Federal participation in the debt management processes without giving rise to inflationary dangers.

Our debt managers need some guidance from Congress. The proposed amendment endeavors to provide this. In the long run, sustained economic growth, increased savings, reasonable price stability, national budgets balanced at full employment and production, are the royal road not only to a healthy economy, but to a well-managed national debt. Meanwhile, Congress must give the clearest kind of immediate directive that it can.

MR. REUSS. I hope it has been distributed to the members of the committee, because it may be easier to refer to it.

The committee is taking a look at the debt management crisis—higher and higher interest rates, lower and lower prices on Government bonds, more and more skittishness on the part of investors, which has brought the Treasury here asking for the heightening of the debt ceiling and the removal of the interest rate ceilings on savings bonds and on U.S. securities in general.

Partly, the debt management crisis is the result of natural causes, but it is also in part, I believe, caused by policies of monetary management and debt management which I believe could be improved.

I therefore present to the House Committee on Ways and Means a proposed amendment, which is set forth at the beginning of my presentation, which in my opinion would be a worthwhile addition to whatever the committee reports out, whether it raises or does not raise either the debt ceiling or the interest ceilings on savings bonds or on U.S. securities in general, or even if it should be determined to do nothing. I believe that Congress should inform the monetary authorities of how its monetary practices may be improved.

The proposed amendment has three thoughts in it. The first thought is that—and here I read:

It is the sense of Congress that the Federal Reserve System, while pursuing its primary mission of administering a sound monetary policy, should, to the maximum extent consistent therewith, utilize such means as will assist in the economical and efficient management of the public debt.

In other words, the Federal would be urged not to turn its back on public debt management, as it has in recent years. Of course, its major concern must be a sound monetary policy, but there is no reason why that which it does, to bring about a sound monetary policy, cannot in the course of that, also assist in debt management.

What I propose involves not one bit of back tracking on the Federal Reserve-Treasury accord of 1951. It does not involve any commitments to peg the U.S. bond market at par. It does not involve any support measures at a time when monetary expansion would be inflationary.

In this connection, I note what Secretary Anderson had to say in some 20 pages of his statement yesterday, in which he sought to answer the contentions of critics as to why the administration was not doing more about helping in the management of the national debt. In doing so, he examined and thoroughly stepped on a number of proposed positions.

I have looked at that part of his testimony, and I find that while the carnage was terrific, most of the men that he was slaying were strawmen. For example, the Secretary spent some time examining the proposition that it would be a good idea, in order to secure a better management of the national debt, that the Government bring about a recession.

Well, I do not think that anyone outside of a lunatic asylum is suggesting such a measure, and I therefore find that the Secretary's answers to criticisms do not really take up the criticism. I have such a criticism to make. I will state exactly what it is. And I hope that the ideas I present will get through to members of the committee, so that they may set me straight if I am wrong.

The main directive that I think the Congress ought to give to the monetary authorities is contained in the second clause of my proposed amendment, and that is also brief and says: "That the Federal Reserve System, to the greatest extent possible, should bring about needed future monetary expansion by purchasing U.S. securities of varying maturities, rather than by further lowering bank reserve requirements."

Now that is my thesis. Let me explain why I urge it.

Consistently in the last 6 years, the Fed, when it has wanted to expand the monetary supply, has done so by lowering reserve requirements of member banks. I have set forth on page 2 of my statement how it has lowered New York and Chicago bank reserve requirements from 24 in 1953 to 18 today; Reserve city bank requirements from 20 down to 16½ today; and country banks from 14 in 1953 to 11 today.

This has resulted in the creation of about \$4,300 million of reserves, which, on a 6-for-1 ratio, have resulted in the creation of about six times as much credit or money, \$26 billion worth.

Never once during this period has the Federal Reserve, when inflation threatened, and it wanted to tighten credit, done so by tightening reserve requirements back to where they were. Instead, it has always tightened money either by raising the rediscount rate, or by selling U.S. securities from its portfolio.

What is more, this is not merely the past, for the historical archives. The Federal Reserve has, just a few days ago before a committee on which I am a member, the Banking and Currency Committee, solemnly set forth that it is going to give us more of the same; that from here on out it intends to continue to increase the monetary supply by lowering bank reserve requirements, not by purchasing U.S. securities for its portfolio; indeed, it says that it is going to go on lowering bank reserve requirements, and if this should prove too inflationary, it is going to take up the slack by selling securities from its portfolio.

The method of meeting necessary increases in the monetary supply which I propose is exactly the opposite. I suggest that the Fed

be told that it should meet necessary increases in the monetary supply in the years to come by purchasing appropriate amounts of the national debt.

There are three advantages in such a method. And let us keep clearly in mind that from the monetary standpoint, from the inflationary standpoint, the methods are exactly equal. I am not here suggesting either tight money or easy money. I am simply saying that whatever rate of monetary increase appeals to our monetary authorities, the Federal Reserve, as a good, right, just, and sensible rate of increase, let them do that, but let them achieve it in the right manner. They say in their recent testimony that they think a rate of increase in the money supply of 3 percent a year is about right. Now I happen to think that 4 or 5 percent is closer to what this country needs to attain the rate of growth that is necessary, both for what we need at home and for our world responsibilities. But let that pass. Let us accept the Fed's judgment at 3 percent.

There are three ways in which debt management can be improved by utilizing the method of increasing reserves envisaged in the proposed amendment, rather than the method that the Fed has in fact pursued, of constantly lowering bank reserve requirements.

In the first place, the use of the method of purchasing U.S. securities by the Fed would tend to raise the price of U.S. securities, because there would be this much added on the demand side of the equation, and thus lower somewhat the going interest rate, not just on U.S. securities, but by communication throughout the entire debt structure, the interest rate on mortgages, corporate bonds, State and local governments, and everything else. Cushioning fluctuations on the down-side is going to make Governments a lot more attractive to investors. I can understand an investor being skittish about purchasing a Government bond at par. Last June the investors who bought that issue of June 1958, now observe that it is selling at around 90.

Even if the additions to the money supply in the future are only the modest 3 percent that the Federal Reserve thinks they should be—and as I say, I am not at this time quarreling with that—this would require an addition to the money supply of close to \$6 billion annually, or close to \$1 billion in new reserves. Now if the Federal Reserve achieves this expansion in reserves by purchases of U.S. securities, it will assure the maximum amount of help for the problem of debt management.

It should be noted that the proposed directive by Congress to the Federal Reserve speaks of purchasing U.S. securities of varying maturities. I think that would be a good directive to give the Fed, because the present policy of "bills only" unduly restricts their freedom of action. While I do not suggest that they ought to be required to purchase bonds only or certificates only or notes only, I do suggest they should free themselves of the self-imposed iron maiden of "bills only," and that they should pursue a policy of purchasing securities which has as its only criterion what is best for the country.

Secondly, the method proposed of Federal Reserve purchases to create needed reserves for needed expansion of the monetary supply would save many millions of dollars annually for the taxpayers, because, as is well known, the interest charge on the national debt which is owned by the Fed comes back to the Treasury. For example,

if the Fed had done what I believe they should have done in the last 4 years, if they had purchased this \$4.3 billion of U.S. securities, instead of creating that amount of reserves by lowering bank reserve requirements, at current interest rates something like \$160 million a year would be saved for U.S. taxpayers.

For the future, if the Fed's net purchases of U.S. securities averaged a billion dollars a year, which is, if you follow my arithmetic, about what I think they would average, in 10 years this would amount to \$10 billion worth of national debt. And at current interest charges, again, this would save for the taxpayers close to \$400 million a year.

Let me quote from a leading economic authority, Prof. Alvin Hanson, of Harvard, on just how this works. He says in a recent book:

For a growing economy an importance issue is raised: Which method of economic controls is to be preferred, changes in reserve requirements or changes in open market operations? Both methods, it is true, provide earning asset windfalls to the commercial banks. But there is this difference. When the expansion is effected by way of open market operations, the earning asset windfall is shared between the banks and the Federal Reserve. The net effect of the open market method is that the Government, since it has paid about 95 percent of the Federal Reserve profits, would participate in the moneymaking windfall. The open market method is thus clearly more favorable to the taxpayer.

So, reason No. 1, it helps eliminate fluctuations on the downside. Reason No. 2, it gives a long delayed and much deserved breaks to the taxpayer. And reason No. 3, it would in large measure protect the Treasury against the frequent embarrassment of what is called attrition, namely, when holders of the maturing national debt come around and are offered a refunding security but instead wave it aside saying, "No, I want cash."

Just last month, for example, more than one-third of the holders of a maturing 1-year U.S. note said, "No, we don't want the 1-year note, even though it bears a coupon of almost 4 percent, which you are offering in exchange. Give us cash." And the Treasury had to go out and raise some money on the drumhead in an embarrassing hurry.

To the extent that the Fed will assume its responsible role in debt management, this embarrassment of attrition will diminish.

So far, Mr. Chairman, I have been discussing just the question of a Federal Reserve helping hand to the Treasury in the course of the normal creation of an expanded monetary supply, at whatever rate the monetary authorities deem it advisable. However, I want to call to the attention of the committee that here may well be occasions when the Federal Reserve, from both the standpoint of sound monetary policy and sound debt management policy, may wish to, and indeed should, raise reserve requirements.

The Fed has in effect thrown away this very valuable anti-inflationary weapon by saying, as it repeatedly does, and as the Treasury said yesterday, "Oh, this weapon is so blunt that we can't really use it." So constantly they lower reserve requirements but never, never, never raise them.

I believe that if the Federal Reserve put its mind to the problems, if it really wanted to smooth off the rough edges of the reserve raising power, it could do so.

A number of very sound and sensible methods of doing this have been suggested by the late E. A. Goldenweiser, who for many years was Director of Research for the Federal Reserve; and in a series

of excellent books published by the highly respectable CED, the Committee for Economic Development, in recent years, Mr. Goldenweiser suggested most cogent and lucid and sensible ways of refurbishing this reserve requirement weapon so that we have a solid weapon of monetary management that can stem whatever inflationary pressures there may be in the economy.

Just recently the House Committee on Banking and Currency in its report, on May 28, just a few days ago, told the Federal Reserve to get off its dime and do a little work and report back to the Congress how it can use this power. The committee said—this is set forth on page 4 of my testimony :

Your committee firmly believes that the Board's monetary tools must be as efficient as possible. We are concerned over indications that increases in reserve requirements may be considered too blunt a weapon to use effectively. Accordingly, the Federal Reserve Board is requested to give further study to this problem.

And it goes on to say to report back speedily to Congress.

The entire Congress, I believe, Mr. Chairman, should express the same wish as did the House Committee on Banking and Currency, and that is why the third and last clause says, and I quote :

\* \* \* that the System should promptly and fully explore methods whereby use of the power to raise reserve requirements may become a more usable and effective anti-inflationary tool.

I believe that our debt managers need some guidance from Congress. The proposed amendment endeavors to provide this. In the long run, sustained economic growth, increased savings, reasonable price stability, national budgets balanced at full employment and production, are the royal road not only to a healthy economy, but to a well-managed national debt.

But meanwhile, I sincerely believe that Congress should give the clearest kind of immediate directive that it can in connection with this problem.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Mr. REUSS, we thank you, sir, for bringing your ideas to the committee. They, I am sure, will be very helpful to the committee.

Are there any questions?

Mr. ALGER. I may have misunderstood what the gentleman from Wisconsin said.

When you referred to the Secretary's statement, I was here throughout that entire statement. Did you say he spent 20 some pages talking about creating a recession?

Mr. REUSS. No; what I said was the Secretary spent 20-odd pages answering assumed criticisms of the monetary management policy of the administration. On pages 19 through 34, particularly, toward the end of his prepared statement, he has a section entitled "Consequences of various proposals to induce lower interest rates." And I feel a little hurt, frankly, that the Secretary of the Treasury did not take up my proposal, which I think is a sound one, and incidentally a proposal which would save the taxpayers millions of dollars, and instead spent his time demolishing various crackpot ideas that nobody is seriously suggesting, one of which was "Let's have a recession so that interest rates will go down."

Well, the Secretary did a marvelous job of running his sword through that idea. But nobody is seriously suggesting it. And I think the Secretary would have been better advised to spend those pages of his testimony answering, if answers there be, the proposition which I have been putting forth both on the floor of the House and here today and in communications to the various monetary authorities.

Mr. ALGER. I apparently did not understand. I better understand now what you said. I recall he did put an addendum to his statement yesterday.

I personally want to object to your saying that you felt the Secretary was attacking or disposing of various strawmen. I rather felt these were very real problems. I felt the Secretary was confronted with certain problems that he felt to be very real, and that he was not trying to scare us or set up imaginary situations. I would like to ask the gentleman in two regards, then, as to what the Secretary said. In his questioning from his statement, he pointed out that he felt deficit spending was creating the inflationary pressure which both makes for difficulty in the refinancing of money through the weakening of the bond market, and also is the force that is bidding up the interest rate.

Would the gentleman care to comment on that? Because we are all faced with the problem of paying the bill.

Mr. REUSS. I am awfully glad to comment on that, and it is a very good question.

Let me say right at the start, as I said a moment ago in my testimony, that I believe an essential concomitant of a sound economy is a balanced budget at a high level of production and employment. Indeed, we want over the years to have a sufficiently growing economy so that we can run a surplus and pay off part of the national debt. And the next witness, Mr. Jim Wright of Texas, is going to offer some very cogent thoughts on that.

However, in my opinion, it would be a dire mistake to say that the debt management problems of the administration and of the Congress are caused by the deficits we have had in recent years. Debt management has become a problem quite independent of deficits.

Just having budget surpluses, for example, and paying off part of the national debt, is not going to solve the problem of debt management. It is not going to bring about lower interest rates, as long as we pursue the policies we are now pursuing.

Strangely enough—and I will be glad to document this very fully for the gentleman if he is interested—in the last 4 or 5 years, the times when the Treasury has had the easiest time in managing the national debt happened to be times when there has been a very considerable deficit. Please do not misunderstand me. Please do not suggest that I am saying that we should have big deficits to ease the management of the national debt. What I am saying is that balanced budgets, however desirable they are—and they are very desirable—are not in and of themselves the way to solve the crisis in the national debt. The crisis in the national debt is very largely the result of monetary and debt-management policies which exacerbate and intensify the tendencies in the economy which, I grant you, are there anyway, producing high interest charges.

Mr. ALGER. Well, I am sure you would agree that we have not had much experience in Government surpluses to pay down the debt or to affect our economy. I am pleased to hear the gentleman say he believes in a balanced budget, but for the life of me I cannot understand how we could reach a balanced budget when we continue to spend beyond income. The entire debt is the result of deficit spending, unless I am mistaken.

Mr. REUSS. Well, of course the entire national debt is the result of deficit spending. The question to which I was addressing myself was: Given a \$285 billion national debt, which we now have, will balanced budgets from here on out make the debt management problem an easy one? My answer is definitely "no"; that as long as we continue incorrect debt management and monetary policies, we will have that problem with us.

Mr. ALGER. The gentleman is not saying that the \$13 billion deficit last year does not play a part in this. That has nothing to do with debt management, but is the creation of this debt. We did it. Is that not correct?

Mr. REUSS. The \$13 billion deficit last year constitutes thirteen two hundred eighty-five thousands of the total debt management problem. That is all it does. Obviously, if you have less of a national debt, you have less of a problem. But my point is that at almost any level you have a very difficult problem, made much more difficult by what I regard as wrong-headed policies by the Treasury and the Federal Reserve. So that if we could lower the national debt to zero, we would then eliminate a national debt problem. But no matter what we do with it, until we improve our debt management practices, we are going to have an extremely serious problem.

For example, in 1956 and 1957, Mr. Alger, we not only had balanced budgets, but surpluses. Yet the Treasury, at that time, could not issue any long-term debt. With interest rates on the increase, investors shied away from any but the shortest term Governments. So even when we had a splendid budgetary picture, with nice surpluses, the problem of debt management, far from being solved, was almost as bad as it is today.

Mr. ALGER. I cannot agree with that, Mr. Reuss, but I will not pursue it at this time. I realize the hour is late. We appreciate your viewpoint.

The CHAIRMAN. Are there any other questions?

If not, we thank you, Mr. Reuss, for the information given the committee.

The CHAIRMAN. The next witness is our colleague from Texas, Mr. Jim Wright.

You are recognized to proceed in your own way, Mr. Wright. Do you have copies of your statement?

#### **STATEMENT OF REPRESENTATIVE JAMES C. WRIGHT, JR., OF TEXAS**

Mr. WRIGHT. I am very sorry that I do not, sir. I have copies of statements that some of my colleagues who are cosponsoring this proposal which I am here to advance have asked me to present for them, and others are presenting their own.

The CHAIRMAN. You always present a matter in such a fine way that I am sure we will be able to follow you.

Mr. WRIGHT. Mr. Chairman, one of the things that has fostered my admiration for this committee and for you as its chairman is the gracious manner in which you receive us and sit there listening patiently to so much tedious discussion as you have done today. I hope I can spare you undue punishment, and I will try to make this as brief as I can.

I am here in the interest of presenting for your very serious consideration, on this committee, a proposal that has been advanced by at least 19 of us in the House, which would create a systematic and orderly method of retiring the national debt.

Among the cosponsors of this legislation are the gentleman from Texas, and member of the committee, Mr. Ikard; the gentleman from Louisiana and a member of this committee, Mr. Boggs; the gentleman from Florida and a member of this committee, Mr. Herlong; the gentleman from Arizona, Mr. Udall; the gentleman from Florida, Mr. Rogers; the gentleman from Texas, Mr. Casey; the gentleman from Florida, Mr. Bennett, who earlier addressed you; the gentleman from Tennessee, Mr. Loser; the gentleman from Nebraska, Mr. Brock; the gentleman from Florida, Mr. Matthews; the gentleman from Nebraska, Mr. McGinley; the gentleman from Iowa, Mr. Coad; the gentleman from Kansas, Mr. Hargis; the gentleman from Maryland, Mr. Brewster; the gentleman from Virginia, Mr. Downing; the gentleman from South Carolina, Mr. Hemphill; the gentlewoman from New York, Mrs. St. George; the gentleman from Florida, Mr. Sikes; and the gentleman from South Dakota, Mr. McGovern.

Similar bills, not identical to this, but varying in slight degree, have been introduced, and have been referred to this committee by such members as the gentleman from Texas, Mr. Teague; the gentleman from Arizona; Mr. Rhodes; and the gentleman from New Jersey, Mr. Thompson.

If I might summarize briefly what our feelings are in this regard, may I ask permission that each of these members may have the privilege of extending his remarks in the record of this hearing?

The CHAIRMAN. Immediately following yours, Mr. Wright, without objection it is so ordered.

Mr. WRIGHT. Thank you.

Early in this session of the Congress—

The CHAIRMAN. Pardon me. You included our colleague, Mr. Sikes, in that; did you not?

Mr. WRIGHT. Yes, indeed.

Early in this session of the Congress, the gentleman from Texas, Mr. Ikard, and I began discussing the stark necessity for doing something to begin a system of orderly retirement of this burgeoning national debt.

We introduced, first of all, a sense of Congress resolution, which would express the intent of Congress that each year not less than 1 percent of the currently outstanding debt should be retired, and that this payment on the principal of the outstanding obligation owed by our Government should come out in the same package with the interest which we are paying on this national debt.

You are confronted here, in these hearings, with the unpleasant task of trying to decide how to handle and best manage this increasing debt. You are confronted with the necessity for arranging some

means of paying an increasing interest. The interest on the national debt, as you so well know, is the second largest single item in the cost of operating our Government.

Today, at some \$81½ billion, as it was represented this morning, I believe, by Mr. Martin, it represents some 11 cents out of every tax dollar that the taxpayer sends in for Federal taxes. This is 11 percent of the cost of operating our entire Government. It is deadweight. It buys nothing. It is the price we pay simply for the privilege of owing this debt.

The interest charges on our public debt have grown and are continuing to grow, so that they constitute today an immense burden upon the taxpayers. And in the foreseeable future, it seems predictable that we shall be paying 3 or 3½ percent on the average Government obligation. And assuming the debt were not to increase actually any more than it is now, 3½ percent would mean \$9,800 million in interest payments annually.

It does not take a mathematical wizard to think of the many other useful and constructive things for which that money could go if it were not needed for interest payments. That much money could build 15,000 miles of superhighway every year, or in 3 years complete the entire 41,000-mile Interstate System. Or applied to the development of the Nation's water resources, it could complete in 1 year three times as many flood control and navigation projects as we have authorized for the next 10 years. Applied to soil conservation for the saving of our Nation's most vitally indispensable resource, it could perform more useful work in 1 year than we have devoted to that awesomely important task in the last 25 years, or perhaps in the entire history of our Nation.

It probably could purchase some 700 B-58's, more than we would ever need, of the world's newest and most modern operational aircraft in our defense arsenal.

Or, considered another way, if we did not have to pay the interest on the national debt, this \$9,800 million, which seems a foreseeable cost of debt management in the near future, if returned to the taxpayers on an equal pro rata basis, could mean that the average tax-paying family head could pay some \$275 less in taxes every year.

Of course, I am not suggesting that we do not have to pay it. Certainly we must pay it. As long as we owe the obligation, we must pay the interest on the obligation.

The only alternative would be to do as Communist Russia has done and repudiate its debts to those of its citizens who have loaned the Government money. This would be unthinkable.

I want to say it is demonstrably provable that it is cheaper to pay the debt than it is to owe it, and far, far less burdensome to the American people in the long run. If we continue, Mr. Chairman, on the present course in which we have been engaged in the last few years, simply mounting up the debt and passing off to some future time the responsibility of beginning a systematic method of payment on the debt, we shall have reached the point, in 28 years, where, in interest alone we will have paid the total amount of the debt we now owe, and we will still owe every penny of it. It would be almost comparable to the situation of one of us as a family head-paying only the interest on a home on which a mortgage was held

by some lender, and for 28 years paying interest, without reducing the mortgage by a penny or purchasing a penny's worth of equity in the home.

If we were to embark on this proposal suggested by the gentleman from Texas, Mr. Ikard, and the gentleman from Louisiana, Mr. Boggs, and the rest of us, it would mean that in 29 years we will have reached the point, by paying 1 percent each year on the presently outstanding obligation and interest on the unpaid balance, in 29 years we will have reached the point where payment on the principal and interest on the unpaid balance will be less than we now pay on the principal alone on this total obligation.

And there is a further thought that I would like to suggest to you, which arose from a discussion the gentleman from Texas, Mr. Ikard, and I were having day before yesterday afternoon with a Government economist from the Treasury Department. And that is the conclusion that paying on the debt has a salutary effect upon the interest rate.

I ask you to think in terms of two 7-year periods, the one that is just ending the 7-year period which is ending with this fiscal year, during which time we have not paid anything on the debt. We have not increased the debt greatly percentagewise, and yet it is costing us some \$3 billion more to pay the interest on it and manage this debt than it was just 7 years ago.

The cost of carrying the debt has increased during this period, while we have not paid any of it off.

And now compare, if you will, the period between 1920 and 1927, when the cost the Government incurred in paying the debt, the interest that it was required to pay on its long-term Government bonds during that 7 years, declined from almost 6 percent to  $3\frac{1}{8}$  percent.

During that time, some \$10 billion worth of debt had been paid off. And as a result of this, I am constrained to the conclusion that Government securities were more attractive and met a readier demand, and it was possible for the Government to finance its debt on smaller interest payments.

There is a second thing I want to say, if you agree, as I believe you will, that it is demonstrably cheaper in the long run to pay this debt than it is to go on owing it. To pay the debt is the fair thing to do from the standpoint of the future of the country and those who will follow us in the country. I am not going to presume to preach you a sermon on that subject. I think you are every bit as cognizant of that situation as I am.

There is something, however, that offends the sensitivities of all of us when we think that we are building this debt on the purchase of equipment on which obsolescence is taking a toll and the building of such things as highways which will be obsolete or wornout, and that we are passing on to a future generation the responsibility of paying for things that we will have used up and wornout, by the time they come on the scene to pay for them.

And then the third thing I wanted to say is this: And I apologize almost for mentioning it, but I think it is crucial in this particular instance, because I have the feeling that many of the Members of the House have felt for a long while that we should begin paying something on this debt. But just have not believed quite strongly enough

that the American people were able to bear it or were ready to embrace it. The public, I am convinced, will approve it.

Since the introduction of these bills by the gentleman from Texas, Mr. Ikard, and the gentleman from Louisiana, Mr. Boggs, and the rest of us, editorials have spontaneously appeared in newspapers throughout the country, in which I have had no part, and I am sure none of my colleagues have had any conscious part in encouraging. I have in my possession editorials which appeared in 55 metropolitan daily newspapers throughout the country. This includes 19 Scripps-Howard newspapers—and includes as a random sample, the Washington Daily News, the Cleveland Plain Dealer, the Nashville Banner, the Wall Street Journal, the Hartford (Conn.) Times, the South Bend Tribune, the Omaha World-Herald, the New York News, and many others, throughout the entire breadth of the country. Without exception, the editorial response has been favorable. If I were able to characterize what the newspapers have said, those that have come to my attention—and I did not employ a clipping service; these were sent to me by people who noted my name or sent them to Mr. Ikard or me from all over the country, Kansas City, St. Louis, Idaho, and so forth—the tenor of them seems to be this: “Why, of course this is a good idea, and certainly it should be done; but of course the Congress is not going to do it.” That is the only negative note that has been cast—a sort of a cynical attitude which assumes that the Congress is not going to do anything about it.

I think we have the opportunity here to disprove that cynicism, to prove that we will do something about it.

During this time, I have received spontaneous letters from people all over the country, inspired by the amount of publicity that has been gained. And here they are. I do not know how many of them there are, but you can look at them. Probably 300 or 400. I have not written and asked anybody to write to me on this subject. Without exception, people are for it. They say, “We should pay off our debt. We should begin, as a homeowner must begin paying off his home, as a man who owns a business must take into account month by month some payments on the principal of his debts.”

I am convinced that on this particular matter the public is ahead of the politicians. And I mean no disparagement in the use of that term. I mean it in the sense in which Webster used it, the science and art of government.

I am convinced that the public would even approve, if necessary, a special tax, the proceeds of which would be earmarked for a trust fund to pay off the national debt bit by bit each year. I think they would embrace it. I am satisfied they would approve it. I am certain they would.

There is one other thing I want to say. And that is that unless we set about such a systematic method and make a firm resolve to do it, and plant our feet definitely and securely on that path, we are not ever going to find it convenient to do. If we simply sit back and await a utopian time when it will somehow be easy to retire the national debt, I fear that we will be waiting a long, long while.

If you need any more proof of that than the experience of the last few years, I do not know what it would be. In the last 10 or 15 years, we have had unprecedented prosperity in this country. If there

has ever been a time when it would have been relatively easy for us to pay off some of our debt, those were the years when it would have been.

I think perhaps we were sitting around waiting, thinking, "Well, maybe these crises will dissolve, and we will have an opportunity to build a big surplus 1 year in the Treasury, and we will pay off in lump sum a good bit of this debt."

Well, to live in that anticipation I fear is living in a fool's paradise, because there is no reason for us to believe that these crises are not going to continue. We have had crises now for 15 or 20 or 25 years, and probably if we are realistic—we may as well face it—this cold war is going to last maybe for another 20 or 25 years.

But in the midst of crisis, we should be making an orderly systematic retirement of our debt, I think. This method has proven successful. It has been employed before. It is not new to us, really. It was used with considerable success following the Civil War in this country, and for a period we retired about a third of the debt accumulated during that war. It was followed after World War I with similar salutary results.

As the gentleman from Texas, Mr. Ikard, pointed out so ably in a study he prepared and presented on the floor of the House, this is the one method which historically has been proven workable and usable as a means of actually retiring debt—to set a goal and take it out first, just as you take out the interest on your debt, and not to consider that you have balanced your budget until you have accounted a certain amount of payment on this principal each year in the expenditures of the Government.

I have probably labored your patience beyond the point of your endurance, and were it not for your tolerance and your good will, I am afraid I would have bored you into leaving before now. I want to thank you very much for this opportunity of having been with you. And if there are any questions I can answer, I would be happy to do my best to try.

Some of my colleagues are here. Mr. Hargis is here, and Mr. Rogers, of Florida, is here, and several of the other gentlemen. The gentleman from South Carolina, Mr. Hemphill, is interested in this proposition. And if any of us can answer any questions, I know that any of us would be glad to.

Mr. HERLONG. I think Mr. Ikard has done an excellent job, and I am very pleased to be associated with him and to have the original companion bill with him on this. I think the whole sense of this, Mr. Wright, is that we apply to the operation of Government finance the same rules that all families apply to theirs, and that is that—as you indicated a moment ago—the family budget is not balanced until you take into consideration the car payment or the house payment or the refrigerator payment or whatever else it is that they might be purchasing on the installment plan, and this attempts to envision a systematic method whereby, even though it would take a number of years, this debt can be retired, and the savings that would be made by doing this would more than offset the minimum payment that would be required through the years, which would be something in the order of \$2.8 billion.

Mr. WRIGHT. It would indeed more than offset it. Using the hypothetical figures of  $3\frac{1}{2}$  percent—which I realize is a little high and for this reason reflects not quite a completely true picture but nevertheless makes the point—I worked out a table of amortization on this debt extending over a hundred years, and it proves out that in 100 years we could completely retire the debt on that basis by paying \$495 billion in interest and \$286 billion in principal, or a total of \$781 billion.

Mr. HERLONG. Mr. Wright, could you furnish that amortization table for the record?

Mr. WRIGHT. I would be very happy to do so. As I pointed out, it is predicated on the assumption of an average interest rate of  $3\frac{1}{2}$  percent, which I realize is a little high, but we were moving in the direction of higher interests. And I would be glad to do it. What is proven in the long run is that if we pay nothing on the debt for a hundred years, but simply continue paying interest, we will have paid \$980 billion in interest, and we will still owe \$283 billion, or a total of \$1,263 billion, which would be \$485 billion more than it would cost us in both principal and interest to pay it off.

The CHAIRMAN. Without objection, that material will be included in the record at this point.

(The table referred to is as follows:)

*Amortization table, based upon a national debt of \$280,000,000,000, paid off at the rate of 1 percent each year, and interest at the hypothetical rate of 3½ percent on the unpaid balance*

(In billions of dollars)

Year end	Total debt	Payment on principal	Interest at 3.5 percent	Year end	Total debt	Payment on principal	Interest at 3.5 percent
0	280	2.8	9.8	52	134.4	2.8	4.704
1	277.2	2.8	9.702	53	131.6	2.8	4.606
2	274.4	2.8	9.604	54	128.8	2.8	4.508
3	271.6	2.8	9.506	55	126.0	2.8	4.410
4	268.8	2.8	9.408	56	123.2	2.8	4.312
5	266.0	2.8	9.310	57	120.4	2.8	4.214
6	263.2	2.8	9.212	58	117.6	2.8	4.116
7	260.4	2.8	9.114	59	114.8	2.8	4.018
8	257.6	2.8	9.016	60	112.0	2.8	3.920
9	254.8	2.8	8.918	61	109.2	2.8	3.822
10	252.0	2.8	8.820	62	106.4	2.8	3.724
11	249.2	2.8	8.722	63	103.6	2.8	3.626
12	246.4	2.8	8.624	64	100.8	2.8	3.528
13	243.6	2.8	8.526	65	98.0	2.8	3.430
14	240.8	2.8	8.428	66	95.2	2.8	3.332
15	238.0	2.8	8.330	67	92.4	2.8	3.234
16	235.2	2.8	8.232	68	89.6	2.8	3.136
17	232.4	2.8	8.134	69	86.8	2.8	3.038
18	229.6	2.8	8.036	70	84.0	2.8	2.940
19	226.8	2.8	7.938	71	81.2	2.8	2.842
20	224.0	2.8	7.840	72	78.4	2.8	2.744
21	221.2	2.8	7.742	73	75.6	2.8	2.646
22	218.4	2.8	7.644	74	72.8	2.8	2.548
23	215.6	2.8	7.546	75	70.0	2.8	2.450
24	212.8	2.8	7.448	76	67.2	2.8	2.352
25	210.0	2.8	7.350	77	64.4	2.8	2.254
26	207.2	2.8	7.252	78	61.6	2.8	2.156
27	204.4	2.8	7.154	79	58.8	2.8	2.058
28	201.6	2.8	7.056	80	56.0	2.8	1.960
29 <sup>1</sup>	198.8	2.8	6.958	81	53.2	2.8	1.862
30	196.0	2.8	6.860	82	50.4	2.8	1.764
31	193.2	2.8	6.762	83	47.6	2.8	1.666
32	190.4	2.8	6.664	84	44.8	2.8	1.568
33	187.6	2.8	6.566	85	42.0	2.8	1.470
34	184.8	2.8	6.468	86	39.2	2.8	1.372
35	182.0	2.8	6.370	87	36.4	2.8	1.274
36	179.2	2.8	6.272	88	33.6	2.8	1.176
37	176.4	2.8	6.174	89	30.8	2.8	1.078
38	173.6	2.8	6.076	90	28.0	2.8	.980
39	170.8	2.8	5.978	91	25.2	2.8	.882
40	168.0	2.8	5.880	92	22.4	2.8	.784
41	165.2	2.8	5.782	93	19.6	2.8	.686
42	162.4	2.8	5.684	94	16.8	2.8	.588
43	159.6	2.8	5.586	95	14.0	2.8	.490
44	156.8	2.8	5.488	96	11.2	2.8	.392
45	154.0	2.8	5.390	97	8.4	2.8	.294
46	151.2	2.8	5.292	98	5.6	2.8	.196
47	148.4	2.8	5.195	99	2.8	2.8	.098
48	145.6	2.8	5.096	100	0	2.8	.000
49	142.8	2.8	4.998				
50	140.0	2.8	4.900	Total		280.0	494.900
51	137.2	2.8	4.802				

<sup>1</sup> At the 29th year the total paid for the payment on the principal and the interest amounts to \$9,758,000,000. This is \$42,000,000 less than the \$9,800,000,000 we are paying per year at the present time, and will continue to pay on our present program.

On the above program, we will have paid out \$494,900,000,000 in interest, and \$280,000,000,000 in principal, or a total of \$774,900,000,000. If we just keep on paying interest, we will have paid \$980,000,000,000, and still have the \$280,000,000,000 debt left, or a total of \$1,260,000,000,000. The difference is \$485,100,000,000 to the good, and our debt is paid.

The CHAIRMAN. Any further questions of Mr. Wright?  
Mr. Alger?

Mr. ALGER. I might say to my colleague I have listened very carefully. It strikes me this is an awful lot like taking a firm stand for motherhood and against sin.

Mr. WRIGHT. I appreciate the comment of my colleague from Texas.

Mr. ALGER. I have been interested for some time in a constitutional

amendment Mr. Byrd had in. I am not sure it is still in, because it was fruitless. It was a constitutional limitation on the power of Congress to tax, spend, and borrow.

My question to the gentleman is this: Do you think there is any validity or any hope for success through this bill, meritorious though it may be, unless it is allied to some limitation on Government spending?

Specifically, some limitation so that the Government cannot spend beyond its means. Otherwise, are you not spending with one hand and paying off with the other?

Supposing last year, for example, Mr. Chairman, we had paid off \$3 billion of the national debt and then ran up \$16 billion beyond the budget, which would have the net effect last year of coming to \$13 billion.

Mr. IKARD. If the gentleman will yield, it would not have that effect. Excuse me.

The CHAIRMAN. One of you gentlemen from Texas speak up.

Mr. WRIGHT. Of course, I do understand what the gentleman has in mind, and it would not be productive of the results we seek if each year in addition to paying off this amount of principal on the national debt we continued to borrow more. I think, however, if we were to set our feet firmly in this path, and if in our budget as it was presented to us by our President, we had a figure representing not less than 1 percent on the principal, there would be a powerful moral force on the Congress, particularly if it had said, in enacting such a bill, that this is what it intends to do, to go ahead and follow through.

I do not know, short of a constitutional provision, how we could bind a future Congress. Obviously, we are not going to be able to solve this unless we do one of two things, increase revenues or reduce expenditures, to the point that we will have a balanced budget.

Mr. ALGER. Does the gentleman think there is any more moral force to paying off the debt than to living within the income?

Mr. WRIGHT. It is one and the same thing; is it not? A family is not living within its income unless it is making its payments on its obligations. I think the moral force would be much greater if we had adopted this provision and thus set ourselves to the firm policy and put in our budget and said, "This is what we are going to do," than it would be if we did not. I think what the gentleman is saying is that it is not going to do any good to say we are going to do this and then not do it. And he is correct. But I think it is demonstrably true by the record of the last few years that we are not going to do it until we say we are going to do it and officially establish such a policy. That is what I am proposing that we do.

Mr. ALGER. It would be nice, of course, if just saying it made it so, and I would like to think that could be the possibility, and if so, certainly would be for it.

Does the gentleman feel that the same Members of Congress who favor this would agree in any year to stay within the budget? Would there be any more moral force to trying to pare down the budget? That is what stops me cold.

Mr. WRIGHT. Let me say this: That I think this House in the months that have expired in this session has made a pretty good record all in all. In some 10 appropriation bills that have come before

us, we have reduced the President's budget requests by a total of \$952 million. Some of us have voted for additional reductions that have not come about, in the House. But I think all in all, over the past 6 or 7 years, the Congress annually has reduced the total amount asked, in the approval it gives its appropriations. I think the total reduction for the past 6 years comes to almost \$23 billion that the Congress has appropriated less than the Chief Executive in his budget submission has asked. So I do not think that is such a bad record.

Mr. ALGER. May I ask the gentleman how much in the same 6-year period we have voted beyond the President's budget that was not included in the budget? And I think that needs to be said, in order to present the whole picture.

Mr. WRIGHT. Well, if I have failed in my presentation of the whole picture, I apologize, because I thought the figures I presented were representative of the total appropriations voted by the Congress in those years. If I am in error, I will stand corrected, because it was not my intention to misrepresent it.

Mr. ALGER. I am certain of that. I merely want to say to the gentleman that obviously we cannot say that last year, as he has just said, along with the total of 6 years, we spent less than the budget, when we went \$13 billion over Government income. We all know some of that is backdoor financing, where some of us are actually not in a position of being immediately responsible, but this too is a part of the legislation we voted.

The thing that appalls me, however, is that this statement is made frequently that the gentleman has just made. Up to the present time, for example, we have reduced X number of appropriation bills. Yet we have the airport bill, the housing bill, the depressed areas bill, and many other bills pending. And this committee is going to have to help raise moneys for it, or we are going into a deficit again.

Mr. WRIGHT. Of course, the gentleman will agree that before money is expended on those bills, the Congress will have to appropriate moneys on those authorizations, will he not?

Mr. ALGER. I think the figure in the last year was some \$9 billion or possibly more than that, that was not going through appropriations, of course.

Mr. WRIGHT. I surely would not quarrel with the gentleman about that. I think probably what we are both trying to say is about the same thing, and that is that the Congress is going to have to face up to the necessity of providing fiscal responsibility and maintaining a balanced budget, including some payment on the debt.

I think each member tries to do that in his own way. I have maintained the record of my particular votes since I have been here, and some of them have not prevailed. And I realize that that is not a fair criterion, for that reason. But I always try to balance the taxes I have voted for with the expenditures I have voted for. I thought I was doing that last year. But our revenues did not live up to expectations, because of the recessionary trend that set in. And I think all of us were surprised that we received less revenues from the taxpayers than we had anticipated and less than the administration had anticipated.

So we have made mistakes. And it would be very presumptuous of me to try to say what, in each of 100 years coming, we are going to

cut out, or what we are going to do in the way of raising revenues, but I think as a matter of principle we can say now that we definitely intend to do it, and we can require the Secretary of the Treasury in his budget submissions to include a payment of not less than 1 percent of the principal of the national debt, and can clearly state that no budget will be considered balanced unless it includes that on the expenditure side.

I think I have intruded upon the more factual answer that the gentleman from Texas, Mr. Ikard, may have wished to make.

Mr. ALGER. I want to congratulate the gentleman for his interest in the debt. If this would help pay down the debt, I certainly would join with the gentleman.

The CHAIRMAN. We thank you again.

Mr. WRIGHT. Thanks to you and the members of your committee.

The CHAIRMAN. We will now hear from our colleague from Kansas, the Honorable Denver D. Hargis.

You are welcome, sir.

Mr. HARGIS. Thank you, Mr. Chairman.

#### STATEMENT OF REPRESENTATIVE DENVER D. HARGIS, OF KANSAS

Mr. HARGIS. On February 25 this year, I had the honor of speaking on the House floor in support of legislation coauthored and cosponsored by my good friends and distinguished colleagues from Texas, Mr. Wright and Mr. Ikard. Certainly the events of succeeding months have done nothing to lessen my belief in, and wholehearted endorsement of, the plan for an orderly, systematic program to reduce the public debt, as embodied in the Wright-Ikard bills, H.R. 4587 and H.R. 4588. On the contrary, the overwhelmingly favorable reaction expressed by the citizens of my home district, and their growing concern with the problem of finding a means of reducing the heavy burden of public indebtedness, have served to strengthen my convictions.

This committee is now faced with an administration request for legislation to raise the ceiling on the public debt. We are told that this is unavoidable, and this may be so. But I do not believe that we need continue to regard as unavoidable, or endless, or forever hopeless, the present necessity of pouring billions upon billions of dollars down a bottomless rathole, by paying interest alone, without taking sensible steps toward annual reduction of the principal.

I do not claim to be an expert on fiscal policy, but I do not believe it takes any marked degree of financial wizardry to gage the desirability of the Wright-Ikard proposal in preference to present policy. The figures offered in support of it are amazing—at least they were to me—but they are also irrefutable. By a budget allocation equal to 1 percent of the aggregate debt, appropriated annually for 100 years, both debt and interest could be paid in full. But if nothing is paid on the debt proper during the same 100-year period, interest alone will amount to approximately \$200 billion more than the total for principal and interest under the 1 percent annual retirement plan—and the original indebtedness will still be there, entirely unpaid.

I am firmly convinced that the public is ready and willing to make the sacrifices this program would entail initially, once they are made to

realize—as a great many already do realize—the incalculable benefits of the plan's long-range goal. Thinking Americans everywhere are distressed, agitated, and appalled, not only by their own share of the burden of public indebtedness, but by the ever-growing share that may well be faced by their children and their children's children.

Before my election to Congress, I was mayor of a fast-growing and progressive city in southeast Kansas, for three consecutive 2-year terms. When I say that this city made tremendous strides during my tenure of office, I do not feel that I am being immodest, because such progress would have been impossible without the full cooperation of a majority of Coffeyville's citizens. They knew that community progress costs money, and they were willing to assume the necessary bonded indebtedness. But they also knew that this indebtedness was based upon a sound and orderly plan for repayment. No annual budget that I assisted in drawing up for city operation would have been acceptable without provisions for substantial payments on both principal and interest. In this respect, what's good for Coffeyville is undoubtedly good for the country.

I feel it is heartening and significant that such able and public-spirited legislators as Mr. Wright and Mr. Ikard have presented a feasible plan for debt reduction at a time when the "big spenders" label is being so carelessly and heedlessly applied to their party and mine. The widespread public support this proposal has drawn is equally encouraging, and provides strong evidence that the people of this great Nation are eager to help. I believe they are willing to accept this program for orderly retirement of our country's obligations, in the nonpartisan spirit of farsighted service in which it was conceived and presented.

I therefore urge this committee to give earnest and serious consideration to recommending the adoption of this plan, and I commend Mr. Wright, Mr. Ikard, and the others supporting this bill for their selfless and sincere efforts to arrive at a solution to a problem demanding immediate attention.

I do not believe there are any of us here in Congress who can fail to take pride and pleasure in visualizing a debt free and prosperous America a hundred years hence. I earnestly hope that we all live long enough to take equal pride and pleasure in feeling that we helped give the country a sensible and very worthwhile start on the long road back to a sound and healthy economy.

The CHAIRMAN. Thank you, Mr. Hargis, for giving us the benefit of your experience.

Our next witness is our colleague from Florida, the Honorable Paul G. Rogers.

You may proceed in any manner you desire, sir.

Mr. ROGERS. Thank you, sir.

#### STATEMENT OF REPRESENTATIVE PAUL G. ROGERS, OF FLORIDA

Mr. ROGERS. Mr. Chairman and members of this distinguished committee, I sincerely appreciate the opportunity to offer testimony today in connection with a problem of the gravest magnitude.

It has been estimated that our national debt will total some \$285 billion by the end of the current fiscal year. While the President

originally estimated a surplus of half a billion dollars, revised estimates of receipts and expenditures for fiscal 1959 indicates that we face a deficit of some \$12.9 billion. The prospect of a balanced budget during 1960 also appears to be somewhat dim despite the President's prediction of a small surplus. An error in computing anticipated revenue similar to the one which occurred at the beginning of the 1959 fiscal year will lead to another deficit for the 1960 fiscal year. The programs now in the process of obtaining congressional approval which carry with them vast new obligational authority are bound to have a considerable impact on a balanced budget for years to come. It makes one wonder just when in the future we might look forward to spending less than we take in. In any event, based on past history, it will take a concerted effort on the part of both the legislative and the executive departments of Government in order to insure some sort of a surplus in the near future.

This state of fiscal affairs leaves us with two alternative courses of action. The first of these might properly be termed the easy way out. It would be to continue on a program of deficit financing and continue to raise the debt ceiling as deficits occur. The adverse effects of such a fiscal policy are many and varied. For the purposes of this statement I will touch lightly on two fundamental effects. Maintenance of the principal of the debt and the constant payment of accruing interest, estimated at some \$8 billion for the coming fiscal year, tend to cripple the productive capacity of our people. Secondly, and equally important, is the fact that the immense size of the debt and its service reduces the action of the Treasury and the Federal Reserve System in their credit policy. The value of Government securities tends to depress thus making them less desirable to the investor. In short, the larger the debt and interest load currently, the less room there will be for the Government to finance readily and soundly some future emergency.

The other alternative open to us consists of a sound Government spending program which includes some provision for paying off this staggering debt. I have been privileged to join with Jim Wright and Frank Ikard and others in submitting a plan to the Congress which would provide an orderly, systematic method for reducing the debt. Our proposal would require the Secretary of the Treasury to include in his annual request for funds an amount sufficient to pay off 1 percent of our national debt.

Objectively speaking, there is substantial merit in a program of gradual debt retirement. Some advantages to be realized are: first, that it results in a saving of governmental expenditures for interest; second, that it strengthens the credit of the Government so that it can better meet an emergency; third, that in times of inflation it may serve as a tool to cope with excessive spending; fourth, that money paid out in debt retirement could well serve as a stimulus to business. Of the amounts paid to individuals and financial institutions, a limited sum may be held in idle balance, but the bulk will be reinvested thus helping to shore up our economy in times of recession.

The important thing to remember in any program of debt reduction is that we must make up our minds to go ahead and then do it. It is no answer to say that now is not the time. I submit that we are passing through the most prosperous economic period in our history. Let's

chart a course now rather than take a chance that a more convenient time will materialize in the future. We need only remember that throughout our history the greatest obstacles to national financial strength and the most acute dangers to fiscal collapse have never been the results of inadequate or failing resources but always consequences of weak financial policies.

Thus, I join with my colleagues in urging the adoption of this plan to put us back on the track to fiscal responsibility.

The CHAIRMAN. Thank you, Mr. Rogers, for appearing before our committee.

Our next witness is our colleague from Colorado, the Honorable Byron L. Johnson.

Please come forward.

You are recognized, sir, to proceed in your own way.

**STATEMENT OF HON. BYRON L. JOHNSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF COLORADO**

Mr. JOHNSON. Thank you, sir. I regret that I did not have time, because of my interest in legislation pending on the floor, to prepare a precise statement, but I think I can speak extemporaneously and cover the main points I would have given you in a prepared statement, and, if I may, I ask permission to revise and extend my remarks to include such other data as may prove necessary.

The CHAIRMAN. You may have that permission.

Mr. JOHNSON. The President has made a series of requests which occasioned these hearings. One of them deals with the debt limit. Frankly, I am prepared to agree to a raise in the debt limit. In fact, I would be willing personally to go further, because I think the debt limit has proved to be more of a mischiefmaker than a source of fiscal responsibility in the operations of the Government.

And, rather than argue that point at this time, I would simply call to the attention of the committee a very fine statement heretofore made by Dr. Walter Heller, onetime assistant to the Director of the Division of Tax Research in the Treasury Department.

If that statement is not in your hearings, or Dr. Heller is not to be a witness, I would be happy to submit his statement, made some time ago, on this point, for the record.

The CHAIRMAN. Without objection, we will receive it for the record.

(The statement of Dr. Heller, referred to, is as follows:)

**WHY A FEDERAL DEBT LIMIT?**

(By Walter W. Heller, Chairman, Department of Economics, University of Minnesota, Before the 51st Annual Conference of Taxation of the National Tax Association, October 28, 1958)

The position taken in this paper can be briefly put by amending the title to read, "Why a Federal Debt Limit, Indeed?" Far from promoting fiscal prudence and expenditure restraint, as claimed by its protagonists, the Federal debt limit has in fact eroded the integrity of our Federal budget, interfered with efficient expenditure scheduling and effective debt management, endangered our defense program, and aggravated the 1957-58 recession. The facts and analysis underlying each of these indictments form the core of my paper.

No attempt will be made here to trace the history of the debt limit, nor to identify the half billion dollars of public debt obligations not subject to the

limit. The testimony of Treasury Secretary Anderson before the Ways and Means Committee last January contains a most useful historical survey of, and commentary on, the debt limit.<sup>1</sup> An annual summary of the basic data and history of the debt limit is contained in the annual reports of the Secretary of the Treasury.<sup>2</sup> A monthly release summarizing the status of the debt is issued by the Treasury Department Fiscal Service. The latest one, for example, shows a margin of roughly \$12 billion between the outstanding debt on September 30 of \$276.4 billion and the limit of \$288 billion (consisting of the permanent limit of \$283 billion, as amended September 2, 1958, and a temporary additional \$5 billion, expiring June 30, 1959).<sup>3</sup>

#### A. EROSION OF BUDGETARY INTEGRITY

One of the most serious charges against the debt ceiling is that it has served as stimulus and sanction for devious budget practices and proposals. Quite apart from the costly defense slowdowns last year, which have been very much in the public eye, the ceiling has been a major factor in prompting (1) manipulations to remove certain spending items from the budget entirely (e.g., in 1953, \$1.2 billion of price support loans), (2) proposals in 1955 for highway financing outside the conventional budget and outside the debt limit, and (3) substitution in 1957 of costly agency borrowing for cheaper Treasury borrowing.

Under the impact of the large deficit in fiscal 1953, compounded by the sparse receipts typical of the July-December half of each fiscal year (when only 40 percent of the year's receipts typically flow into the Treasury), the pressure of the debt limit mounted steadily. By August 1953, Treasury Secretary Humphrey was moved to say, "The present debt limit severely restricts flexibility and will more and more limit our ability to administer the financial affairs of the Government."<sup>4</sup> Simultaneously, the fiscal authorities found an escape valve that has been utilized many times since, namely, requesting Federal agencies to finance themselves by direct operations in the money market rather than through Treasury borrowing. The Commodity Credit Corporation led the way by selling \$1.2 billion of certificates of interest to the commercial banks during the second half of 1953 against a nationwide pool of price-support loans on grain. This amount stayed out of the national debt and the nearly \$1 billion still outstanding on June 30 quietly disappeared from the fiscal 1954 Federal budget.<sup>5</sup>

When the rest of the 1953 support loans matured in 1954, bringing much of this amount back onto the budget a roughly equivalent amount was similarly financed the following summer. When this phase of off-the-budget financing was terminated in fiscal 1955 by retiring about a half-billion dollars of certificates still outstanding, the Federal National Mortgage Association (FNMA) issued an offsetting amount of notes directly to the public. The collateral in this case was not farm crops but the FNMA mortgage portfolio. In both cases, interest costs were substantially higher than on direct Treasury obligations.

In 1955, a related fiscal maneuver in connection with the Federal Highway Program never got beyond the proposal stage because of a storm of congressional protest. The proposal was that an independent authority be set up to finance

<sup>1</sup> Statement by Treasury Secretary Anderson before House Ways and Means Committee on H.R. 9955 and H.R. 9956, bills to amend the statutory debt limitation, Jan. 17, 1958, U.S. Treasury Release No. A-138.

<sup>2</sup> See, for example, the "Annual Report of the Secretary of the Treasury on the State of the Finances, Fiscal Year 1957," U.S. Government Printing Office, Washington, 1958, tables 26 and 27, pp. 432-433. These tables show the fiscal yearend status of the debt under the limit and the history of the debt limit since 1941. Monthly summaries are presented in the Treasury Bulletin. The pre-1941 history is summarized in the Treasury's annual report, fiscal year 1940, p. 70.

<sup>3</sup> Treasury Department Fiscal Service, "Statutory Debt Limitation as of September 30, 1958," Release No. A-341, Washington, Oct. 9, 1958. The two controlling laws at the present time are the act of Sept. 2, 1958; U.S.C., title 31, sec. 757b, and the act of Feb. 26, 1958; Public Law 85-336, 85th Cong.

<sup>4</sup> Treasury Department release, Aug. 3, 1953 (H-211).

<sup>5</sup> The Treasury noted that this financial maneuver increased the participation by banks in the crop loan program and gave temporary assistance to the Treasury in staying below the statutory debt limitation (U.S. Treasury, annual report, fiscal year 1954). Pressure on the budget and the public debt was also diminished by "the Federal National Mortgage Association's accelerated program of mortgage sales and repayment of advances by local housing authorities to the Public Housing Administration," *ibid.* For a more detailed explanation of the maneuvers to minimize the budget totals in 1953-54, see Frederick C. Dirks, "Recent Progress in the Federal Budget," National Tax Journal, June 1954, vol. VII, No. 2, pp. 141-154.

the program by the issuance of general revenue bonds to be repaid out of the growth of Federal revenues from excise taxes on gasoline and lubricating oils.<sup>6</sup> There was bitter objection to thus circumventing the debt limit and hiding the expenditures from ordinary budget view. As finally passed, the program provided for increased highway-user taxes, earmarked for highway purposes and channeled through a special trust fund.

One does not have to go back to 1953 and 1955 for examples of evasive action and financial brinkmanship under the debt ceiling. The Treasury's greatest hour of jeopardy to date under the ceiling was in 1957. No halfback threading his way precariously down the sidelines ever executed more nimble maneuvers than the Federal fiscal authorities did to keep from going out of bounds during the past fiscal year.<sup>7</sup> "In order to help keep the debt under the limit in 1957-58 various agencies, particularly the Federal National Mortgage Association, borrowed funds from the public to permit repayment to the Treasury of sums which had been advanced to them. About \$1.5 billion of such repayments were made by the Federal National Mortgage Association from February 1957 to March 1958."<sup>8</sup> Coupled with these moves were slowdowns of defense programs and payments (to be examined in sec. C) and monetization of some of the Treasury's gold.<sup>9</sup>

The debt limit, then, has served as an ethical shield behind which assaults have been made on the fidelity of our Federal budget. I put it this way because some of the manipulative practices described above were attractive in serving quite a different purpose, namely to make the budget look smaller than it really was—sort of an incredible shrinking budget—but they might not have been dared without the protective casuistry of the debt ceiling.

#### B. SELF-DEFEATING EXPENDITURE CONTROL

Defenders of the statutory debt limit usually cite its salutary effect in curbing Federal spending. For example, in the hearings on the debt limit last January, Senator Harry Byrd asserted, "The only protection Congress and the people have against wasteful expenditures is the debt limit." Prof. Yale Brozen of Chicago came to its defense in a similar vein during a panel discussion before the Joint Economic Committee last February. Prof. Lester Chandler of Princeton had proposed "that they should abolish the debt limit or raise it so much that this would become ineffective as a ceiling," a position quickly concurred in by Prof. J. Kenneth Galbraith of Harvard, Mr. Ralph J. Watkins, director of economic studies of the Brookings Institution, and Prof. Roy Blough of Columbia. Mr. Brozen disagreed, stating "I think to some extent there has been a salutary effect from the existence of the debt ceiling inasmuch as the administration does tend to think a little more seriously about its overall spending program."<sup>10</sup>

The expenditure restraint which these statements contemplate typically has two facets. One is economizing, i.e., eliminating waste and thereby providing a given service with a smaller input of money and resources. The other is simply

<sup>6</sup> House of Representatives, Committee on Public Works, Hearings on National Highway Program, 1955, p. 130. For the detailed proposals and the criticisms directed at them, see these hearings as well as the corresponding hearings before the Senate subcommittee of the Committee on Public Works, also in 1955.

<sup>7</sup> The following item from the Wall Street Journal, Sept. 27, 1957, p. 1, vividly brings out the mood of the time and the measures that were contemplated to meet the debt ceiling crisis: "Fiscal chiefs struggle to stay under the debt limit. They seize on new tactics. Defense officials postpone every postponable spending item beyond the critical next few months. They confer with major contractors on delaying payments. Less urgent operating maintenance outlays will wait till after January. The Budget Bureau holds back funds to keep other agencies from expanding employment as much as Congress allowed, at least for now. Other weapons are in reserve. Farm officials consider selling private banks certificates representing shares in a pool of price-support loans: the cash would ease the current squeeze. The Federal National Mortgage Association can sell more securities privately, pay off some debt owed the Treasury. Money men talk of last-ditch moves if the scrape with the debt ceiling gets desperate. Defense officials say they could stop paying all bills until January tax receipts roll in."

<sup>8</sup> The First Boston Corp., "Securities of the United States Government," 18th edition, 1958, Boston, pp. 40-41. This publication also summarizes the history of debt limit legislation from 1917 to 1958 and charts the relationship between the debt and the legal limit for the fiscal years 1954-59.

<sup>9</sup> Monetization is effected by converting the free gold in the Treasury's general fund into gold certificates for deposit in Treasury balances in the Federal Reserve banks. By this method, \$500 million of gold was monetized in November 1953, and another \$100 million in February 1958. The process is described in detail in the Treasury's annual report, fiscal year 1954, p. 26.

<sup>10</sup> Joint Economic Committee, U.S. Congress, hearings, January 1958 Economic Report of the President, U.S. Government Printing Office, Washington, 1958, pp. 490-491.

the curbing of growth or forcing of cutbacks in Government spending when deficits threaten to push the debt through the legal ceiling.

On the first score, the record of the debt ceiling is lamentable. It has forced Government borrowing into uneconomic, expensive channels. The \$802 million FNMA notes sold outside the debt limit a year ago are a perfect case in point. That they were sold at the Treasury's request in the context of the painful debt squeeze is beyond dispute.<sup>11</sup> That they were costly is also beyond question. Maturing in only 8 months, the notes carried an interest rate of 4½ percent, when the Treasury could have borrowed the money directly at 4 percent.<sup>12</sup> In other words, a loss of \$4,667,000 can be laid directly at the debt limit's door on account of this single evasive action.<sup>13</sup>

One cannot so readily put a price tag on the much greater waste attributable to the debt limit's disruptive affect on expenditure management and scheduling of particular programs. The force of the debt ceiling can strike swiftly, and to some extent, unexpectedly. Consider, for example, that Secretary Anderson's estimates last January (later revised) placed the prospective debt as of September 30, 1958, at \$271.3 billion and the required debt limit at \$274.3 billion. In fact, the debt was \$276.4 billion on September 30. Even when the debt squeeze was anticipated in 1957, and advance action was taken to slow down expenditures, still further stretchout and pinchpeny economizing measures had to be taken when the squeeze turned out to be worse than expected. The resulting on-again, off-again scheduling of expenditures is just as wasteful of public moneys as stop-and-go driving is of gasoline.

As an overall curb on the growth of Government, the debt limit is even more inept and perverse in its impact. In a boom, when cutbacks might make some sense as an anti-inflationary device, bulging revenues nullify any restraining effect. Thus, Federal cash expenditures rose from \$70.5 billion in fiscal 1955 to \$80 billion in fiscal 1957 at a time of little or no discomfort under the debt ceiling. It is at the onset of recession, as in the fall of 1953 and again in 1957, that the debt ceiling tightens its grip.

Does it then lead to rational choices among alternative programs, to a careful weighing of relative returns offered by different possible applications of resources? Quite the contrary. It seems to be a case of the devil, i.e., the debt ceiling, taking the hindmost. For example, when the psychological impact of the periodic debt limit wrangle hit Congress last July, the \$2 billion community facilities bill bore part of the brunt, not necessarily because it was deemed a poor use of resources but because it happened to be under active consideration when the debt limit psychosis took hold.<sup>14</sup> This is budget pruning by the last-in first-out principle.

But perhaps it is fruitless to ascribe to the debt ceiling any rigorous disciplinary logic at all. Perhaps it is more realistic to view it as an atavistic or nostalgic substitute for the annually balanced budget in the age-old battle between rules and authority, between laws and men, in Government budgeting. In this light, the debt limit is seen as a wistful vestige of the fiscal orthodoxy which, for example, led Franklin Roosevelt to drive income and excise tax increases through Congress in 1933 at the depths of the great depression is a quixotic attempt to carry out his campaign promise of a balanced budget.

Its kinship with the ill-fated "legislative budget" procedure (enacted in 1946) is even clearer. Under that procedure, Congress tried, unsuccessfully, to impose budgetary discipline on itself by requiring the enactment, early each session, of an overall ceiling on expenditure appropriations. But in the very first year of operation, the sum of the individual appropriations pierced the House ceiling by nearly \$6 billion and the Senate ceiling by nearly \$3 billion. In effect, the procedure foundered on our national schizophrenia in budget matters which leads us

<sup>11</sup> See, for example, the Business Week article, "Treasury's Eye Is On Ceiling," Nov. 2, 1957, p. 46.

<sup>12</sup> Outstanding Treasury notes maturing in June were yielding 3½ percent at the end of October 1957. Assuming that the Treasury would "sweeten" the yield a bit to gain market acceptance of a new issue, one arrives at a Treasury interest rate of 4 percent.

<sup>13</sup> In reporting plans for redeeming the FNMA 8-months notes, the Wall Street Journal on June 16, 1958, reported that the notes, which had been issued "at the request of the Treasury, when the Federal debt was close to the ceiling," would not be replaced with a new offering, thereby reflecting "the improved position of the Treasury since the new debt ceiling went into effect." The higher interest rate was also cited as a factor dictating against any refunding of the maturing notes. In other words, with the debt limit strait-jacker loosened, the Treasury followed a course directly opposite to the one that had been forced on it by the debt ceiling squeeze in 1957.

<sup>14</sup> Wall Street Journal, "Treasury Seeks Debt Ceiling Hike to \$288 Billion," Aug. 25, 1958.

to recoil in dismay from the budget totals, even though they be no more than the sum of the parts we have warmly embraced one by one.

Failing in its attempt to curb its own spending tendencies with the aid of one rigid rule or another, the Congress has, ironically, used the debt ceiling to harass and castigate the executive authorities for the deficits which congressional budgetary enactments have forced them to incur. In this sense, the statutory limit has been an instrument of fiscal hypocrisy.

If the influence of the debt ceiling were benign, or at least negligible, we could afford to indulge ourselves in this hollow symbol of our budgetary schizophrenia. But the facts simply do not permit such tolerance. Last year's undercutting of defense in the very teeth of sputnik is a most telling case in point.

#### C. THE NATIONAL DEFENSE CRISIS OF 1957

The operation of the debt ceiling "as a ruinous and arbitrary determinant of Government policies" is nowhere better illustrated than in last year's actions. "In the second half of 1957 the debt ceiling forced the administration to cut back programs needed for long-term national security. And the resulting slash in defense expenditures was an important contributing cause of the recession."<sup>15</sup>

A bill of particulars on the disruption of the defense program was summarized as follows a year ago: "Here are major Defense Department actions in recent months that are related to the campaign to save the debt ceiling: (1) The services stretched out production schedules—for at least 19 big plane and missile projects, (2) overtime for defense contractors was restricted, (3) installment buying of weapons was banned, (4) a \$38 billion spending ceiling for fiscal 1958 was clamped on, stimulating a new round of program reshuffling. Form this action came the 5-percent reduction in progress payments; an order to contractors to cut payroll costs 5 percent; the Air Force's limitations on monthly payments to contractors, creating new stretchouts a 200,000-man cut in the Armed Forces."<sup>16</sup>

Apart from the dangerous 1957 slowdown itself, these actions have had lingering effects which have undermined the vigor of our response to the Soviet challenge. As the Wall Street Journal reported (July 8, 1958), "Because of the delayed action effects of the Wilson economy slashes, spending actually dropped in the post-sputnik January-March quarter of this year to \$9.4 billion, from \$9.6 billion in the previous quarter." Even as late as May and July 1958, defense contractors were expressing such apprehension of a repetition of the 1957 slowdown of payments and stretchouts in delivery schedules that the Secretary of Defense was moved to write a memorandum referring to "needless apprehension about a financial crisis."<sup>17</sup>

Thus far, the consequences of the 1957 cutbacks have been no more than dangerous for our national security. They could have been tragic.

#### D. PERVERSE STABILIZATION EFFECTS

We have already noted the perversity of the debt limit in relation to inflation and recession. Its discipline on spending is little felt in the boom, but pinches hard in recession. The defense cutbacks to squeeze by under the ceiling are believed by many to have helped trigger the 1957-58 recession and increase its severity. As Ralph Watkins so forcefully put it: "\* \* \* the crisis of confidence which shook American society last fall \* \* \* may well have been precipitated by the cutbacks and stretchouts in military procurement starting in the summer. They affected a wide range of industry all across the country and, added to the impact of evidence of slow payment of bills by Government, could hardly fail to influence business confidence adversely. The real culprit, given our defense needs, may have been the arbitrary debt ceiling \* \* \*."<sup>18</sup>

Apart from its direct impact in accelerating the 1957-58 recession, the debt ceiling has a more insidious indirect effect in that it condemns deficits without regard to economic circumstances. As long as there is substantial unemployment

<sup>15</sup> Quotations are from a Business Week editorial, "Common Sense in Budgeting," June 28, 1958, p. 124.

<sup>16</sup> Business Week, "Treasury's Eye Is On Ceiling," Nov. 2, 1957, p. 47. The various moves are also described in Editorial Research Reports, under the heading "Fiscal Maneuvers to Avoid Piercing Debt Ceiling" in its article, "National Debt Limit," Nov. 27, 1957, vol. II, pp. 879-880.

<sup>17</sup> As quoted in "Getting the Budget Back in Line," Business Week, July 12, 1958, p. 27. See also, "Arms Makers Fear Retrenchment," Business Week, May 31, 1958, pp. 21-22.

<sup>18</sup> Joint Economic Committee, "Hearings on the January 1958 Economic Report," op. cit., p. 467.

ment and idle plant capacity, deficits should be applauded as the hero of the peace, not hissed as the villain. They act as a constructive economic force, cushioning the shock of recession and stimulating production during the recovery phase. They become destructive only when the response to their expansionary impact is no longer rising employment and output, but rising prices, i.e., inflation. But the debt ceiling condemns all deficits alike, whether expansionary or inflationary.

Undoubtedly, the debt limit played a considerable role in restraining the administration and Congress from taking more resolute action to counter the recession in 1958. To be sure, it is a matter of open dispute whether the avoidance of tax cuts was economically a good or bad thing. It can be argued on one hand that we are enjoying a brisk recovery without tax reductions. It can be argued on the other that, with them, we might be farther along the path toward our full economic potential of \$470 to \$475 billion of gross national product against a current level approaching \$450 billion. But even if the no-cut position could be proven correct, the debt limit would, at best, gain the distinction of being the wrong reason for reaching the right decision.

#### E. RIGIDITY IN DEBT MANAGEMENT AND THINKING

The debt ceiling also inhibits stabilization policy by denying the Treasury the flexibility it needs to make full use of debt management, especially in strengthening our defenses against inflation. This point has been stressed again and again by Treasury officials in petitioning Congress for an increase in the statutory limit. As Secretary Anderson stated in his January testimony. "There is need for more flexibility for more efficient and economical management of the debt." He went on to say: "We have been able to discharge our obligation within the debt limit \* \* \* only by maintaining cash balances which have been distressingly low at times. We have had little or no margin for contingencies. We believe that with some flexibility we would have been better able to manage the public debt to a better advantage for the public interest."<sup>19</sup>

With a higher debt ceiling, or in its absence, the Treasury would be able to build up a more comfortable cash balance when good opportunities presented themselves for marketing long-term debt. Long-term borrowing might be advantageous, for example, shortly in advance of a refunding operation. The net cash redemption or "attrition," during the refunding, could readily be handled out of the ample cash balance. Given the debt ceiling, however, the Treasury might run afoul of too little attrition, i.e., the refunded issue would overlap the newly issued long terms, thereby piercing the ceiling. To avoid this contingency, the Treasury, in the shadow of the debt ceiling, would have to give up the opportunity to go into the long-term market and rely on bills instead.

Such rigidity in the short run is perhaps symptomatic of the patterns of thought that inhibit the all-out use of debt management as a stabilizing instrument. In this pattern, the debt ceiling assumes more the position of a limiting strategic factor than that of a basic cause.

If we are truly confronted with a complex of inflationary forces in the longer run, it is high time that we removed such shackles as the debt limit and permitted the Treasury, for example, to compete aggressively for long-term funds at the height of the boom and, if necessary, stockpile the proceeds in the Treasury cash balance. We need to reexamine the near axiom that the Treasury cannot borrow long in a boom because it would impinge unduly on sources of investment funds needed for private capital construction and State-local public works. Perhaps such borrowing, combined with stockpiling of the cash or retirement of bonds owned by the Federal Reserve banks, has advantages over traditional Federal Reserve measures to restrict the availability and raise the cost of credit. More freedom in shifting from one type of debt to another also merits further exploration. To clear the way for moving from a largely passive to an aggressively active debt management policy would involve many things. One of them would be to abolish the debt limit.

#### F. MEASURING DEBT BURDEN

This brief digression on unleased debt management raises doubts that our statutory debt limit—insofar as it may be anything more than an empty gesture—is even cast in meaningful terms. As it stands, the debt limit perpetuates

<sup>19</sup> Statement to the House Ways and Means Committee, Jan. 17, 1958. op. cit., pp. 1-2.

the myth that the overall dollar figure somehow represents the burden of the debt. But this figure bears little relationship to our fiscal capacity or to the burdensomeness of the debt.

Merely subtracting the debt held by Government agencies gives us a more meaningful figure for most purposes. As part I of the accompanying table shows, the \$270 billion of debt subject to the ceiling in mid-1957 shrinks to \$215 billion if we exclude the holdings of Government agencies and accounts and \$192 billion if we eliminate the Federal Reserve holdings to arrive at privately held debt.

To infuse greater significance into the debt figure, even if still in a rather passive sense, we need to relate it to some magnitude that measures or reflects our ability to carry the debt burden. Part II of the accompanying table shows that, as a proportion of annual national income, the Federal debt was cut in half, or more, between 1946 and 1957. Or relating the interest on the debt to national income, the burden has fallen by one-third.<sup>20</sup>

*The size of the Federal debt and interest, 1946-57—A comparison of various measures*

[In billions]

PART I: DOLLAR AMOUNTS OF DEBT, CASH BALANCE, AND INTEREST

Fiscal year <sup>1</sup>	Total outstanding debt	Total debt less debt held by Government account <sup>2</sup>	Privately held debt <sup>3</sup>	Treasury cash balance	Annual interest charge on total public debt
1957.....	\$270.5	\$214.9	\$191.9	\$5.6	\$7.3
1956.....	272.8	219.3	195.5	6.5	7.0
1955.....	274.4	223.9	209.3	6.2	6.4
1954.....	271.3	221.9	196.9	6.8	6.3
1952.....	259.1	214.8	191.9	7.0	6.0
1950.....	257.4	219.5	201.2	5.5	5.6
1948.....	252.3	216.5	195.1	4.9	5.5
1946.....	269.4	240.3	216.5	14.2	6.4

PART II: RATIO OF DEBT AND INTEREST TO NATIONAL INCOME <sup>4</sup>

Fiscal year	Total debt as percent of national income	Total debt less debt held by Government accounts as percent of national income	Privately held debt as percent of national income	Interest on public debt as percent of national income
1957.....	74	59	53	2.00
1956.....	78	63	56	1.99
1955.....	83	68	61	1.94
1954.....	90	74	65	2.09
1952.....	89	74	66	2.05
1950.....	106	91	83	2.31
1948.....	113	97	87	2.44
1946.....	149	133	120	2.96

<sup>1</sup> All debt and cash balance figures are shown as of June 30, the end of the fiscal year.

<sup>2</sup> "Government accounts" includes Government agencies and trust accounts.

<sup>3</sup> Excludes debt held by Federal Reserve banks as well as debt held by Government accounts.

<sup>4</sup> These percentages relate June 30 debt totals and fiscal year interest charges to the calendar year national income.

Source: U.S. Treasury, Annual Report, fiscal year 1957, Washington, D.C., 1958. National income figures underlying pt. II were taken from U.S. Department of Commerce, "Survey of Current Business," July 1958.

<sup>20</sup> Another approach to measuring the dead weight burden of the debt is suggested by James Buchanan in his new book, "Public Principles of Public Debt" (Richard D. Irwin, Homewood, 1958, pp. 206-210). First, he would adjust the maturity value of the debt downward for increases in the interest rate since issuance, a process which would have shaved \$15 billion off of the size of the debt in mid-1957. Next, he would capitalize the value of the stream of interest payments on the debt in accordance with the pure rate of yield on capital investment at the margin of use. This brings the sum of the debt down to \$185 billion, a "pure" measure of the national debt in the sense that the net yield from \$185 billion of earning assets in the private economy is obligated to the service of the national debt.

Quite apart from these quantitative measurements, the real burden of the debt in a functional sense consists of its complication of inflation control, the possible unsettling effects of public debt transactions on the money markets, and the disincentive effects that may be involved in transferring funds from taxpayers to bondholders. Only a dynamic and continuous analysis of the debt, its composition, and its relation to economic conditions will serve as a basis for appraising its burden in this sense. Any single magnitude merely diverts attention from the intrinsic debt problem.

#### G. CONCLUSION

Trying to infuse into the debt ceiling as now stated any rationality as an indicator of debt burden probably goes far beyond its central purpose: to curb Federal spending. This paper has shown that it not only fails to accomplish this purpose, except in occasional episodes of arbitrary and capricious cutbacks, but that it involves heavy costs which are out of all proportion to any value it might have as a nostalgic symbol of passive and puerile government.

In the name of budgetary integrity, financial prudence, adequately financed national security, and aggressive policies to combat inflation and counter recession—in other words, in the name of everything that is fiscally holy and wholesome—our anachronistic Federal debt limit should be abolished.

Mr. JOHNSON. Secondly, the President has requested an increase in the interest rate on series E and H bonds. In face of the prevailing conditions, and in face of the importance of preserving private savings and the willingness of private savers to invest in Government bonds, I would give my reluctant support to an increase of not more than one-half of 1 percent in those interest rates.

But his third basic recommendation deals with the interest on long-term Government obligations. And I wish to register here my opposition to that proposal.

I would note that the law under which the Treasury manages the debt was put into effect by the Congress during the heat of World War I. We successfully financed World War I. We got through a major boom, a great depression, World War II, a postwar reconversion period, and the Korean incident down to date, without needing to modify that basic legislation, the Liberty Loan Act.

We have provided for far more difficult periods in the Nation's financial experience than we are currently involved in, without modifying the interest rate limit. And I see this as no time to change the rate. The slight deficits that the Treasury may experience during the present fiscal year or in the forthcoming one are no reason to change the maximum rate.

Furthermore, I see no reason to make long-time contracts on the public debt at the highest interest rate in the Nation's recent financial history. It makes more sense to me to encourage the use of short-term credit at the present time until the long-term rates can be brought down.

And my third reason for opposing the increase in interest on long-term loans is that I believe it is high time that the Federal Reserve Board of Governors and its Open Market Committee discharged their responsibility to help provide an orderly market for Government obligations. I think that the reasons which gave rise to the accord in 1951, during the heat of the Korean incident, were sufficient for the accord at that time, but I long ago accepted the wisdom of James Russell Lowell's comment that "New occasions teach new duties; time makes ancient good uncouth; they must upward still, and onward, who would keep abreast of truth."

The Treasury should be asked to reconsider the logic it has been following.

I recognize in making this observation that if the Federal Reserve were to buy up large amounts of Government bonds in efforts to provide an orderly market, this would greatly increase bank reserves. I therefore am prepared to support an increase, if need be, in the maximum amount of Federal Reserve requirements, and this can be done by a simple amendment on S. 1120, an amendment which I supported in the Banking and Currency Committee, and which I will support on the House floor whenever S. 1120 reaches the House floor.

But I would call to the committee's attention that the bulk of the postwar inflation, insofar as it can be said to relate to the increase in debt, is not due so much to increases in the Federal debt, but rather to increases in State and local and more particularly in private debt.

Now, the increase in short-term private debt is not responsive to the raise in interest rates, particularly in face of the remarkable loosening of credit terms that has taken place since the end of World War II. We have consistently lowered downpayments, and we have consistently lengthened amortization periods and encouraged a splurge in private debt use. I submit that a far more effective way to control the aggregate volume of outstanding debt, which is the important step to be taken insofar as classical inflation is concerned, is to modify the terms of credit, particularly the downpayment requirements and the amortization periods. These will be far more effective in controlling the volume of private debt, which is quite as inflationary—when it is increasing more rapidly than the economy can absorb—as any increase in the Federal debt.

In other words, if we are concerned about inflation, our concern must extend to the private sector as well as to the public sector of debt management, and the Federal Reserve has an obligation to be quite as concerned about both. Indeed, concern should be shown not just by the Federal Reserve, but by the other Federal credit agencies, and the indirect agencies such as the Federal Housing Administration.

And my final reason for opposing it is that I am opposed to inflation. The first bill I introduced in this Congress was one to implement the President's recommendation that we declare that we want stable price levels to be one of the purposes of the Employment Act of 1946. This bill was heard by the Government Operations Committee. They have brought out a different bill in a report to the House of the Clark-Reuss measure, which would underwrite the concern of the House that we put an end to inflation.

I would note for the committee's sober contemplation one of the closing paragraphs in the President's statement, which noted that the rise in the cost of money in the past 5 months, since the budget for fiscal 1961 was submitted to the Congress, is so great as to cause him to ask us to appropriate an extra \$500 million for next year's interest on the public debt alone.

We talked earlier this afternoon about the Airport Act, the Housing Act, the Stream Pollution Act, and so on. I submit that all of these programs put together, insofar as their burden on next year's budget is concerned, will be less than the increase in the budget for the coming year due to the interest rise in the past 5 months. I think

it is extremely important, in terms of the burden upon the taxpayer, that this committee give the interest ceiling sober contemplation, and I would recommend that we refuse to permit an increase in the interest rate on long-term Government loans.

I would go further. I would note that the interest rise during the past 6 years has raised the cost of carrying the public debt from about \$5½ billion to now apparently \$8.6 billion. We have just heard an excellent suggestion that we budget retirement of 1 percent per year of the outstanding debt. The entire proposal just made by the gentleman from Texas could be financed out of the increase in interest rates, the increased carrying cost on the public debt, during the past 6 years. If we could push interest rates back down to what they were in 1952, we could include in the budget the cost of the entire suggestion just made, without increasing the budget by one thin dime.

Now, the Federal debt is only one-third, roughly, of the whole of public and private debt, and therefore if the increased cost of the Federal debt has been of the order of \$3 billion a year, the taxpayers, businessmen, citizens, and farmers, who have been in the market and borrowing in recent years is of the order, or will be when the old loans are paid off and new loans are made, of 8 to 10 billions of dollars a year in increased costs, with no increase in the real value of the service provided. The same amount of money, in other words, will today cost \$8 to \$10 billion more to negotiate than it would have cost for the same volume of loans in 1952.

This is an increase in cost, without any increase in the quantity or quality of service being provided to the people of the United States.

I submit further that the inflation we have been experiencing in recent years, as was so ably demonstrated by the testimony of Dr. Gardiner Means, is primarily administered price inflation rather than the classical inflation of too many dollars creating too few goods. Changing interest rates, tightening money, making money hard to come by, has absolutely no effect on that type of inflation.

I hope that the Clark-Reuss bill will be adopted by the Congress as a demonstration of our intent to hold prices stable.

There is no question but that there has been gradual price inflation since the end of World War II. In the last year the aggregate price index has been stable, but I say regretfully that that is only because farm prices have fallen by as much as other prices have risen. There are still inflationary pressures operating within the economy. But if we could demonstrate to the people of the United States that it was our intent to actually hold prices stable, then we would have a very fine answer for them in explaining why we are now prepared to drive interest rates down. The rise in interest rates can be explained in part, but not fully, by the fact that people have come to fear that the value of the dollar will gradually decline, and they want a higher interest rate in order to partially offset or fully offset the decline in the value of the dollar.

If we can demonstrate that we intend to have a stable dollar, we will be more than justified in then taking the steps necessary to push interest rates back to the kind of interest rates that saw us through the entire period of the 1930's and the 1940's and most of the early years of the 1950's.

Finally, I would note that the argument with respect to debt management really has almost nothing to do with whether the total public debt is increasing or decreasing. The Treasury is involved in the next 2 years in debt operations of the order of \$130 billions in magnitude. Whether we have a \$13 billion deficit or a \$3 billion deficit or a surplus, the Treasury will still have to redeem the bonds that come due and to float new bonds to pay them off, because we are not going to pay off \$130 billion of debt except by borrowing a similar amount or almost a similar amount from somewhere.

So for all of these reasons, Mr. Chairman, while I am quite willing to see the debt limit go up, while I am willing to see a slight rise in the rate for true savings bonds, series E and H, I strongly recommend against the committee's even reporting to the House an increase in the interest on the long-term loans.

I think that the alternative courses of action that I have suggested here are a far better way by which the Congress and the administration should proceed at this time in history.

I thank you.

The CHAIRMAN. Mr. Johnson, we thank you, sir, for bringing to the committee your views on this subject. Thank you very much.

The Chair understands that Mrs. Cecil Norton Broy, first vice president of the American Woman's Council, would like to be heard for 3 or 4 minutes; is that right?

**STATEMENT OF MRS. CECIL NORTON BROY, FIRST VICE PRESIDENT,  
AMERICAN WOMAN'S COUNCIL**

Mrs. BROY. Yes, Mr. Chairman.

Thank you, Mr. Chairman and members of the committee, for your patience. I will be very brief.

The CHAIRMAN. Will you identify yourself?

Mrs. BROY. Yes; I would like to say that my first husband was the late Thomas Upton Sisson, who for years was a member of the Appropriations Committee of this important body. And I received my first interest in sound Government from Congressman Sisson.

The American Woman's Council stands for integrity in Government, and after 15 years of interest in the money question we have determined that money reform is basic to all reforms, and I trust you gentlemen will not follow the President's advice on this increase in the debt ceiling or interest rates on bonds.

We have come to the place in the history of this Republic where we must call a halt, and it is up to you gentlemen. You have the power. I think that our children and grandchildren and posterity generally will think we did not know what we were doing if we do not call a halt on this now \$8.5 billion interest on the public debt, for which we get absolutely nothing, and which comes out of the taxpayers' pockets, because, of course, we have no money that we do not take from the taxpayers, I being one of the humble ones of that body.

Now, I think that I should say that in my study on the money question, one of the most terrific things that I read was in the June 1957 American Mercury magazine. Carter Glass, who as as Member of

the House of Representatives, helped to put through the Federal Reserve Banking Act, was quoted as saying :

Had I known that the Federal Reserve Banking Act would bankrupt this Nation, I would never have helped to put it through the House of Representatives.

So by way of exhortation, as a Baptist preacher's daughter, I would like to say that I hope you will investigate the manipulation of money as described by Congressman Patman and Congressman Wright, who have studied it, and you all know about it. Unless we go back to the beginning with our banking system and stop manipulation, we will never survive as a republic, and as a free and independent people.

It has been the history down through the ages that certain people who believe in public debt have—well, even way back in England I have read that in the 14th or 15th century—one of the monarchs wanted to contract a loan to carry out a certain project, and these people working through the Bank of England said, "Not unless you will take it and not pay us back all at once."

Now, I am not speaking of commercial loans. I think short-term loans in the business field are very important. I am talking about the public debt, and I am talking about this great big interest bill that we have piled up.

Our American Woman's Council has gone on record in favor of Congressman Jim Wright's proposition, that we start paying 1 percent of the principal of our public debt each year and start to get this public debt down. And I think if we do not, we are going to be very, very sorry.

Andrew Jackson while President of the United States told the money manipulators in no uncertain terms what he thought of them. Thomas Jefferson warned us that we must not let the banking interests control the Government of our country. Abraham Lincoln also knew, because he borrowed \$23 million to fight the Civil War, and he would not borrow it from the Bank of England, because he did not want to pay interest rates on a loan.

I leave this in your hands. Again I say, you have the power. We have a constitutional government composed of three equal divisions. The taxation part originates with the committee. The tax burden is your responsibility, and we now feel this burden heavily. The value of our dollar will again go up, if we do something to decrease the huge interest bill on the public debt. It is at this time \$8.5 billion per annum. I have followed the hearings of Senator Byrd's Finance Committee in the Senate. The value of our dollar is scheduled to go down 3 cents every year. The then Secretary of the Treasury Humphrey took part in those Senate hearings. This devaluation of the dollar must stop, gentlemen, or we will not have a free republic. We will have a superworld government, and we will have a dictator, and you folks together with the rest of us, will go back on the farm and be told how much produce to raise. I

suggest that the solution to our dilemma will come with an investigation of the Federal Reserve Banking System.

I wish I had longer, but you are very kind to permit me to speak.

The CHAIRMAN. We appreciate your bringing to the Congress the views of the American Woman's Council.

Without objection, the committee will adjourn until 10 o'clock in the morning.

(Whereupon, at 5:10 p.m., the committee adjourned, to reconvene at 10 a.m., Friday, June 12, 1959.)

# PUBLIC DEBT CEILING AND INTEREST RATE CEILING ON BONDS

---

FRIDAY, JUNE 12, 1959

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in the committee room, New House Office Building, Hon. Wilbur D. Mills (chairman) presiding.

The CHAIRMAN. The committee will please come to order.

Our first witness this morning will be our colleague from South Carolina, Hon. Robert W. Hemphill.

We welcome you, Congressman.

Mr. HEMPHILL. Thank you, Mr. Chairman.

## STATEMENT OF REPRESENTATIVE ROBERT W. HEMPHILL, OF SOUTH CAROLINA

Mr. HEMPHILL. Mr. Chairman and members of this great committee, some time ago our distinguished colleague, Jim Wright, of Texas, discussed with me the bills he and his great colleague on your committee, Hon. Frank Ikard, had introduced. After study and consultation, I introduced H.R. 7469, which in purpose, is identical.

My bill calls for amendment to the Budget and Accounting Act of 1921 to include an item in each appropriation bill, except in war-time, to effect a 1-percent reduction each year in the national debt. It further provides that no budget shall be considered as balanced unless such item is taken into account.

I am mindful of the letter from the Secretary of the Treasury to the Speaker of the House asking for the removal of the present interest-rate ceiling on savings bonds, removal of the present 4¼-percent interest rate on new Treasury bond issues, and an increase of the debt limit. I wonder if this is the administration's surrender to inflation.

It is amazing to me that at a time when business is supposed to be booming that we cannot begin some effort to retire the national debt. How can we ever expect to retire the debt in hard times when money is scarce and the economy is at a low ebb? It does not make sense and it is not sense.

As I understand the argument of the administration for removing the ceiling and increasing the debt limit, the increase in the supply of money would, by their theory, make so much money available that the Government will be able to borrow at less interest. If this is true,

then why not increase the debt limit, print the money, and see what happens. I do not believe this theory is sound, as there is no provision in the program for any surplus with which to retire the debt.

Is it reasonable for the administration to think that the bankers are going to rush to buy the Treasury bond issues at a lower rate if they can get them at a higher rate? Of course not, they are in business to profit, and since the current administration's philosophy is one of borrowing to the hilt, Americans are more loan conscious than any other people in the world. Americans expect to borrow and pay back with the inflated dollar.

So far as I can see this administration has done nothing to restore the soundness of the dollar and the proposal of the Secretary of the Treasury offers nothing to that end. The reason the Government is holding securities that have gone down is twofold: (1) Inflation in the past 6 years has caused Government bonds to be less desirable, and (2) the increase in consumer goods has taken from the savings for the purpose of purchasing them.

The reason I comment on both the bill I have introduced and the report of the Secretary of the Treasury is that I feel the committee is now in a position as never before to force the administration to take a positive step toward lowering the debt. Regardless of what legislative action this committee takes, it can put the administration in a position of having to recognize the desire of all of us to start on the road back toward a sound dollar and a balanced budget.

Last year I voted against the increased debt limit. One of my friends asked me if I had any fiscal responsibilities. I told him I not only had fiscal responsibilities, but it was time somebody protested against the annual surrender to inflation. I consider raising the debt limit a surrender, and, like you, seek some alternative. The hypocrisy of the temporary increase each time the debt limit is raised is gradually being exposed. Now we are asked to have a temporary increase to \$295 billion. The next request will be to have the \$295 billion made permanent.

Finally, let me associate myself with the high purposes of Congressman Wright and Congressman Ikard. I shall appreciate any consideration given my thoughts.

The CHAIRMAN. Thank you, Congressman Hemphill, for giving us the benefit of your thoughts.

Our next witness this morning is Dr. Gerhard Colm, of the National Planning Association, who appears in response to the request of the Chair, in that Dr. Colm is not in a position to be a witness of his own choosing, and because we wanted to have his views on this subject, having worked with him over a number of years and having great respect for his judgment.

Dr. Colm, I know that you are appearing here not to express the views of the National Planning Association but in response to our request to give us the benefit of your own thinking on this subject.

We appreciate it very much that you have accepted our invitation to be present. You are recognized, sir.

**STATEMENT OF GERHARD COLM, CHIEF ECONOMIST, NATIONAL  
PLANNING ASSOCIATION**

Mr. COLM. Mr. Chairman, I thank you for your kind words.

I have a prepared statement, which was prepared with the thought that the committee might have 10 minutes for me.

I had the privilege of listening to the extremely interesting presentation and discussion of the last 2 days; and with your permission, Mr. Chairman, I would like at times to depart from my prepared testimony and make a few comments on the testimony.

The CHAIRMAN. I would certainly want you, Dr. Colm, to not only give us the information you prepared ahead of time to deliver to the committee but, if you can, include as much comment as possible with respect to various suggestions that have been made during the course of the 2 days of the testimony since you have been present and have had an opportunity to hear what was said.

Mr. COLM. In that respect, Mr. Chairman, I would like to make one introductory remark. I will make a few critical comments about certain statements made by the Secretary of the Treasury, the Chairman of the Board of Governors, and others.

In order not to repeat this later, I would like to say right at the beginning that I was deeply impressed with the Government witnesses, and by the staff work that was reflected in their testimony. Anything I say in criticism is in the professional spirit of trying to find the best answers, and by no means should be considered as in any sense apart from my respect, and in one of the cases friendship, for these extraordinary men.

It was a presentation of high caliber and great competence.

Mr. Chairman, I would like to focus my statement on one specific proposal; namely, the removal of the interest ceiling. I may at the end make a short remark on the question of the debt ceiling, but in general I shall be very happy to answer any questions you have concerning other aspects of the legislation that is before you.

Mr. Chairman, I am in favor of the proposed removal of the interest ceiling, first, because in principle it is in my opinion not desirable to tie the hands of the debt managers by statutory provisions. Since the time when debt issues were pretty much specified by legislation, a great many changes have occurred. At that time nobody thought that debt management might be closely related to changes in the business cycle.

Today debt management must be a flexible instrument in the hands of the managers of the debt in the Treasury Department and in the Federal Reserve. Therefore, I think under present-day conditions, only a minimum of specific legislative direction is desirable, even though these agencies are fully responsible to Congress and I hope Congress in this case will see fit to clearly state the objectives that should be accomplished by debt management policy.

My second reason for recommending the removal of the interest ceiling is because I do not believe that these restrictions, under present conditions, really accomplish the purpose.

The continuation of the restrictions might induce the Treasury to rely more heavily on short-term securities and to raise their short-term interest rates. So it is entirely possible—and that was pointed out

both by Mr. Anderson and Mr. Martin—that under the present ceilings the interest from the total debt, short term and long term, may go up, even though the ceiling would be maintained.

But, Mr. Chairman, there is one argument that could be advanced against adopting this legislation at the present time. It would be unfortunate if this action by Congress were interpreted by the monetary authorities and the financial community as a whole as advice or even as a mandate for a further rise in the rate of interest on Government securities. This would have undesirable effects on the whole interest structure of the country and would result in a further increase in the already very heavy interest burden on the Federal budget.

There are already signs that the Presidential request is being understood as foreshadowing a further general rise in interest rates.

If the Congress decides that the request should be granted, the legislation should be accompanied, in my opinion, by the strongest possible statement which will dispel any misinterpretation of the intent of Congress with respect to the present interest rates on Government securities.

If the Treasury and Federal Reserve adopt appropriate measures, it may well be that a further rise in interest rates can be prevented and a decline in interest rates in the foreseeable future will be possible.

Some parts of the concurrent resolution of Congressman Reuss could very well be adapted to the legislative proposal which is before you. Actually Congressman Reuss yesterday evening proposed an amendment which includes some parts of his concurrent resolution and I will at the end come back to this and make a specific proposal in that direction, if that is agreeable to the committee.

Mr. Chairman, I would like to elaborate why I believe that with appropriate policies a further general rise in interest rates is not a necessity under present and foreseeable circumstances.

Let me begin by stating the opinion of those who believe that a further rise in interest rates is more likely.

When I wrote this I thought: Perhaps I am building up a strawman. But I think what I am saying here pretty much applies to the argument presented by the Secretary of the Treasury.

Those who take this opinion refer to the law of supply and demand, namely, the supply of funds on the one hand through saving and the demand for funds on the other through investments by business in plants, equipment, and inventories, through consumer and mortgage credit, through State and local borrowing and last, but certainly not least, through the financial needs of the Federal Government.

Some believe—and I believe the Secretary said—that there are so many claimants for the funds provided by saving that there are simply not enough funds available to satisfy everyone.

Then, in accord with the supply and demand, the price for funds must go up in order to cut out some of the claimants, that is, those who are unable to pay the high price for funds.

If that is the situation, no artificial holding down of the interest rate would do any good unless at the same time savings could be substantially increased. And few economists suggest that a rise in the interest rate really makes people save more.

I might add here, Mr. Chairman, a word about this view related to this situation of excess demand.

Actually, our knowledge in the field of saving is not very good. As a matter of fact, in the preparation of this whole testimony, I became very much aware of how limited, unfortunately, our knowledge is in many of these fields. I do not offer a statement of absolute certainty, but I give you my opinion. I think legislative action should be taken in full consideration of the uncertainty which we are facing.

I see no evidence of a general shortage of funds in the near future. Through recent months an extraordinary demand for funds took place when nonfarm inventors shifted from a liquidation of \$1 billion in the fourth quarter of 1958 to an accumulation of \$5 billion in the first quarter of 1959, everything expressed as an annual rate.

At the same time, outlays for residential construction and for plant and equipment increased by an annual rate of about \$3 billion, and installment credit increased, too.

As a consequence of this bunching in the demand for loanable funds, financial transaction of the Treasury got into a kind of traffic jam.

I have here attached to my testimony a table which illustrates this special situation for the fourth quarter of 1958 and the first quarter of 1959.

It is quite a remarkable fact, Mr. Chairman, how the deficit of the fiscal year 1959 has been financed. As far as we have data on the changes in holdings of Government securities—and they are not quite up to date—I take this as of February—the conclusion seems to be clear that all financial institutions in the United States have actually not contributed anything to the financing of that deficit.

Neither the Federal Reserve, except for perhaps a \$100 million, nor the commercial banks, nor insurance companies, nor any other savings institutions. Virtually the entire increase in the holding of Government securities took place outside the financial institutions.

Apparently corporations, using their idle funds, have absorbed about one-half. By corporations, I mean outside banks and insurance companies. They have absorbed about one-half. The other half apparently was absorbed by pension funds, individuals, and miscellaneous funds.

Another fact, one mentioned repeatedly, is that most of the financing was short term, in bills and notes.

I do not believe that an absolute shortage of funds was really the main explanation of the rise in interest. I think there were more specific reasons why the investment in Government securities was discouraged.

One is the following: Government securities are bought to some extent by individual and institutional investors who are interested in steady capital values as much as in a high interest yield. The dramatic decline in Government security prices in recent years, particularly last summer, which in part resulted from a rise in interest rates, paradoxically deterred some investors and made for still higher interest rates.

Here we have a kind of vicious circle.

A second argument was the fear of inflation, and that argument was very much emphasized, both by the Secretary of the Treasury and the Chairman of the Board of Governors.

The investors fear a devaluation in the real value of fixed obligations in contrast with the expected growth in stock values, and this

helped to channel some funds away from bonds and into the stock market.

Thirdly, the Federal Reserve has given only a minimum of support to the Government security markets, because such support was believed to be in conflict with the anti-inflation policy of the Board.

Mr. Chairman, I think that this third point requires a bit of discussion. I think the views presented to you can be understood only in the perspective of the views of the inflation problem. I cannot discuss the inflation problem in all its aspects in 5 minutes, but I would like to present to you a few views which I think will help us to understand the view of the Government witnesses and the Federal Reserve.

The traditional theory is that inflation is a result of the increase in money supply, assuming velocity of circulation remains the same, which is usually taken for granted, even though yesterday the witnesses emphasized the point that change in velocity would have to be taken into account.

And, second, the changes in money supply, when they come about through Government deficits, always result in inflation.

Mr. Chairman, the argument that we just have to watch the money supply is very much weakened by the fact that this velocity is a very changing item in the equation. Thus there would be no correlation between money supply and prices.

We have situations where the money supply did not change and prices went up. We have other situations where the money supply went up, and prices remained stable. That was as a result of changes in velocity. But strangely enough, that is where most of the economists have to learn something.

Also, the deficit has not quite played the role which we thought it did play. If I had been asked some years ago what would happen if the Government has a \$13 billion deficit to be financed by short-term bills and notes, I would have said without much hesitation, "That will be a period of inflation and of price rises." You may have noticed yesterday, in response to a question by Congressman Curtis, I think, about whether this deficit had any inflationary effect, the Chairman of the Board took it for granted and was somewhat surprised that this was a period of extraordinary price stability.

Mr. Young gave the figure of 2 percent increase in wholesale prices, which I cannot find in any statistics. He is a good friend of mine. I will ask him where he found that. I find only seven-tenths of 1 percent increase over a period of 12 months.

He later stated that although we didn't get the consumer price rise, an increase in the wholesale price always foreshadows a rise in the cost of living index, which in my experience sometimes happens and sometimes does not happen.

Furthermore, again in response to questions, the chairman agreed to the statement that the \$13 billion did not yet have its full effect on inflation, but that we were just at the beginning, which I take is a rather scaring prediction of an unavoidable price rise, which is contrary to the statement made by the Secretary of the Treasury that such a price rise is not unavoidable.

And I would emphasize that as much as I can; that, as a matter of fact, the experts are cautious in making such predictions. And Mr.

Martin did not make any prediction, except by implication. I know that people in the Bureau of Labor Statistics think we are in a period of pretty good price stability probably for a year or so.

I never make short-range predictions which catch up with me too soon. I only make long-range predictions. So I am only presenting to you these views.

But it was quite clear that Mr. Martin was surprised by this price stability, and it didn't quite fit into his concepts. And it doesn't quite fit into my ideas, but I am willing sometimes to learn by experience.

As a matter of fact, that is not a new experience. If we look back, we had period of budget surplus with a considerable price rise. The cash budget had a very considerable surplus in the calendar years 1947 and 1948, both years—a big surplus, and we had the price rise in spite of the surplus.

In 1956 and 1957, we had a similar situation.

On the other hand, we had the deficit of the year 1953, with considerable price stability.

So I would say in all humility, Mr. Chairman, that the frame of reference which was presented to you, which was more or less the general economic reasoning we all have been engaged in, in recent decades—that this requires a bit of reexamination. If we only look at the money supply and budget surpluses and deficits and know what is going to happen, that is one thing, but it isn't as easy as that.

As a matter of fact, we had a price rise during the recession. Mr. Martin was very sure that an increase in interest rates would be just a phenomenon of a recovery period. We had periods of recovery without price rise and without rise in interest rates, and we had periods of rising prices during a recession. I don't say without decline in interest rates—I think that rule still applies, but not necessarily to a continuing price rise. This is something that should give us pause to think whether we have not, in the present inflationary situation, phenomena which we have not thought of before. I am referring to what has popularly been called the cost-push kind of inflation and administered prices.

Wage determination sometimes does and sometimes does not push prices up. I am not suggesting to you that there is a new scapegoat that is no longer the Government deficit but labor. We have a much more complex situation, in which we cannot follow the simple rule that if prices go up that is time for stepping on the monetary brake. We may have a situation where such a policy may contribute to the recession, as in my judgment it has done in the fall of 1957. Because of a continuing rise in prices, the Federal Reserve continued its policy until late in the fall or early in the winter, at the time when other than price indicators already told us that we are in the beginning of a pretty severe recession.

I think, if I may use a metaphor, Mr. Chairman, we are a little bit in the situation—the Federal Reserve has been in the situation—of a driver coming from the Mountain States, driving toward the east coast. And he is told, "Well, it goes pretty much downhill, so you had better keep your foot close to the brake." But in order to be really cautious in this situation, the driver not only kept his foot near the brake, he pressed right down a bit on the brake and consequently found that he could not reach his destination on time.

So they were surprised that the brake got a little worn out. I think this is a time when we have to reexamine our brakes, our anti-inflationary weapons that we have available.

Coming back to my prepared testimony, from this discussion I would like to draw the following conclusions. One, if there has been an absolute scarcity of funds in recent months, it was largely the result of temporary factors. It is not unreasonable to maintain that the Federal Reserve should tide the market over a period of merely temporary stringency rather than add to it by a restrictive credit policy.

I believe that with advancing recovery as great an increase in private and corporate savings will be generated as will be absorbed by private and public demand under present or possibly even somewhat lower interest rates.

Mr. Chairman, if I may bring to the attention of the committee a table, which on page 7 is attached to my testimony, you will find here I think one quite interesting fact.

This table shows the sources and uses of gross savings. You will find that in the first quarter of 1959, earnings available for business finance were running more than \$6 billion higher than in 1957. And this was a relatively good year.

It was the second quarter before there was any drop due to the oncoming recession. Business retained earnings, \$6 billion above 1957. Investment in plant and equipment, which in the first quarter of 1959 had made a little comeback after the recession, was still \$5 billion below 1957. That means accrual of funds was \$6 billion above; the use of funds for fixed investments, \$5 billion below the 1957 level.

We had a situation in inventory which absorbed part of that accrual of funds, as I said before, switching from a big inventory liquidation early in 1958 to a very big inventory accumulation in the first quarter of 1959. In part this shift was influenced by the anticipation of a possible steel strike.

That has in part absorbed these funds. But that is what I call a temporary factor, Mr. Chairman. Because we cannot have for long such an accrual of inventories year after year.

Second, such a development—that means a more ample availability of funds and a consequent easing on the pressure for increased interest rates—such a development will be enhanced if the Federal Reserve System assists in the maintenance of an orderly market for Government securities. This can be done, for example, through open market operations, to mitigate major fluctuations and to promote the development of an interest rate which relates to longer run supply and demand conditions, rather than to short-run fluctuations.

Mr. Chairman, I would like here to add a few comments, unless I am taking too much time.

The CHAIRMAN. Go right ahead.

Mr. COLM. Many of the arguments presented, particularly in the appendix material that the Secretary of the Treasury inserted in the record, but also part of the argument presented by Mr. Martin, anticipated this argument or this proposal, that the upward pressure on interest rates should be in some part counteracted.

I would like briefly to discuss these arguments.

First, Mr. Martin to some extent has constructed a strawman and knocked it down, and I must say effectively and with beautifully convincing language.

I enjoyed that, particularly since I felt he could not be referring to my position or to the position of others, like Congressman Reuss, before this committee. Because he knocked down the strawman of going back to the preaccord pegging of the bonds of March 1951. And I think he knocked it down effectively.

Anybody who really recommends that policy—I think he got his answer, which he deserves. But I would like to submit that there is something in between a policy which in effect pushes interest rates up, on the one hand, and the pegging of a fixed bond price on the other hand. I think there is a wide range in between and I think we should somewhere search for a policy that is in between these two things.

You can have a flexible policy, which leaves lots of uncertainty for the investor, and still avoids and counteracts, the wide fluctuations in bond prices which we have had in recent years.

I do not want to go into detail how that could be done, but I think temporary and seasonal increases in the debt should be counteracted by an active Federal Reserve policy. Of course, it would be more desirable if there were working funds of the Treasury which could absorb these fluctuations, but unfortunately we do not have them.

It is said that in any case, this is an inflationary policy. It is said that if we recommend that such temporary or seasonal increases in the issue of securities should be absorbed in part by Federal Reserve purchases, open market purchases, this is by necessity inflationary.

The answer given is that such an inflationary pressure, if it develops—and it might develop—could be counteracted then by the instrument of changes in reserve requirements.

Mr. Anderson has dealt with this proposition and he says that, for instance, if the Federal Reserve buys \$5 billion in bonds and then, through an increase in reserve requirements, absorbs the reserves created in the member banks, then the Government would have to take away with the right arm what they have given with the left arm, and the result is the same as before.

I submit that this overlooks two things. First, the result is not the same, because there would be a somewhat better position for the interest rate or the prices of Government securities, with possibly some rise in interest on private loans. The Federal Reserve takes Government securities and curtails funds available for private lending.

And so while I believe that in the postwar period the Government was exclusively concerned with Government securities and not sufficiently with the controls of the private credit system, I do think now we are doing the opposite. There is less concern about what happens to Government credit on the side of Federal Reserve and, as I have suggested before, I think there should be a more balanced position.

Second, I would not propose that if the Fed buys \$5 billion worth of Government securities they should really take away the full rise in lending power by higher reserve requirements. I only would say that to the extent that these open market operations have an inflationary impact, it should be counteracted by using the instrument of reserve requirements.

It does not need to be a 100-percent offset because we have to have an increase in credit for a growing economy.

That is the sort of answer I would give to the Secretary and to the argument which he has on pages 24 and 25 of the document presented for the record.

I want to make quite clear one thing in this connection. We have heard a lot about the free market for Government securities.

Basically, I agree. I do not believe that it is possible in the long run or would be prudent for the Government to try to fix an interest rate which is not in accord with the savings and use of the savings situation over the long run.

My point has been that we should aim at a policy in that respect which takes account of the longer run factor, but which absorbs shorter run fluctuations in the process.

We should also remember that the market for funds is not a very ideal competitive market. I mentioned already one fact, that the supply of funds is not very elastic, in response to changes in the interest rate. When the interest rate goes up, it is not that you then consume less and save more, at least not substantially more. And we have encountered effects which go in the other direction, because with higher interest rates a lesser amount of saving permits you to make some provision for your future rainy day or your life insurance, et cetera.

Second, the big demand for funds unfortunately is largely outside the influence of our interest rate policy. The biggest factor is the demand of corporations for plant equipment, and that is almost fully covered by their internal accruals, which are only very vaguely and indirectly affected by monetary policy. Therefore, the interest rate is not a very perfect instrument.

As a matter of fact, I agree with what Mr. Martin said yesterday, in response to a question, that in the long run interest rates are determined by supply of and decreased demand for saving. They can be influenced, however, by policy in the short run. And I believe this power to influence interest rates in the short run should be used.

In the present economic juncture, Mr. Chairman, I cannot give any definite advice with respect to appropriate monetary policies for a longer period ahead. As a matter of fact, I would challenge any economist who says he can.

Therefore, I would not propose that your committee should go on record with a recommendation or a direction that the Federal Reserve Board should switch now to an easy money policy.

With the end of the recent inventory boom, it is still not clear whether the pace of recovery will slow down, will turn into balanced and sustained economic growth, or will develop into an inflationary boom. In such a situation, the monetary authorities need to be on guard and should be prepared to respond promptly to changes in the employment and production outlook. In the terms of my metaphor today, I would say we should have the foot near the brake, but we should not always step on the brake. The readiness to take anti-inflationary action if excessive demand develops should not and need not prevent the monetary authorities from playing their role in debt management.

Third, the problems of debt management cannot be solved merely by increasing the rate of interest. Several witnesses have said that. Improvements in tailoring debt issues to potential markets and im-

improvements in the marketing techniques should be explored. Lessons should be learned from past failures.

What I am referring here to is the fact that there was no sale to the financial institutions during the last year, and I think a way should be found to tap that money. Also, the relationship between fiscal policies, especially tax policies, debt management, and credit policies, require reexamination.

I know that this committee has planned such a reexamination as far as tax policies are concerned.

Fourth, the Federal Government should do everything in its power to combat the notion that promotion of a desirable rate of economic growth will lead of necessity to continuing inflation. Policies needed to reconcile the objective of economic growth with a reasonable degree of price stability should be explored and adopted. I know that other committees of Congress are looking into this problem. This will be more helpful to the restoration of confidence in Government securities than scare talk about unavoidable inflation as a result of deficit. I believe that such restoration of confidence is entirely possible. The fact that savings deposits and similar fixed forms of savings have been rising all through 1958 and into 1959, as long as we have records, demonstrates that the confidence of the American people in the soundness of the dollar has not been shaken.

I refer to the fact that from April 1958 to April 1959 time deposits of all kinds have increased by more than \$6 billion. That does not look like running away from the dollar.

In conclusion, I would like to repeat that I favor removal of the interest ceiling on Government bonds. The increase in the debt limit and the removal of the interest ceiling on bonds should be used as an opportunity for the Treasury and the Federal Reserve System to improve their debt-management policies. In order to avoid possible misinterpretations and unwarranted expectations resulting from such congressional action, it would be most desirable if the appropriate committee and the Congress as a whole would make it clear that this action is not taken in support of generally higher interest rates on Government securities in general.

In the last part of my prepared testimony, I changed after I heard Congressman Reuss yesterday, and I tried to utilize some of his proposals, though I modified them. I do not know whether he would agree or not. I guess he would not agree with this.

The Congress could direct, as was proposed by Congressman Reuss, that the Federal Reserve System:

While pursuing its primary mission of administering a sound monetary policy, should, to the maximum extent consistent therewith, utilize such means as will assist in the economical and efficient management of the public debt.

And I add to this: Also, the System could be directed to explore what use of purchase of U.S. securities of varying maturity could be made in order to bring about needed future monetary expansion, and what improvement in the methods of reserve requirement could be made so that they become a more usable and effective anti-inflation tool.

That is the end of my suggestion for this committee.

With such affirmative policies, a further rise in the interest rate on the national debt may be avoided, and in time a decline may be

possible. Such policies would also make a contribution to the broader national objective of economic growth without undermining confidence in the dollar.

Mr. Chairman, I would like to add just one remark on the debt ceiling problem. I do that with some hesitation, because my logic as an economist is somewhat contrary to my feeling of political feasibility on this thing. But after all, I do not want to take your job, and I want to do mine. I think the debt ceiling in essence has become a two—

The CHAIRMAN. A two-edged sword?

Dr. COLM. I think in one respect it would be good to have the debt limit high, to give elbowroom to the authorities. But this could be interpreted as meaning that Congress is not concerned with the rise of the national debt and is going on spending to that limit. On the other hand, a tight debt limit may have very unfavorable consequences, as was demonstrated to us in the fall of 1957. That was a situation where it was believed politically not wise to go to Congress and ask for an increase in the debt limit, with the result that there were cuts in expenditures. And the result was waste, because we had to make up for it in the defense program afterward. Also, there was great inconvenience for some of the procurement corporations, which simply were not paid.

In addition, Mr. Chairman, there is always a way of getting around this, and that is also undesirable. By manipulation of transactions, it is always possible, to some extent, to engage in debt transactions which are not reflected in the debt subject to the statutory limits.

I bring to your attention that the fiscal year 1960 budget, which is in balance on the books, shows, in an appendix table, that there is proposed for the fiscal year 1960 an increase in private debt secured by Federal insurance and guaranties, of more than \$10 billion.

Mr. MASON. Backdoor expenditures?

Dr. COLM. \$10 billion. Now, I am not criticizing these operations. In some cases that is a better instrument than outright spending and borrowing. But I do not think the situation is desirable when the administration is induced to use that instrument, even when the merits would be on the other side. But I have said that, Mr. Chairman, because it is my conviction, as an economist, that we are getting into trouble with the debt limit. But I recognize that this is one bit of advice which you will certainly disregard.

Thank you.

(Chart entitled "Sources and Uses of Gross Saving" is as follows:)

*Sources and uses of gross savings (seasonally adjusted at annual rates)*

[Billions of dollars]

	2d quarter, 1957	1st quarter, 1958	4th quarter, 1958	1st quarter, 1959
Sources of saving .....	71.0	62.3	69.5	72.2
Private saving .....	68.4	62.3	69.5	72.2
Personal saving .....	23.2	19.9	19.9	20.4
Business retained earnings .....	45.2	42.4	49.6	51.8
Government surplus (Federal) .....	2.6			
Uses of saving .....	72.5	60.7	69.2	72.0
Gross private domestic investment .....	67.1	50.9	61.6	70.2
Investment in plant and equipment .....	47.7	42.1	41.5	42.8
Residential construction .....	16.5	17.1	20.1	21.7
Inventories .....	2.9	-8.2	0	5.7
Net foreign investment .....	4.2	.5	-1.0	-1.7
Government deficit .....	1.3	9.3	8.5	3.5
Federal .....		6.6	7.4	1.8
State-local .....	1.3	2.7	1.1	1.7
Statistical discrepancy .....	1.5	-1.5	-3	-2

Sources: Survey of Current Business; Federal Reserve Bulletin; and National Planning Association.

The CHAIRMAN. Dr. Colm, we thank you for your very fine presentation of your views on this problem.

Without objection, the table to which you referred on page 7 of your statement will be included in the record at the point where you referred to it, or at the conclusion of your statement.

Dr. Colm, we have heard a lot in the last 2 days about, primarily, the matter of the elimination of the interest rate. And you have referred in your discussion this morning more to that than to the question of the debt ceiling.

Actually, about the only issues involved with respect to congressional action on the debt ceiling at this point, as I see it, would be whether or not such increases as appear necessary are to be on a so-called temporary basis or on a permanent basis; or whether or not we might reevaluate the present requirement and prepare a different type of a limit with respect to the debt itself; whether the limit shall apply to a debt every moment of every day of every fiscal year, or whether the limit shall apply with respect to the close of business at the end of a fiscal year.

Those issues are not so technical that they are not understandable. You realize and I realize that the Congress, for many reasons, perhaps, will not think at this time in terms of eliminating entirely the ceiling on the debt as has been recommended by some people outside of Government.

Let's pass from that, then, into this more troublesome area of eliminating the ceiling on the interest that will be paid by the Government.

Now, let us understand first of all, clearly, just what the existing situation is. As I understand the existing law, there is no ceiling with respect to interest that can be paid by the Government on securities up to 5 years in term. The ceiling applies with respect to securities that are issued for a period of longer than 5 years.

We have been told—and I want you to speak up at any moment if I am not stating this correctly—we have been told that banks generally are the purchasers of Government securities that are of short duration.

Dr. COLM. Yes, sir. That has usually been the case.

The CHAIRMAN. So that if the future should develop circumstances in which the Government would have to pay a higher rate of interest in order to refinance the existing obligations than it is permitted by law to pay now with respect to long-term obligations, the Treasury would, of necessity, turn more and more to short-term securities, where there is no limit, and which are securities that would be bought by banks, rather than individuals.

Dr. COLM. Yes, sir.

The CHAIRMAN. So that the result would be, as I see it, that we would, under existing law, be frozen into a position where greater interest than has to be paid to the Government would be paid to banking institutions rather than to individuals. We would not be in a position to pay more, if necessary, in order to attract the savings of individuals to Government securities.

Is that true?

Dr. COLM. That is my understanding, Mr. Chairman.

The CHAIRMAN. Now, let me ask the question: Is not that procedure in and of itself conducive to further inflation?

Dr. COLM. Mr. Chairman, if the nonfinancial corporations and pension funds would stop buying the Government securities which they have been buying during the last 6 months, then the Federal Reserve would have to make available the reserves for commercial banks to enable them to buy the securities, and that would have an inflationary tendency. I make a small distinction between inflationary tendency and inflation. What I mean is that sometimes there are offsetting factors in the economy. That is why sometimes a deficit or an expansion of credit and purchase of Government securities does not create inflation—it still is an inflationary tendency which is offset by other tendencies in the economy. I do not see that it necessarily would result in price rise and inflation.

The CHAIRMAN. No one could say that, because we do not know what the other factors would be that could counteract this. But you say at least this would be a factor that would tend to cause inflation. That is what I am trying to ascertain.

Dr. COLM. Yes, sir.

The CHAIRMAN. That is true, is it?

Dr. COLM. If the purchase is made available through expansion of Federal Reserve credit.

The CHAIRMAN. Well, it would have to be, would it not?

Dr. COLM. Well, theoretically, Mr. Chairman, there might be a switch from private loans into Government bonds, if they are secure, if they are more attractive. Theoretically. I mean not each purchase of a commercial bank, of Government securities, is inflationary in itself, if there is a switch in assets. It is inflationary if the Federal Reserve in order to promote that makes the reserves available by either lowering of reserve requirements or open market operations.

The CHAIRMAN. What I am getting at this this: Over the next year or 2 years the Secretary of the Treasury will in all probability have to refund \$130 to \$140 billion of public debt. Some of that is in short-term obligations. Some of it is in long-term obligations. If he cannot induce investors in the long-term area, then he will of necessity have to induce investors in the short-term area.

Dr. COLM. Yes.

The CHAIRMAN. So that the short-term obligations of Government, which today may be some \$75 or \$76 billions, could be expected, under those circumstances, to materially increase, and there would, therefore, be pressures for greater availability of credit on the part of the banks if they are the ones that we must look to to take these short term obligations.

Dr. COLM. Yes.

The CHAIRMAN. Now there would have to be, if inflation did not occur under those circumstances, a number of factors counteracting that influence, would there not?

Dr. COLM. Yes, exactly.

The CHAIRMAN. And we are told already by those in a better position than we to predict with respect to Government spending, that even if Government spending may be \$78 billion in fiscal 1960, but there is also evidence to cause us to believe that it may be \$80 or \$81 billion. Already the evidence causes us to believe that with respect to 1961.

Dr. COLM. Yes.

The CHAIRMAN. So that we would be in a very tight fiscal situation, maybe in a deficit. Now we would not want to be in that position, would we, under circumstances such as I have described?

Dr. COLM. No.

The CHAIRMAN. Because that would be another factor working in the direction of inflation, would it not?

Dr. COLM. Yes.

The CHAIRMAN. All of these things that we can think of working together might well bring about the very thing that none of us want, higher interest rates.

Dr. COLM. That is right.

The CHAIRMAN. In spite of the fact that we might write up a report to the contrary, that might follow?

Dr. COLM. Yes. That is the reasoning that led me to the support of the removal of the interest ceiling on long-term bonds, longer than 5 years.

The CHAIRMAN. Have you discussed this matter on the outside with other economists? Do you know their thinking with respect to it? Do those that you have talked to possess about the same views that you do on this?

Dr. COLM. I could mention a number of economists who I believe hold the same views, and at least an equal number with different views. Unfortunately there are differences of opinion.

The CHAIRMAN. Are economists divided on this question that we are talking about, that our failure to do this thing would create inflationary trends? Are there some who think it would not?

Dr. COLM. I can hardly imagine, Mr. Chairman, that somebody would question that statement, if you called it an inflationary trend. That means possible offset by other factors. And if you considered the pressure on the monetary authorities to make the purchase of short-term bills and notes possible by the banking system, I can hardly imagine that somebody would deny that that is an inflationary trend. There may be some who say that is what we need, because we have other deflationary factors, for example, a very high accrual of funds within corporations. We may have such factors which require offsetting. But with respect to the facts, Mr. Chairman, I can hardly believe there is a difference of opinion, though I am only talking for myself and I cannot talk for my colleagues.

The CHAIRMAN. Let me see now if I can get from you some understanding of the basic propositions that are involved in this policy area. I am talking now about this question of the interest rate. If we are to have a growing economy, does this not mean that this year's money claims have to be greater than last year's; and next year's money claims greater than this year's?

Dr. COLM. We think that growth in the economy, let us say, year by year, should be in the neighborhood of \$15 to \$20 billion.

The CHAIRMAN. Are you talking now in terms of net money claims?

Dr. COLM. Gross national product.

The CHAIRMAN. All right. Go ahead.

Dr. COLM. And that such a growth is likely only if there is a corresponding growth, one that is proportionate, in money claims.

The CHAIRMAN. That has to follow, does it not? There has to be that increase in money claims?

Dr. COLM. Yes.

The CHAIRMAN. You do not have growth without an increase.

Dr. COLM. That is right.

The CHAIRMAN. If you maintain your money supply on a static basis so that your claims do not grow, you do not have growth. So we must, therefore, conclude that we are not opposed to any and all increases in credit, which is the bulk of what we call our money supply. That is true, is it not?

Dr. COLM. Yes.

The CHAIRMAN. Our whole purpose, then, in this connection, is to be certain that the increase is not excessive. That is the purpose, is it not?

Dr. COLM. Both, Mr. Chairman; that the increase is adequate, and not excessive.

The CHAIRMAN. We repose such latitude in the Federal Reserve as to give the Federal Reserve System authority to see that it is adequate and not excessive.

Dr. COLM. Yes, sir.

The CHAIRMAN. They are the ones that we charge with that responsibility. Now if velocity of money remains a constant, that means

that the money supply must increase proportionately with the increase in total production, does it not?

Dr. COLM. Yes. That is correct.

The CHAIRMAN. Would it be the same percentage? If velocity remains constant and if you had 3 percent growth in your economy would you need 3 percent growth in your money supply?

Dr. COLM. Yes.

The CHAIRMAN. If that does not happen, then the economy slows down, does it not?

Dr. COLM. Yes. That has been the experience in recent years.

The CHAIRMAN. I am getting back to the question I raised with Mr. Martin. Has the money supply over the past years increased enough, in your judgment?

Dr. COLM. The money supply has increased much less than the increase in the gross national product, because we had some increase in velocity.

The CHAIRMAN. All right. Then the money supply not having increased as much, of course, the velocity has not remained constant. But does it mean that the money supply has not increased, in your opinion, taking into consideration velocity, as much as it should have increased to satisfy the needs of the growth that has occurred?

Dr. COLM. I think over the last few years, starting with 1957, the money supply has not increased adequately to support even a modest rate of growth at 3 percent or a more desirable rate of growth, I would say, of around 4 percent.

The CHAIRMAN. You say it has not?

Dr. COLM. It has not.

The CHAIRMAN. Then if it has not, has that made a contribution to the rise in interest rates?

Dr. COLM. I think it has made a contribution.

The CHAIRMAN. You would criticize, then, the policy that the Federal Reserve has followed up to date with respect to making money and credit available?

Dr. COLM. Yes, and I think it became most obvious in the fall of 1957.

The CHAIRMAN. That is what I am thinking about.

Dr. COLM. That is the period where it is most obvious. At the present time it is a little bit more doubtful, because there are some inflationary signs. But during 1957—I am speaking of the last half of 1957—there was in my judgment no reason for holding down the increase in money supply and every reason for stimulating expansion. We had curtailment in Government expenditures, due partly to the effect of the debt ceiling. I am not for an increase in expenditures if other factors in the private economy are permitted to go ahead. But we had a slowdown in the private sector and in the Government sector at the same time, with the result of the recession of 1958.

The CHAIRMAN. If you will pardon the personal reference, I made a speech on the fifth of November 1957. I do not know whether my audience appreciated what I said or not, but they had given me unlimited right to select my subject. I called attention then that the policies of the Federal Reserve were such—this was the beginning of November—that if it continued and if there was not an easing of these

policies, that is, the creation of more credit, through Federal Reserve policies, by March of 1958 there would be 5 million people unemployed.

You say you do not like to make predictions with respect to the near future, because you could be wrong. I do not, either. But I could not escape the conviction that there was this downturn, and that the policies of the Federal Reserve were policies more appropriate to an inflationary period, and they were not appropriate to a period of decline.

Now, what I am concerned about today, very frankly, is that there will not be enough shift or change with respect to Federal Reserve policies in this area to cause interest rates to remain constant or to go down if we take the ceiling off of Government obligations, and we thereby will be accused, at least, rather than the Federal Reserve, of having created the situation of higher interest rates.

DR. COLM. I agree entirely with that, Mr. Chairman. That was exactly the reason why, recognizing the logic of the proposal for removal of the ceiling, I felt that Congress wants to be protected against the misinterpretation of that action. That could be done by some such language as I proposed at the end, which was a modification of the amendment proposed by Congressman Reuss.

THE CHAIRMAN. It will be said to you and me that we are wrong in our thought that the policies of the Federal Reserve should be so adjusted as to bring about a greater supply of money, because that action would be inflationary in all probability. Now, you have said, and I have said, that I did not think enough had been made available in the past, and that that was a factor causing higher interest rates.

Now, can we catch up, make up for what may have been a mistake according to your thinking and mine, through Federal Reserve policies, without running the risk of creating an oversupply and therefore inflation?

DR. COLM. Mr. Chairman, it is in the nature of the problem that there always will be the risk of doing the wrong thing. I think in this area, with our imperfect knowledge, there is only one way, and that is proceeding by trial and error. If I would give advice to the Federal Reserve, I would pursue a policy designed to increase the money supply and make funds available. But I would not take my foot too far off the brake.

THE CHAIRMAN. You mean away from the brake?

DR. COLM. Not too far away from the brake. I would take it off. I would not step down. I would let it go. But I would keep it in a position where I could step down as soon as I see that I have gone too far. I do not think this is an area in which we can say the one or the other policy should be pursued. That is why I am in favor of discretionary power for the Federal Reserve as long as they are told that they have to look at all the objectives, namely, promoting economic growth, orderly market for Government securities, and the stability of the dollar. And particularly, Mr. Chairman, they should recognize that not every price rise is a sign of excessive demand. We had price rises, inflation, certainly during the recession, which had nothing to do with excess demand, and where the use of the Federal Reserve instrument was the wrong policy.

THE CHAIRMAN. What I am trying to find out is this: We all agree that the Federal Reserve System could so expand credit and money

as to take care of this problem of the Treasury without an increase in the interest rate. Now, can it do so without the possibility of this resulting in inflationary expansion of the credit supply?

Dr. COLM. I think it can, Mr. Chairman.

The CHAIRMAN. Do you think it should make the effort to do it?

Dr. COLM. I think it should make the effort; always ready to step on the brake if a truly inflationary situation develops. And "inflationary" means here excess lending because of too great monetary reserves.

The CHAIRMAN. All right. This is another point that bothers me. If the Federal Reserve does not do what we are talking about, the Secretary of the Treasury has no alternative but to go into the market and to take this ceiling off and pay such interest as is required to be paid to get people to buy these securities. Does that not mean that if there is a continuation of the present Federal Reserve policy without any easing, as you and I have suggested should occur then there would be some would-be borrowers who are going to be squeezed out of the money market?

Dr. COLM. Yes, I think so.

The CHAIRMAN. Now, who are they going to be?

Dr. COLM. Pardon me?

The CHAIRMAN. Who, in your opinion, are they going to be?

Dr. COLM. Those squeezed out? Well, the situation to which I referred, where most of the long-term fixed investments in plant and equipment are financed not through the credit mechanism but through internal fund accruals the victims of high-interest rate are the construction industry, unless that is offset by Government mortgage policy, smaller businesses, which depend on credit, and some public utilities, which traditionally are financed by debt rather than by their own means, State and local governments, which are very sensitive to the interest rate. I think that is about it, Mr. Chairman.

The CHAIRMAN. All right. Now, let us turn in another direction.

Even if we do not do it, even if we do not take the course of action that you suggest, that the administration suggests, and if the Federal Reserve does nothing but maintain its present policy of making less money and less credit available than you and I think expansion requires, then are not the same people affected? Are not the same people squeezed, anyway? Through the use of the short-term obligations by the Treasury?

Dr. COLM. Yes, they are, Mr. Chairman.

The CHAIRMAN. They are. There is no question about that. So that we cannot say, and it cannot be successfully proven, first, that the elimination of the ceiling on the rate of interest by Congress will be the cause of any increase in the rate of interest that may or may not follow.

Is that true?

Dr. COLM. Yes, that is true.

The CHAIRMAN. Second, it cannot be proven, it cannot be demonstrated, that the Congress will be the cause of the hardships that are going to develop in the next months with respect to some of these would-be borrowers of the next several months, because they are squeezed either way.

Dr. COLM. Yes.

The CHAIRMAN. And it comes right back to this basic problem, that is basic, I think far more so than the things that we have discussed, perhaps—that it is in the operation and the management of the supply of money by the Federal Reserve that we find the crux of the criticism if these things that we are talking about do happen in the future.

Dr. COLM. Yes, sir.

The CHAIRMAN. If interest rates go up and certain people are crowded out of the market, because of the necessities of the debt situation?

Dr. COLM. Yes.

The CHAIRMAN. I know very little about it, frankly. I know very little about anything. But as to what is a satisfactory monetary policy, as I said yesterday, I certainly would not want to have Mr. Martin's job. But I guess it can only be done on a basis of trial and error, and it looks like there are about as many errors as there are trials in the process of making decisions.

Dr. Colm, I thank you very much for being here today and for straightening me out, at least, on some of these problems that I have with respect to this basic policy area.

Are there any other questions?

Mr. Mason?

Mr. MASON. Dr. Colm, reverting to the chairman's phrase, or statement, that the total money claims must go along with the total production or expansion of the economy, is it not also true that if we want a healthy economy the balance of the money savings, the other side of the picture, must go along with this increase in money claims? Those two, you might say, balance each other in a healthy economy. Is that not true?

Dr. COLM. That is true, Mr. Mason.

Mr. MASON. And while we cannot determine the amount of money savings, because that fluctuates without any rhyme or reason, it seems to me, we have got to keep that in mind in this expansion of our economy and the total money claims that must be met.

Now, then, with that settled in my mind, or for me, particularly, I want to try to clarify what you said about the Federal Reserve and its responsibility.

As I gather, you liken the Federal Reserve to a power brake on our economy that must be handled very, very carefully, not pushed down, not taken away, but just kept there so as to have our economy on an even keel all the time and not inflation or depression. And I would judge that you said that maybe the Federal Reserve put the pedal down a little bit too much in 1957, say.

Dr. COLM. Yes, sir.

Mr. MASON. It was not adjusting it about as it should be. That is a delicate brake and must be handled in a delicate way; is that not true?

Dr. COLM. Yes, sir.

Mr. MASON. Now, then, you told this committee a well-known truth in economics: that economic truth and an economic proposition that is excellent does not always go along with political feasibility. And we particularly are sensitive to political feasibility, and we may not always follow what we know to be economic truth because of the fact. And I was delighted that you brought out that point.

We have heard a good deal in the last 2 days about the money velocity; that it is not the total amount of currency available by itself, but we have to consider the velocity of movement of that currency in order to know whether it is too much currency or not enough, because the velocity determines the effect upon this.

I like, as a schoolteacher, to illustrate things. A \$5 bill that is used 10 times in 1 month to buy some goods equals a \$50 bill that is used once. Is that not what we mean by velocity?

Mr. COLM. That is right.

Mr. MASON. That is all, Mr. Chairman.

The CHAIRMAN. Any further requests of Dr. Colm?

Mr. BYRNES. Mr. Chairman.

The CHAIRMAN. Mr. Byrnes will inquire, Dr. Colm.

Mr. BYRNES. Very briefly, I want to go back to the last discussion of the chairman with respect to what the effects would be, assuming no change in the general attitude or operations of the Federal Reserve, in all actions by them, to change the credit supply available.

The suggestion was, and I think there was agreement on it, that if the Congress removes this interest rate ceiling, some borrowers eventually are going to be squeezed out of the money market and if we do not do anything and the Government has to rely on short-term financing, the borrowers are still going to be squeezed out.

I do not want to put words in the chairman's mouth.

The CHAIRMAN. That was a part of it.

What we were trying to emphasize was that a continuation of existing Federal Reserve policy, regardless of what happens here, in all probability will bring about a squeeze with respect to many would-be borrowers in the next several months ahead.

Mr. BYRNES. That is what I was getting at. However, assuming the Congress does not do anything and the Federal Reserve Board does not change its policy, is not the squeeze going to be more severe than if we eliminate the ceiling or raise it?

What I am getting back to is the implications that were involved, particularly in the statement of the Secretary of the Treasury to us in regard to the psychological effect on savers with the Treasury being bound in and restricted to short-term borrowing and therefore the assumption that inflation is bound to be the order of the day.

Mr. COLM. Mr. Byrnes, it is difficult to answer the question as to which one would have the most effect. The assumption the chairman made was that there would be no change in the Federal Reserve policy.

Mr. BYRNES. That is the same assumption I make.

Mr. COLM. If the ceiling is removed and some of the notes and bills due are replaced by a long-term issue of higher rate, that in itself would lessen the inflationary impact.

On the other hand, it would have a repercussion through the whole interest structure, because as was mentioned yesterday by one gentleman these higher interest rates on bonds do affect the interest rates on other competitive securities, they may affect State and local securities, and so on.

On the other hand, if the ceiling is not removed and the Treasury through the same Federal Reserve policy is forced to go up in short-term interest rates in order to make somebody buy the bonds and notes, then you have pretty much the same effect.

I would guess that the difference would not be too great, but I think there might be a chance that the effect on interest rates outside the Government might be somewhat larger with the present ceiling than without, because you have some chance of saving through long-term investors.

Mr. BYRNES. The Secretary, as I recall, put a great deal of emphasis upon the psychological effect, even internationally. He suggested that in the financial field if there was a feeling that the Treasury was going to be bound in and forced to seek its bonds in short-term borrowings, the psychological effect of that would be bad from the general interest standpoint and from the tendency to interpret that as indicating that we were going to be moving even faster into an inflationary period.

Do you agree or disagree with the Secretary's interpretation of the psychological effect?

Mr. COLM. I guess none of us, without any reflection on the Secretary, is an expert on psychology.

As a matter of fact, this is at least as complicated as the economic issue itself.

I think there are all kinds of psychological repercussions. There has been much emphasis on the psychological effect of, let's say, a tight money policy, and one Economic Minister of a foreign country, in a television show 10 days ago, said that he had advised the Federal Government to engage in a tight money policy, while his own country was reducing the interest rates month by month.

But I think there is also another psychological effect. If, because of that monetary policy, the economic growth is not what it could be, I would submit, Mr. Byrnes, that can have a more important undesirable effect on the psychology both at home and abroad.

Labor during the recession became less willing to cooperate, let's say, with automation and technological advances because there was a fear for job security, and in foreign countries you got very unfavorable reaction on the lack of economic growth in the United States. So if you refer to psychology, I think we have to take all sides into consideration and not only the one effect Mr. Anderson talked about. Mr. Martin, on another occasion, also talked about the experience in New Delhi.

This question of the dollar was discussed, but I submit among the people who were assembled in New Delhi, there was a certain selection and the selection assembled in New Delhi on that occasion was not exactly a cross section of the population of those countries.

Mr. BYRNES. In other words, your point is that assuming no change by the Federal Reserve in policy, what we do with the recommendations of the Treasury Department with respect to the ceiling on the medium- and long-term obligations won't make any appreciable difference?

Mr. COLM. I didn't mean that what the Federal Reserve does makes little difference.

Mr. BYRNES. Am I right in inferring from your statement that based on the assumption the Federal Reserve Board does not make any change in policy, that what we do here is of no significance.

Mr. COLM. I come out in favor of the removal, as you know, Mr. Byrnes, because I do think that with the removal there is a better

chance that the Federal Reserve will adopt a flexible policy in time. I mean the whole discussion was based on the assumption—I hope unrealistic—that there is no change in Federal Reserve policy.

I ask the question of myself, under what kind of action of Congress is there a better chance that there will be a change, and I come out, rightly or wrongly, with the recommendation that with the removal of ceiling, Congress has a better chance to exert a wholesome influence rather than if you do not grant that.

Then the Federal Reserve will say, "Well, it was Congress which prevented us from taking the necessary action."

Mr. BYRNES. I understand that you recommended that we comply with the Treasury's request as far as eliminating the 4-percent ceiling.

Mr. COLM. Yes, sir.

Mr. BYRNES. However, you also coupled it with the change in Federal Reserve policy.

I was wondering, though, what your position would be after the questions asked by the chairman and your answers, or what your recommendations would be on the 4-percent proposal if you went on the assumption that the Treasury and Federal Reserve policy was not going to be changed.

Would you still advocate that we act to remove the ceiling?

Mr. COLM. I advocate that Congress remove the ceiling with a strong declaration which reaffirms the objectives of the monetary policy, both to work toward stability, an orderly market for Government securities, and promotion of economic expansion, and implement that with exploration.

Mr. BYRNES. Even if we did not take this second step of the suggestion that the Federal Reserve Board had to make some changes or if the Congress did not direct that they make some changes, you would still advocate that we take off the ceiling?

Mr. COLM. Mr. Byrnes, I don't as a witness necessarily have the privilege of saying that that is an "iffy" question. I wish I could.

If Congress says go ahead and says nothing else, I think the psychological impact would be that all interest rates will go up further, and this would have a very bad effect.

I would be hard pressed if you say, "Now, assume nothing else can be done, just give the green light, and go ahead and increase the interest rate on the bonds."

Quite frankly, at this moment I don't want to make up my mind.

Mr. BYRNES. In your opinion, if the Congress does not do anything would the Federal Reserve have been forced to act in some way?

Mr. COLM. Mr. Byrnes, I don't think the Federal Reserve could be forced. There would be an increase in the interest rates on bonds and notes. That to some extent is a self-defeating policy, because the rise in interest on bonds would create a fall in the price of these bonds, which again deters purchasers, and this is the spiral to which I referred, which may then create another need for an increase in interest and then comes a point when the Federal Reserve says, "We have to do something."

I think it is much more desirable if that situation is anticipated so that action be taken before it comes to that situation.

Mr. BYRNES. Thank you.

The CHAIRMAN. Mr. Watts will inquire.

Mr. WATTS. In view of the statements I have heard I would like to ask whether the Federal Reserve Board has, within the framework of its authority, the ability to correct the situation that is before us now, irrespective of whether we take any action or not?

Mr. COLM. The way I interpret the Federal Reserve Act, I think the Federal Reserve has not only the ability, but the duty to act in accordance with the lines proposed here.

What is proposed is more a reaffirmation of Federal Reserve objectives which I think are already in existence.

If you consider both the Federal Reserve Act and also the fact that the Federal Reserve has a responsibility under the Employment Act of 1946, as has been repeatedly acknowledged by the Federal Reserve authorities, it is really not a new function. It is a reaffirmation of existing responsibilities.

Mr. WATTS. Do I understand you to say then that the Federal Reserve does have the authority to correct that situation and it would not be necessary for us to take any action?

Mr. COLM. It is not necessary to create a new law. There are possible improvements in certain provisions concerning reserve requirements, I think it would be very desirable if such improvements would be explored. This may require legislative action at some future time; there are all kinds of structural improvements which would make it easier for the Federal Reserve to live up to its responsibilities.

I may remind you that there is working on these things a monetary commission to make proposals in the long run. These are structural improvements.

The things we are discussing here probably could not wait for such improvements and at the moment the Federal Reserve would have to act with the powers available now, and I think the powers are adequate for dealing with the present situation.

Mr. WATTS. However, you do think it would be better if both Congress and the Federal Reserve moved together?

Mr. COLM. Yes, I think you have a better chance if there is an expression of legislative intent concerning Federal Reserve policy which makes it clear that this removal of the interest rate ceiling is not intended to say: This is all there is to it, go ahead, increase interest rates, and then the problem will be solved.

The CHAIRMAN. Dr. Colm, the Congress need have no timidity about doing so, because actually the law is quite clear, as you point out, that not only does the Federal Reserve have the right, but it has the duty.

Mr. COLM. Under existing law.

The CHAIRMAN. And it is an instrument of the Congress, as all of us know and as agreed to here yesterday by Mr. Martin. Any time the Congress feels that the Federal Reserve is not performing its duty, then the duty is on the Congress to tell it, is it not?

Mr. COLM. Yes, sir.

The CHAIRMAN. Mr. Baker.

Mr. BAKER. Doctor, I compliment you very highly on your testimony. Assume that the Congress does nothing, what could the Federal Reserve do or what action could the Federal Reserve take which would encourage or cause the holders of these \$50 billion worth of series E and H bonds to hang on to them and to continue to buy them?

How would any action by the Federal Reserve encourage present holders of the \$50 billion worth of series E- and H-bonds to hold on to them, not cash them and to continue to buy as we want them to buy without increasing the interest rate.

Mr. COLM. Mr. Baker, I have not mentioned in my testimony the third proposal of the Treasury to increase the interest on the savings bonds.

Mr. BAKER. Which to my mind is highly important from every aspect.

Mr. COLM. Yes.

I don't have a very strong conviction on it. I don't think I have anything to add. That is why I didn't go into it.

I also feel a strong conflict of interest in this because I have quite a number of these bonds and I would be very happy if not only future buyers, but also those that bought them in the past, enjoy the high interest rate. So, since my feeling was that good policy and my personal interest went together, I thought I better be quiet on that point, but I am in favor of the proposal since you asked me.

Mr. BAKER. I assume that practically all of us would be in the class of interested witnesses on that subject, so just disregard that.

Mr. MASON. Will you yield?

Mr. BAKER. Yes.

Mr. MASON. The answer to your question, sir, is that Federal Reserve could do nothing about the E- and H-bonds and it is up to the Congress. If the Congress wants the holders to hold and to buy more to make that increase as proposed in the bill.

Mr. BAKER. Do you agree with Mr. Mason on that?

Mr. COLM. Yes; I do.

Mr. BAKER. That answers my question just as clearly as anything.

The CHAIRMAN. I do not agree to that myself.

You think a little more about that, Dr. Colm, because if the Federal Reserve does what we are talking about, asking it or requiring it to do, then there is the effect upon future purchasers of the E- and H-bonds. There is the effect upon the present owners of those bonds, holding those bonds, to drive in the direction of the adjustment of your interest rate, stabilizing it, or bringing it down.

Mr. COLM. There is an indirect effect.

What I meant when I agreed with Mr. Mason was that the Federal Reserve directly has no influence on the interest rate of these bonds.

The CHAIRMAN. Not directly; no.

However, the actions that you and I are suggesting they should take indirectly make those desirable enough for them to hold them and to buy more.

Mr. COLM. Yes.

Mr. BETTS. Would you state what those actions are?

The CHAIRMAN. All right.

Dr. Colm and I have suggested that they have not permitted enough money in credit to be made available from time to time as the increase in economic activity would justify and they are falling behind following a policy that we would call tight money when it should have been just a little less tight and that maybe \$100 million more money or credit should have been made available at a given time than was made available, or a billion dollars more, whatever the figure is.

That is what we are talking about.

Mr. COLM. Yes, sir.

Mr. BETTS. I cannot quite see how it would help the Government to sell long-term bonds.

The CHAIRMAN. Because the squeeze, at least according to Dr. Colm and me, that is in existence is that the demand through economic growth for dollar claims is not compensated by the availability of dollar credit.

Mr. GREEN. Doctor, do I understand correctly that the reason we have this request before us to lift this ceiling on the 4¼-percent long-term securities is that the Treasury Department, in order to better manage the national debt, would rather see a shift to more money in the long-term securities than in the short-term securities?

Mr. COLM. I think this is one of the main reasons.

As you know, in recent years all efforts toward lengthening the maturity of the debt have been in vain. For instance, in 1951 the average length was 6 years and 7 months and in March 1959, it was 4 years and 9 months.

Mr. GREEN. I understood the Secretary to say that they could better manage the national debt if they could direct more of their securities into long-term instead of short-term.

We know that there is a ceiling of 4¼ percent on long-term securities. I do not know whether the interest paid by the Treasury Department on short-term securities has been brought out here?

Mr. COLM. We have notes for 1½ percent up to 3 percent.

Mr. MASON. They offered here a few weeks ago and could not replace what became due an offering of 4 percent on this short-term.

Mr. COLM. That is right.

The CHAIRMAN. I want to check, but I understand that there are some short-term obligations outstanding today at 4.07 percent, I believe.

Mr. COLM. I would like to answer that more fully for the record.  
(Information referred to follows:)

*Representative yields on U.S. Government securities of short maturity, based on closing bid prices, June 11, 1969*

Maturity date	Type of security	Period remaining to maturity	Yield in percent
September.....	Treasury bill.....	90 days.....	3.28
December.....	do.....	182 days.....	3.49
Apr. 15, 1960.....	do.....	10 months.....	3.92
May 15, 1960.....	3½-percent note.....	11 months.....	3.99
May 15, 1961.....	3¾-percent note.....	1 year, 11 months.....	4.17

Mr. GREEN. Doctor, I just have one or two more questions.

As a result of the question of the chairman and your answer to it which would pretty much determine who gets hurt by the squeeze as a result of the policy of the Federal Reserve Board, and assuming that there is no change in it, who benefits?

Mr. COLM. We have a pretty good profit situation in the banks. This is really a double-edged proposition because on the one hand they charge more, and, on the other hand, they have to pay more on time deposits where they do pay, but since there is no interest on

demand deposits, I think the banks profit from the high interest rate policy.

Mr. GREEN. That has pretty much been the policy of the Federal Reserve Board up to the present time. I have the same fear, that I think that the chairman does. If there is not any change in that policy and we pass this legislation, even with your suggestion that we put into the legislation a strong declaration that it is our hope that the Federal Reserve Board will change its policy, and they do not, then I am impressed with the testimony that I heard here, that we would be worse off instead of being better off.

Mr. COLM. Mr. Green, I am looking for a table.

The Secretary has presented a table as to who gets the interest on the long-term. You get a pretty wide distribution through the pension funds which in turn may be pension funds in favor of insured workers. You find a distribution of interest payments on page 12 of this material put into the record by the Secretary. It is the classification of the receipt of interest on the public debt.

The commercial banks have a substantial amount, but they are not the only ones who profit.

Mr. GREEN. Mr. Watts asked a question and I have one I thought was similar.

If there would be no change, in other words, if we did not take off the ceiling on the  $4\frac{1}{2}$  long-term securities, but the Federal Reserve bank would change the policy they have been following, then would this legislation be necessary?

Mr. COLM. I think the legislation would be desirable, first, because there might develop a situation in which some increase is desirable, in interest on bonds, with no increase or decline in interest on the short-term securities. That means you may have, as a result of this legislation, plus the influence Congress may have through this occasion on the conduct of Federal Reserve policy, a lower interest on the Government debt as a whole. It might be desirable to go above the  $4\frac{1}{4}$  for some new bond issue, but this would be offset by developments of the short-term securities, so that with the hoped-for change in monetary policy, I still would think that this legislation is desirable.

Mr. GREEN. That is where you lose me and that is where it is hard for me to understand.

Both the Secretary and the Chairman of the Federal Reserve Board said they thought that the legislation was desirable and the eventual result would be a decrease in the interest paid on Government securities overall, and it just seems to me sitting here, and I am very frank to say to you that I am pretty well confused about this whole situation, that if we lift the ceiling the interest rate will increase, and I believe both the Secretary and the Chairman of the Federal Reserve System said that we would probably pay another half-billion dollars in interest rate as a result of lifting the ceiling of  $4\frac{1}{4}$  percent.

The CHAIRMAN. No, Mr. Green. Let me correct that impression, if you will yield to me.

This \$500 million additional in interest rate is predicated upon interest increases that have occurred without regard to any action by the Congress in this respect. They estimated that it would cost in fiscal year 1960 \$500 million more for interest than in 1959, when the

President delivered his budget message to Congress, but since then they have revised that estimate.

They now tell us that it will cost a billion dollars, \$500 million more. That is where that comes in, not with respect to this proposition. Whether we do anything or not here, that appears to be the situation.

Mr. GREEN. That is under the present operation as a result of the original estimate being lower than they expected?

The CHAIRMAN. The size of the debt and the increases that have occurred this year in rate of interest since January.

Mr. COLM. Mr. Chairman, if I may answer this question in the following way: Assume that there is a rollover of, let's say, \$100 billion during the next year or so in short-term securities. Assume that there is an increase in the interest rate on short-term securities of, let's say, one-fourth of 1 percent. That gives you \$250 million, if my arithmetic is right.

But now assume that the interest on new issues on Government bonds—what could be issued during the next year and a half is probably a relatively small amount, let's say one or two billion dollars—is increased by a quarter of a percent on some new issue on bonds; that is much cheaper than if you get a quarter of a percent on the whole rollover of the short-term securities.

That is why it is not a necessary conclusion, but it is a possible conclusion, that you may have a small increase on long-term bonds and still a lower total interest burden on the Government debt than you would have otherwise.

Mr. GREEN. Thank you.

The CHAIRMAN. Mr. Alger will inquire, Doctor.

Mr. ALGER. Dr. Colm, you mentioned earlier that there is a difference between economic considerations and political considerations.

Very obviously we are in a very technical economic field and you can see that we are seeking light and trying to get the facts in what would be economic decision.

Would you agree that to whatever degree we would make a political decision in an economic field, particularly if there is a conflict between the political decision and the economic facts, we would be making a mistake?

Mr. COLM. Mr. Alger, my remark was addressed particularly to the question of the debt limit. I said on strictly economic grounds, or even, say, on political science grounds, there is no need for a debt limit because Congress controls appropriations, which determine expenditures, and Congress controls revenue through tax policy, and the result of these is the change in debt. All the facts are under the control of Congress.

I think that the debt limit is in a way a political fact because it serves as a red flag, that there must be a new discussion of the problem, and that is what I referred to.

In general, Mr. Alger, I must say that with the situation in the country and the world today, economic and political considerations are much closer together than they used to be because there is nothing that affects international and domestic politics as much as a well-going economy.

We can make no better contribution to, let's say, the question of the cold war and coexistence than showing that our economy is solving its problems. I am naive in these things but I think that if an administration has a good economic record this should do no harm at the polls. So I would not say as a general proposition that there is a wide discrepancy between the economic and political considerations.

I have tried to cover one particular problem, the debt issue, and I just wanted to say what I had to say, knowing that Congress will not remove the debt limit.

Mr. ALGER. Dr. Colm, I did not intend either to misinterpret what you said nor in any sense unfairly put you in a position that would be at cross purposes politically or economically, so let me make this statement.

Mr. COLM. I am sure you didn't.

Mr. ALGER. I have seen, in my 5 years here, Congressmen make many political decisions. I am convinced some of those were made without regard at the time to the facts involved, particularly in matters of economics, where there is a great need for understanding. This results in part because of the terrific pressure of our job, the rush that we are faced with, and the fact that we are elected politically.

I simply was saying to you, and I will make it as a statement rather than a question, that to whatever degree Congress makes a political decision in an economic field that is contrary or conflicting with the facts, I feel, No. 1, Congress would be making a great mistake, and No. 2, it will hurt our economy.

Finally, I want to commend you for the objective way in which you have presented your economic facts, and I hope that I will benefit from the knowledge you have imparted.

Thank you.

Mr. COLM. Thank you, Mr. Alger.

The CHAIRMAN. Dr. Colm, we do very deeply appreciate your taking time from your busy schedule to come to committee at our invitation and be of the assistance to use that you very evidently have.

You have made it possible for us to see these policy issues in this area more clearly and I am sure you have stimulated us to even deeper thinking.

Thank you so much.

Mr. MASON. I want to join the chairman in that expression. You have done me a lot of good.

Mr. COLM. Thank you.

The CHAIRMAN. Thank you again, Dr. Colm.

Without objection, the committee will adjourn until 10 o'clock Monday morning when it will go into executive session.

(The following material was submitted for the record:)

TACOMA, WASH., June 10, 1959.

WILBUR D. MILLS,  
*Chairman, Ways and Means Committee,*  
*New House Office Building, Washington, D.C.:*

As chairman of the American Bankers Association Savings Bonds Committee, I should like to express to you and your colleagues our approval of the proposals before you for revision of the rates and terms of series E- and H-savings bonds. The savings bonds program urgently requires this revision to place these bonds in a realistic competitive position in this money market. We

have been finding it increasingly difficult to sustain the momentum of the program in recent months. The proposed revisions will put us back in the picture and give us every hope of reaching our \$5 billion goal in sales this year, as well as insure a lower rate of redemptions than has appeared recently.

After some 18 years of voluntary service in this savings bonds program I continue to feel it is the most desirable and healthy process in the management of the debt problem. Forty-two and one-half billion dollars of such savings by millions of people represents about 15 percent of the total debt, and an increase in that outstanding amount would be healthy and noninflationary.

I earnestly urge early approval of the proposals by your committee.  
Respectfully submitted.

RENO ODLIN,  
*Chairman, Savings Bonds Committee,*  
*American Bankers Association.*

WASHINGTON, D.C., June 12, 1959.

HON. WILBUR D. MILLS,  
*Chairman, House Ways and Means Committee, U.S. House of Representatives,*  
*Washington, D.C.*

The American Farm Bureau Federation favors elimination of interest rate ceilings on long-term Government bonds and savings bonds as means of helping to combat inflation. Removal of ceiling will not of itself raise interest rates. Rates have already been raised by market trends which have reduced prices of outstanding bonds. If ceilings are maintained, Government will be forced to engage in increased short-term financing (on which there is no rate ceiling) through commercial banks. This would be highly inflationary. The antidotes to the rising cost of the Government debt are increased savings and debt reduction—not a ceiling on interest rates.

CHARLES B. SHUMAN,  
*President, American Farm Bureau Federation.*

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS,  
*New York, N.Y., June 12, 1959.*

HON. WILBUR D. MILLS,  
*Chairman, House Ways and Means Committee, House of Representatives,*  
*Washington, D.C.*

DEAR CONGRESSMAN MILLS: The Federal debt is so large a part of our entire capital and credit structure that its management influences the course of activity throughout the Nation's financial and industrial markets. Current Federal statutes impose unrealistic restraints on debt management operations, and hinder efforts to maintain fiscal discipline.

Accordingly, legislative action is necessary to enable the Treasury Department to manage the debt more effectively through greater flexibility. The President's proposals with respect to ceilings on interest rates and on debt limits represent such constructive legislation and, thus, have the support of the savings banking industry.

It is a basic tenet of our free enterprise economy that buyers and sellers, borrowers and lenders, compete in open markets for the goods, services, and financial claims, which they offer and seek. In this setting, the Federal Government, in financing its operations, must be free to compete with other types of borrowers for available funds. The only ultimate alternative to permitting the Treasury to compete freely on the basis of interest rates and other terms is to turn to Federal regimentation requiring investors directly to purchase U.S. Government securities.

Recognizing the basic importance of an effective Federal savings bond program, savings bankers have always supported this program even though it competes directly with thrift institutions for the funds of small savers. A higher interest rate on these bonds is important to restore their competitive position in financial markets and their basic role in Federal debt management.

The recommendations in this letter are based on proposals made in December 1958 by Carl G. Freese, chairman of the national association's committee on Government securities and the public debt. These proposals were approved at that time by our board of directors.

I would have no objection to your including this letter in the record of the committee's hearings.

Very truly yours,

JOHN DELAITTRE, *President.*

P.S.—I am enclosing a copy of Mr. Freese's statement, with this letter.

#### FEDERAL DEBT MANAGEMENT AND THE SAVINGS BANKING INDUSTRY

Address of Carl G. Freese, chairman of the Committee on Government Securities and the Public Debt of the National Association of Mutual Savings Banks, and president and treasurer, Connecticut Savings Bank of New Haven, before the 12th Annual Midyear Meeting of the National Association of Mutual Savings Banks, Hotel Commodore, New York City, December 2, 1958

The Federal debt is so large a part of the Nation's entire capital and credit structure that its management has an important influence not only on the state of Federal finances, but also on the course of the national economy. Our Government now owes close to \$280 billion, about one-third of the total indebtedness outstanding in this country. Reflecting recent and expected deficits, moreover, the Treasury requested an increase in its temporary debt ceiling from \$280 to \$288 billion which the Congress recently granted.

All things considered, there is little likelihood in the years ahead of reducing the huge Federal debt; indeed the prospects are for further increases. In addition to problems associated with raising large sums of additional new financing, the Treasury's debt management team must contend with trying problems of refinancing maturing and called issues. In meeting these problems the Treasury has a profound and continuing influence on general financial developments. Indirectly, its debt management policies influence the level and rate of savings; directly they influence conditions in capital markets, including interest rate movements and terms of lending. As savings bankers, therefore, we clearly have a special and continuing interest in Treasury activities. Sound management of savings banks' investment portfolios requires our close interest in, and understanding of, Treasury financing problems and practices.

Recent refundings and new cash offerings have, in the main, not been particularly suited to savings banks. Large Treasury operations scheduled for the early months of 1959, however, may hold greater investment opportunities for our industry.

#### DEBT MANAGEMENT AND INFLATION

It is important to recognize that present burdensome Treasury problems are the result of heavy wartime expenditures together with spending programs recently undertaken. In fiscal 1958, the Federal Government spent close to \$72 billion, nearly \$5 billion more than it took in. In the current fiscal year ending June 30, 1959, it expects to spend \$78 billion, \$12 billion more than anticipated receipts. Clearly, the most direct and effective way of easing debt management problems without inflation is to reduce expenditures and/or increase revenues. The deficit in fiscal 1959 may well be lower than the \$12 billion anticipated because of possible higher revenues resulting from the general improvement in business activity. It is not likely, however, that Federal expenditures will soon be reduced. Yet the volume of Federal spending must be controlled if we are to avert a steady erosion of the purchasing power of the dollar.

Apart from broader economic considerations, the Treasury has a direct interest in combating the forces of inflation. Fundamentally, a sound market for U.S. Government securities depends on allaying the widespread fears of inflation. So long as consumers and investors are motivated in their actions by a belief in the inevitability of inflation, so long will it be difficult to market new Treasury securities successfully.

#### COORDINATION OF TREASURY AND OTHER FEDERAL PROGRAMS AND POLICIES

Clearly, debt management policy is but one of the anti-inflationary weapons available to the Federal Government. Its coordination with Federal Reserve monetary and credit actions is essential and, by now, a well accepted principle. During periods when economic expansion threatens to become excessive, for example, and the monetary authorities are rightfully pursuing a policy of credit restraint, it is important that the Treasury offer securities which do not require Federal Reserve support on more than a temporary basis.

It is not as well accepted, at least in practice, that there are other Federal programs in major credit areas which must also be coordinated with Federal Reserve and Treasury operations if debt management is to be most effective and the battle against inflation won. In particular, Federal programs to insure and guarantee mortgage credit operate in direct competition for investment funds with the Treasury Department. Higher yielding mortgages, backed by the contingent liability of the Federal Government, provide nearly as much safety as do U.S. Government securities. Indeed, their amortizing nature provides for a type of liquidity not inherent in Government bonds. When the Federal Government pursues a policy of stimulating demands for mortgage credit, out of social rather than economic considerations in the housing field, at a time when inflationary forces are rampant, it is assuredly acting at cross-purposes.

It is necessary, therefore, that the huge and expanding Federal mortgage credit programs—some \$48 billion, or 44 percent of all home mortgage debt, is now underwritten by the Federal Government—be subordinated to, and modified from time to time in accordance with the changing need to control inflationary forces. For, after all, if the ability of the Federal Government to stabilize the value of the currency is seriously impaired, the public's confidence in Federal obligations is undermined and Federal credit guarantees become of limited value. The coordination of Federal housing credit policies with fiscal and monetary policies must include not only the Federal Housing and Veterans' Administrations—the Federal underwriting agencies—but also the Federal National Mortgage Association, Federal Home Loan Bank System, and Public Housing Administration. Coordination must extend, also, to the Nation's agricultural credit programs.

#### COMPETITION FOR CAPITAL MARKET FUNDS

It is a basic tenet of our free enterprise economy that buyers and sellers, borrowers and lenders, compete in open markets for the goods, services, and financial claims, which they offer and seek. In this setting, the Federal Government, in financing its operations, must compete with other types of borrowers—both private and public—for the funds available in financial markets. This is as fundamental a principle of sound debt management as the need to combat inflation and to coordinate all Federal fiscal, monetary, and credit policies.

There are no isolated or preferred markets in which the Treasury can operate. Thus, in order to attract funds away from other borrowers, and successfully to finance its debt largely outside the commercial banking system, the Treasury must compete on the basis of interest rates and other terms. There can be no other effective financing method short of Federal regimentation or statutes requiring investors directly to purchase U.S. Government securities, or banks to hold them as part of their legal reserve.

Techniques of moral suasion and appeals to institutional investors to overlook normal market considerations in order to support Treasury financing are not realistic, short of war or grave national emergency. Fiduciaries are themselves in sharp competition for the savings of individuals and have a prime obligation and public trust to depositors, shareholders, and stockholders to earn the highest return possible on invested capital commensurate with safety and liquidity requirements. Long-run considerations of inflation are, of course, essential but the best weapons in this battle are sensible and courageous fiscal and monetary policies of the Federal Government, effectively coordinated with housing and agricultural policies to preserve the purchasing power of the dollar.

To be sure, a debt management policy based on offering securities at competitive rates of interest is not without its problems. The Treasury is, for the most part, in competition with borrowers who are able to deduct interest payments from their tax bill. A corporate borrower, for example, who pays 5 percent interest on debt securities has a net cost, after Federal income tax, of 2.4 percent. The same principle applies to the mortgage borrower. To compete effectively with these borrowers, it may be necessary at some future time for the Treasury to request an increase in the statutory rate of interest which it can pay on Government bonds.

Competing with other capital market borrowers on the basis of interest rate means, also, that the cost of interest payments in the Federal budget will be increased. It means, further, that prices on outstanding issues of Government securities may decline and fluctuate over a wider range than they have in

other earlier years. This phenomenon has characterized the market for Government securities over the past year or so.

Higher interest costs on the Federal debt, while not in themselves desirable, are a necessary price for managing the huge Federal debt so as to contribute to the prevention of inflation and of an unsustainable rate of economic growth. Market instability may likewise be considered a price that must be paid to prevent economic excesses. Bankers and other investors, of course, rest more comfortably when markets are stable and risks are reduced, but this peace of mind is a luxury that must at times be sacrificed in the Nation's battle against its principal internal enemy—inflation.

It must not be overlooked, on the other hand, that a higher level of interest rates—which might result from vigorous Treasury competition—may well stimulate an increased flow of savings, an essential element of an anti-inflationary program. Moreover, deferral of plans for increased investment as interest rates rise, will relieve the pressure on the limited supply of capital funds. In an expanding economy the Treasury can successfully draw funds away from marginal borrowers, in both the corporate and mortgage sectors, only if it is willing to compete on the basis of rates and terms.

#### TREASURY MARKET TECHNIQUES

While a willingness and determination to compete for capital funds in the open market must be the chief factor in a successful debt management program, other factors relating principally to techniques for offering new, and refunding outstanding U.S. Government securities, should also be given careful consideration. Among these techniques, the following might be considered.

The technique of forward commitments, widely used in the marketing of mortgages and in the direct placement of corporate securities, may be adaptable to the marketing of U.S. Government securities. Basic modifications would, of course, be necessary. The extended period of time covered by commitments in the mortgage market, for example, would be inappropriate in the Government securities market. In the corporate securities market, however, the length of time covered by commitments has been generally shorter.

Actually, a commitment technique was used by the Treasury in 1955 in connection with its offering of 3 percent bonds due in 1995. Not many institutional or other types of investors subscribed for this issue on a commitment basis, however. This suggests that the technique may not have been well suited to investors, or that the Treasury did not appropriately publicize it. In any event, the commitment device will have to be studied more carefully and refined before it can again be employed.

One refinement which might be considered is the payment of a modest commitment fee by the Treasury. Such a fee to investors would be an added inducement to enter into contracts and would tend to offset in part the disadvantages of a possible market reduction in the price of forward contracts soon after the closing of books. If the problems associated with the commitment technique can be overcome, there will be distinct advantages both to the Treasury and to investors of permitting payment for Government securities over a limited period of time as funds become available from savings, insurance premiums, etc.

There are other marketing techniques, associated with redemption and conversion privileges, which might be considered. A limited disadvantage of these techniques is that, in most cases, the initiative for debt management is transferred from the Treasury to investors. This course is to be avoided when possible but may be a necessary price, on occasion, in order to attract new groups of investors. Privileges of redemption were granted in connection with the two 4-percent note issues offered in 1957. These notes, it will be recalled, had definite maturities, but holders were given the right to redeem them at par at about the midpoint of their contract maturity.

This redemption device need not be limited to note issues. Further, there might be one or more optional redemption dates. For example, the Treasury might offer a 30-year bond, giving the holder the right of redemption on a fixed date, after appropriate notice, perhaps at the end of 2 years and again after 5 years. The disadvantage of this type of security is, of course, that it is redeemable in cash, a fact which might be inconvenient to the Treasury or blunt monetary policy at redemption dates.

In this respect, the offering of securities with conversion rather than cash-redemption privileges might be preferable. The offering of a long-term bond

which for the first several years of its life would be convertible into any new issue of Treasury securities having a maturity of, say, more than 5 years, might be attractive to investors. Another possibility would be to offer a long-term security bearing a rate of interest in the early years different from that in the later years—higher or lower depending on market conditions—with the option of redemption at the end of the earlier period or retention for the longer period.

An approach of a different sort, directed toward increasing the participation of individuals in the market for Government securities, might operate through tax benefits. Tax exemption per se is not considered to be good public policy, and and rightfully so. This is not to say, however, that there are no tax advantages associated with U.S. Government securities. Certain issues which are available at discounts, for example, may be used in payment of certain tax obligations at face value. All issues selling at discounts, moreover, offer some tax advantage in that the discount may be regarded as a potential capital gain.

In the case of individuals, a tax deduction of \$1,000 is permitted, with carryover privileges of amounts in excess of \$1,000 for losses sustained in U.S. Government and other types of securities. In this connection, the Treasury might wish to consider the advantages of broadening this privilege by permitting individuals to deduct from taxes an additional \$1,000 or more, with similar carryover privileges, for losses sustained in the sale of U.S. Government securities issued after January 1, 1959. To encourage the continuing interest of individuals in the market for Treasury securities, however, it should be provided that additional tax losses be deductible only from current or future interest earned on Treasury securities.

Consideration might also be given to similar limited tax benefits to nonbank corporate holders of U.S. Government securities.

#### DEBT LENGTHENING AND ORDERLY MARKETING

I would like to offer a brief comment about the general Treasury objectives of debt lengthening and orderly marketing. Lengthening the average maturity of the outstanding debt is important to the extent that it makes for a more orderly marketing of obligations and contributes the fight against inflation. There seems to be a tendency at times, however, to overemphasize average maturity statistics without solving the basic problems of Treasury financing. For example, the average outstanding maturity of the debt may be lengthened without materially reducing the problem of refinancing immediately maturing issues.

The Treasury is undoubtedly aware that an orderly scheduling of maturities can be accomplished without necessarily going into the longest maturities. In this respect, issues in the 10- to 15-year maturity range would contribute importantly to bringing about a better spacing of outstanding obligations. As market conditions permit, it would be desirable to have frequent but relatively small amounts of long-term offerings both for cash and refunding.

#### ASPECTS OF ADVANCE REFUNDING

The Canada conversion loan of 1958 has created considerable interest with regard to the feasibility of a similar advance refunding operation in this country. Apart from considerations of the relative success of the Canada conversion loan, there is a serious question about the applicability of this type of large-scale, dramatic refunding operation to the United States. At this time such an action is hardly to be recommended.

While the near-term problem confronting the Treasury concerns the issues maturing in the period 1959-61, it does not appear feasible to undertake an advance refunding of these issues considering their large volume, relatively attractive yields, and current conditions in the capital markets. With respect to the feasibility of an advance refunding of issues scheduled to mature in later years, particularly the more than \$28 billion of 2½ percent wartime issues with final maturities in 1967-72, there would seem to be little practical advantage to the Treasury in such an action. These issues do not now present a problem to the Treasury, nor would their refunding ease the refinancing problems of the 1959-61 maturities. There are enough "inbetween" dates available in the 1967-72 range to accomplish such refinancing in this maturity area, if desired, when the time is appropriate.

Finally, it is open to question whether conversion of the 2½ percent wartime issues into long-term bonds bearing higher interest rates would reduce sales from investment portfolios. At current low prices, holders of the 2½s are reluctant to take the substantial losses attendant upon sale. Conversion to securities with higher yields instead of making for more "permanent holders," might result in increased net selling as losses were reduced or perhaps converted to gains.

For all of these reasons, advance refunding of outstanding securities does not seem appropriate at this time. Because an advance refunding on a relatively small scale offers important advantages with respect to debt lengthening and orderly scheduling of maturities, I do feel, however, that the question should be kept under continuing study in the event that subsequent market changes make it feasible to undertake such an operation.

#### MODIFICATION OF U.S. SAVINGS BOND PROGRAM

Since the end of the war the public appeal of savings bonds has been considerably reduced even though the rate of return on these bonds, when held to maturity, has at times equaled or exceeded that paid by mutual savings banks and commercial banks on savings deposits and by most savings and loan associations on share accounts. The clear indication is that savers prefer the convenience and flexibility of savings and share accounts and the protection of life insurance to ownership of savings bonds. Only in time of war does it seem possible to sell U.S. savings bonds readily and in large volume.

While large-scale expansion of savings bond sales does not appear feasible, nor in fact economically desirable, the general rise in interest rates that has occurred in recent years suggests the need for a revision in savings bond terms.

The 3¼-percent series E bond was first offered to the public in February 1957. Since that time yields on U.S. Government securities have advanced by approximately one-half percent. Rates on newly offered issues of corporate and State and municipal securities have also advanced by about one-half percent or more during the intervening period. The maximum rate on savings bonds is set by Congress and it may be February or March of 1959 before congressional action can be taken on this matter. In order to restore the competitive position of savings bonds, therefore, it would seem reasonable to have the yield on series E bonds raised from 3¼ to 3½ or 3¾ percent. It is also desirable to shift responsibility for establishing the rate from Congress to the Treasury, which would administer the rate in accordance with market needs.

Accompanying this revision in interest rate there should be a revision in terms and prices of savings bonds. Heretofore, advances in rates have been achieved by a shortening of maturities. Thus, when the rate on series E bonds was raised from 3 to 3½ percent in 1957, the maturity was reduced from 9 years and 8 months to 8 years and 11 months. The price at which the bond was offered remained unchanged at 75 percent of ultimate maturity value. In revising the present rate to 3½ or 3¾ percent, a similar device might be employed and an effective rate change achieved by a corresponding reduction in the maturity.

In view of the expense incurred by the U.S. Government in connection with the issuance and turnover of these bonds, however, consideration must be given to maturity extension in order to achieve a reduction in expenses. It is desirable, also, that the cost of the bond be a round fraction of its ultimate maturity. The present and older series E bonds, as you know, were offered at a price of three-fourths of their maturity value. If the cost were to be reduced to five-eighths of maturity value, then the term could be adjusted to provide a 3¾-percent return. For example, a \$100 bond costing \$62.50 would give a return of 3.75 percent compounded semiannually at a maturity of 12 years and 8 months.

A price reduction, as suggested above, would give the Treasury an opportunity to eliminate the \$25 denomination and make the \$50 denomination the smallest issue. This would reduce the administrative costs of the savings bond program considerably. Corresponding modification should be made in the yield, price, and terms of the series H bonds.

## CONCLUSION

The highest order of economic intelligence and political statesmanship must be brought to bear on the complexities of debt management problems. Because of its fundamental influence on the Nation's economic life, debt management policy must have as its primary long-run aim the contribution it can make toward achieving sustained economic growth and relative price stability. No matter the difficulties or the so-called practical problems of Federal finance, all other considerations must be subordinated to these basic objectives, lest the Nation's economic health be undermined.

(Thereupon, at 12:10 p.m., the committee recessed, to reconvene at 10 a.m., Monday, June 15, 1959, in executive session.)

×