Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 4, 1941

To Chairman Eccles

Subject: A call feature for United States savings bonds

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H.E. H.W.

From the standpoint of compensatory fiscal policy, an argument can be made for making the new savings bonds callable by the Treasury at any time after issuance. During the period of heavy national defense expenditures, public investment in savings bonds should be encouraged, but when the defense program tapers off it would probably be desirable for people to cash in their savings bonds and use the proceeds for consumption expenditures. Giving the Treasury authority to redeem savings bonds would be the most effective method by which the savings bond program could accomplish the latter objective. In order not to penalize investors in savings bonds, the Treasury could pay the same annual rate of interest up to the redemption date as had been scheduled if the bonds were held to maturity. For an accumulation bond this would be a price below the final maturity value, and for a coupon bond it would be par.

While it may be argued that all of the funds so paid out would not be spent for consumption purposes, nevertheless the individual investors, when they received their funds, would have to make a choice whether to spend them or to find new investment outlets. Even if the funds were reinvested, this would tend to reduce interest rates, which would presumably be in line with the monetary policy being followed by the Government in the event of a deflationary post-defense period.

Possible objections to the proposal

There are several objections which would probably be raised to making the new savings bonds callable. In the first place, the possibility that the bonds might be called by the Treasury would lessen their attractiveness as a method of building up annuities, which has been a principal selling point for the bonds. Next, this proposal would introduce a new complication that would have to be explained to the public, whereas the Treasury is seeking in every way to simplify the terms of the new types of savings bonds. Another possible objection is that many holders might fail to read or fully appreciate the significance of the redemption notices, with the result that they would hold their bonds until final maturity only to find that interest had ceased some years previous. Finally, there is some doubt as to how large in dollar amount the sales of the new forms of savings bonds will be to the lower income groups. If the relatively large investors purchase most of the savings bonds, the stimulus to consumption would be small if they were redeemed prior to maturity. To the extent that bonds are purchased by the lower income groups, they will be redeemed by the holders if they need money for living expenses in the future regardless of the sacrifice of interest involved in the redemption.

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