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REPORT OF THE COMMITTEE ON GOVERNMENT BORROWING, AMERICAN BANKERS ASSOCIATION, TO THE SECRETARY OF THE TREASURY, THE HONORABLE JOHN W. SNYDER, AT A MEETING HELD IN WASHINGTON, D. C.
APRIL 25-26, 1950

After having the advantage of discussions with the Secretary and the comprehensive review of statistics by the Treasury staff, the Committee is impressed with the way the Treasury has weathered the period of heavy demands upon it and made a satisfactory adjustment to changed monetary conditions and policies. The country has been able to finance the defense program up to this point without deficit financing and without increasing bank holdings of government securities. This is testimony to the general strength of the tax structure and methods of financing. The Committee also benefitted from a conference with Chairman Martin of the Reserve Board.

At this time the phase of the program which gives us concern is the approach of deficit financing by mid-summer if present trends continue. This emphasizes the desirability of prompt passage of a further tax bill and every possible further reduction in nondefense government expenditures. With respect to Treasury financing the problem is to keep the sale of securities to the banks at a minimum. This objective has been in our minds in the following recommendations on specific problems.

1. The Question of Calling the 2% Bonds of September, 1951-53. The Committee recognizes considerations on both sides of this question and there is some difference of opinion in the Committee. The majority, however,

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believe it would be unwise to call these bonds for payment this coming September. The Treasury already faces very heavy maturities of bonds and notes for the balance of the year, totaling over $28 billion, exclusive of callable bonds, at a time when the market is still unsettled from recent changes in monetary policy. If these bonds were called they would have to be refunded, under present conditions, into short term maturities, increasing the congestion of such maturities and accentuating the responsibility for maintaining an orderly market. If they are allowed to run until maturity the rate of 2% for two-year money is just about on the market. Very little saving could be effected by calling. There is also a certain amount of leakage in refunding as some holders require payment in cash. Those who believe the bonds should be called suggest that this action would be psychologically encouraging and a sign of strength on the part of the Treasury and failure to call might be considered as a sign of weakness and might affect prices of later callable issues. The majority of the Committee does not hold this view. The partially tax-exempt 3% bonds of September, 1951-1955 in the amount of $755 million should, of course, be called for redemption as substantial saving in interest can be made.

2. Methods of Obtaining New Money. The statistics presented by the Treasury staff indicate that the principle possible source of new money is corporation cash. This immediately suggests the need for a prompt revision of the terms of tax notes which have not been revised since the change in money conditions. An attractive scale of rates for Series "D" tax notes should attract considerable corporation money and to that extent reduce the amount required from the banks. For the balance of the new money required

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it seems clear that under present conditions short-term securities should be offered and the Committee believes in particular that the amount of Treasury bills outstanding could readily be increased by $1 or $2 billion. Under present conditions bills are particularly attractive.

3. Refunding Maturing Issues. It is too early to make specific suggestions for the refunding of the maturities in June, July and August but under present conditions with an unsettled market it will be necessary to handle this refunding in short-term issues of not over one-year maturity at an attractive rate. It is particularly important that the issue be successful because the Treasury cannot afford to take a chance on partial failure, nor is it desirable that the Federal Reserve be placed in a position where it would have to abandon its freer market policy to support a new issue. By the time it is necessary to announce the refunding the market may be in a position to absorb a longer-term issue, but this is not so at present. June and July maturities should probably be handled at one time.

4. Sales of Savings Bonds. The Committee is greatly concerned about the lag in Savings Bond sales at this time when the Treasury should be increasing its sales to nonbank investors and when personal incomes are huge and expanding. Part of the difficulty lies in broad economic trends, and some of the resistance to Savings Bonds will be lessened when the government's anti-inflationary policy is clearer and more effective. The fact is, however, that the inflationary atmosphere and higher taxes have made Savings Bonds much less attractive to the people in America's great middle class who pay heavy taxes and are sensitive to the increases in the cost of living.

The Committee has discussed with many bankers and others ways in which Savings Bonds could be made attractive. As a result we renew unanimously

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the proposal put forth somewhat tentatively at the last meeting that the small investor in Series E Savings Bonds should be given some tax preference. Our proposal is that the interest on a limited amount of such bonds should be free from tax.

This matter comes to a head now because of the proposal to impose a withholding tax on dividends and interest, including interest on Savings Bonds. If this plan should be adopted and if the Government should actually withhold part of the interest on Savings Bonds on redemption, we believe the effect would be very bad. These bonds were sold on the commitment that the Government would pay $4.00 at maturity for every $3.00 invested in these bonds and any withholding deduction from this figure would be considered by many a violation of contract.

Even if the withholding program is not adopted we most earnestly believe that the small holder of these bonds should be given a preference similar to what he had prior to the Spring of 1941 and that the interest paid in the form of appreciation should be exempt from tax in some limited amount on redemption of the bond.

It is our belief that this arrangement would do more to stimulate the sale of Savings Bonds in the great middle class than anything we can suggest. As far as the principle goes, it would simply be reverting to the arrangement prevailing a decade ago. It now seems clear that the Treasury will not be successful in withdrawing the tax exemption from state and municipal bonds. Under these circumstances it is unnecessary and unwise for the Treasury to abstain from using this privilege as a means for making its own bonds more attractive and stimulating their wider circulation among small holders. With this change, and progress in the anti-inflation program, we believe a reinvigorated Savings Bond campaign could be undertaken.

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5. Changes in Reserve Requirements. The Committee is convinced that any increase in reserve requirements of banks in any form or any legislation giving such authority would be undesirable under present conditions. In the first place it would immediately put additional pressure on the Government security market, for the only way banks could obtain funds to meet new requirements would be by the sale of government securities. Even the anticipation of the change through the passage of legislation would lead to the liquidation of securities at a time when the Treasury will probably have to go to the banks for funds.

Through the change in the Federal Reserve program and through the voluntary credit control program very substantial pressure is now being placed upon bank credit, and loans are being screened with care. If additional pressure is imposed through changes in reserve requirements borrowers who are declined credit will inevitably turn to government agencies which would again become heavy lenders and the budget deficit be increased.

It is the belief of the Committee that the next step in checking inflation is not in placing more pressure on bank credit, but rather is in the area of long-term investment. This area can be reached both through a more discriminating allocation of materials and through the work of the voluntary credit control committees. The present problem is not so much an inventory program as an excessive program for investment by private business, by states, and municipalities piled on top of the defense program.

The Committee again wishes to state its appreciation of the opportunity of conferring with the Secretary in these important matters, and in behalf of the bankers of the country expresses its desire to assist the Secretary of the Treasury in every way it can in the performance of the arduous tasks he faces.

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