Financial Mobilization

In a speech on “Financial Mobilization”, January 18, Secretary of the Treasury Snyder sketched out the main lines of the debt management policies he proposed to follow. The immediate occasion for an official statement on debt policy was the approach to maturity of the non-marketable Series E Savings bonds, sold to individuals to help finance the war. These first went on sale in May 1941 and there will be some falling due every month from May of this year onward. It had been known for some time that the Treasury had been studying possible means to encourage reinvestment by holders of maturing Savings bonds.

The decision announced by the Secretary was to give two alternatives to cash redemption: an exchange for a twelve-year Savings bond of Series G which pays 2½ per cent interest currently; or, with Congressional approval, continued increase in redemption value for holding the Series E bond beyond its ten-year maturity. Under this last option a matured Savings bond purchased at $75 and worth $100 at maturity would increase in redemption value $2.50 a year for seven and a half years and thereafter at a more rapid rate to afford a redemption value of $133.33 ten years after the regular maturity and twenty years after original purchase. The plan has the merit of being simple and automatic. It affords the same 2.9 per cent compound rate of interest for the second ten-year period as for the first. It retains the option the holder has always had of deferring payment of income tax on the interest until the bond is finally redeemed. Once in effect, the automatic extension would apply to all outstanding Series E Savings bonds as they mature and to all new ones that are sold.

In his speech the Secretary stressed the importance of reducing the proportion of Federal securities held by the commercial banks and Federal Reserve Banks. Sale of regularly marketable bonds, principally to savings institutions, life insurance companies, and private pension funds, provide one means to this end. The sale of Savings bonds, now outstanding in the amount of $35 billion for Series E alone and $38 billion for all series combined, provides another. So far as Series E bonds are concerned, the record has not been favorable since the Korean war broke out; more bonds have been turned in for cash redemption than have been sold. This reflects consumer buying in anticipation of price advances and shortages, but it also reflects forebodings of a continuing shrinkage in the buying power of money over the life span of the bonds.

The surest means of stimulating bond sales is to convince the Savings bond investor that an effective anti-inflationary program is under way and that his money is not going to lose a large part of its value over a ten or twenty year period of investment. Shortages of consumers’ goods, when and if they develop, independently may spur sales of Savings bonds as a medium for storing up buying power. Savings bonds sold in World War II helped in this way to build a basis for prosperity after the war and for the amelioration of business slump.

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Marketable Debt

Describing “very much higher taxes” as a necessary measure for avoiding “the evils of deficit-financing”, the Secretary entered highly controversial territory when he expounded his ideas on interest rates to be offered on marketable long-term bonds in refunding and new borrowing programs. Appealing to investors and savers to make a financial sacrifice, the Secretary rejected recommendations he had received to improve the rate offered on future issues of long-term marketable bonds, above the 2½ per cent maximum used in World War II, in order to make such obligations more readily saleable under prevailing market conditions. He described the idea that “fractional changes in interest rates can be effective in fighting inflation” as a “delusion” which “must be dispelled from our minds.”

On the other hand, the Secretary took the position that the 2½ per cent rate on long-term Treasury bonds had become “an integral part of the financial structure of our country.” He expressed fear that “any increase in the 2½ per cent rate would... seriously upset the existing security markets—government, corporate, and municipal”:

In the firm belief, after long consideration, that the 2½ per cent long-term rate is fair and equitable to the investor, and that market stability is essential, the Treasury Department has concluded, after a joint conference with President Truman and Chairman McCabe of the Federal Reserve Board, that the refunding and new money issues will be financed within the pattern of that rate.

When I came to the Treasury in June 1946, the war had been over less than a year, and war financing had only recently been completed. I felt at that time that stability in the Government bond market during the transition period was of vital importance. As the economy became more stabilized, the Treasury used more flexibility in its debt management program by allowing short term rates to increase gradually.

Later, beginning with the crisis in Korea, however, the considerations calling for stability in the Government bond market became tremendously important. The credit of the United States Government has become the keystone upon which rests the economic structure of the world. Stability in our Government securities is essential.

I do not think that we can exaggerate when we emphasize these matters. I think they are basic to our national survival.
February, 1951

A 2 1/4 Per Cent "Pattern"

Mr. Snyder made it quite clear that he regarded 2% per cent as a fixed rate for the indefinite future. His allusion to rate "pattern" naturally calls to mind the fixed rates adopted in 1942 for financing World War II. With this pattern, which ran from % per cent to 2% per cent for various classes of securities, the Treasury was able to sell all the bonds it needed to finance the war and at the lowest rates in history. For this success there were four essential conditions: (1) the existence of a total war requiring enormous borrowings; (2) the carryover of a low rate structure from the depression of the thirties; (3) a drying up of private credit demands resulting from shutdowns of civilian goods production; and, (4) a commitment by the Federal Reserve to feed out more money as needed from time to time to hold down market rates of interest.

The pattern scheme was a successful expedient. Federal Reserve officials, in retrospect, have held that it was in effect too successful, attracting too many sheerly speculative subscriptions, requiring too much Federal Reserve buying, and leaving the country at the end with a dangerously swollen money supply.

Fortunately, the question is not one that has to be settled immediately. The Secretary has indicated that the Government will have no new borrowing to do until the middle of the year, and the next heavy maturities of marketable bonds and notes, to be handled by exchange offer, do not begin until June and July. Neither is there, right now, substantial loose money around in the hands of institutional investors that a 2 1/4 per cent bond issue could effectively tap. The several issues of 2% per cent bonds already outstanding are quoted at moderate premiums above par but only because the Federal Reserve is in the market to take up surplus offerings. In the weeks ahead there is time which ought to be used for full and free public discussion of the vital issues raised by the Secretary.

The Reaction

The government bond market reacted buoyantly to Mr. Snyder's speech, particularly since his reference to Chairman McCabe of the Federal Reserve Board seemed to imply that the Federal Reserve was committed to the support of the 2 1/4 per cent pattern. As it became evident that the Federal Reserve authorities had some reservations, prices promptly dropped back on the minimum price pegs that have been maintained since last November.

Public statements on credit policy, since the Secretary's speech, by members of the Federal Open Market Committee have omitted any endorsement of the Treasury plan. This Committee is the body charged with the responsibility of buying and selling government securities for the account of the Federal Reserve Banks.

Reserve Board Chairman McCabe, who is also Chairman of the Open Market Committee, speaking at Philadelphia on January 26, had no direct comment but listed the discount rate and open market operations among weapons that may have to be used to restrain credit expansion. Allan Sproul, President of the New York Federal Reserve and Vice Chairman of the Open Market Committee, speaking in New York January 22, pointed out the inflationary risks in a "Government security market requiring extended periods of extraordinary support":

I am afraid that the announced debt management policy would lead us directly or indirectly into too much financing by the banks, if we had to do any substantial amount of deficit financing. And even in terms of possible refunding of bank-held debt, by sale of long-term obligations to nonbank investors who temporarily find other outlets for funds lacking, it would have shortcomings. It runs the risk of falling short of attracting willing nonbank investors in the first instance, and of creating reluctant holders of Government securities for the longer run.

We must have learned from our experience during and following the last war, with respect to market bonds, and more recently since the Korean fighting started, with respect to savings bonds, that these are real risks. If these risks were realized, they would mean that too much of our financing would sooner or later be done with bank credit based on the readily available Federal Reserve credit. And when that credit began to express itself in inflationary price advances, we would again find our powers to control the inflationary brew greatly impeded by the needs of a Government security market requiring extended periods of extraordinary support.

Fortunately, we are not faced with the necessity of deficit financing, nor should we be for as far ahead as one can see, if stern tax talk is followed by stern tax action. Despite the inspired comment of some of our market letters, deficit financing in the period we are now entering does not need to be immense; pay-as-you-go is not a pious proposal which ducks the facts; the magnitude of our borrowing needs does not require a market floating buoyantly on the promise of unlimited access to central bank credit.

Marriner Eccles, Governor of the Federal Reserve Board and ex-officio member of the Open Market Committee, testifying before the Congressional Joint Committee on the Economic Report on January 25, stated bluntly that: "Inflation and debasement of the value of the dollar is the price we pay for the luxury of a booming Government securities market":

18
If the Federal Reserve is to be required to maintain a fixed interest rate pattern set by the Treasury, then the system should either be discharged of its responsibility for controlling the volume of credit and money or be given new powers as partial substitutes for those that it is not permitted to use.

In arguing for higher interest rates Governor Eccles asked why "the investor should be the forgotten man":

You don't hesitate to pay labor higher wages. You don't hesitate to pay defense contractors what they demand for their goods, you don't hesitate to pay purity to farmers. Why should investors get no consideration as the value of the dollar goes down?

The Present Pattern

The spectacular controversy between the Treasury and the Federal Reserve last autumn stemmed from the unwillingness of the Federal Reserve to continue to support a 1½ per cent short-term borrowing rate for the Treasury. The long-term 2½ per cent rate was not involved. Since late November the Federal Reserve has been stabilizing an unformalized pattern of rates running in a graduated fashion from 1½ per cent for 91-day paper and 1½ per cent for one-year up to 2½ per cent for the longest-term bonds. When bank reserve requirements were raised recently the Federal Reserve bought up government securities to maintain this pattern intact. Treasury bills were bought on a yield basis of 1.39 per cent; ten months' 1½ per cent notes at a discount below par of about $1.90 per $1,000, equivalent to a yield basis of 1.49 per cent; and Victory Loan 2½ per cents at a premium above par of around $7 per $1,000, equivalent to a yield basis of 2.45 per cent. Secretary Snyder's proposal in effect would place on the Federal Reserve the obligation to keep 2½ per cent bonds continuously and indefinitely above par, and also purchase other government securities on a set scale.

The Decline of Easy Money Abroad

Interestingly, the popularity of bond market management in favor of government treasuries has been waning in many foreign countries. People have waked up to the fact that price-ppegging and very easy money breed inflation and weaken the essential function of saving. The British Government, after driving the market up to permit sale of 2½ per cent long-term bonds in 1946, withdrew support until supply and demand struck a balance at a lower price level. The Swedish Government gave up on a long-maintained fixed price peg for its 3 per cent bonds last summer, and allowed them to decline. The Bank of Canada, just within the last few weeks, has allowed Canadian "Victory Loan" 3 per cents to break par. In Germany rates have been jacked up to help restore the balance of payments.

On January 30 the British Chancellor of the Exchequer, Mr. Hugh Gaitskell, facing a problem similar to that here, announced an offering of 3 per cent Defense bonds to replace a current issue paying 2½ per cent. At the same time an increased rate of return was offered on future issues of ten-year Savings certificates, analogous to our Savings bonds. In making these announcements, Mr. Gaitskell stated:

The rearmament program makes it all the more necessary that there should be the greatest possible volume of savings. This is an essential part of the policy of combating inflation and preventing price increases.

The 1952 Federal Budget

The 1952 federal budget is a staggering document. Calling for expenditures of $71¼ billion in the fiscal year beginning July 1, it will mean, if the President's recommendations are approved by Congress, a spending total exceeded only in the three peak years of World War II—1943-45.

While the President estimated actual expenditures in fiscal '52 at $71¼ billion, he asked Congress for still larger sums in the form of authorizations for entering into new spending commitments during the year. This new obligatory authority, including appropriations and loan and contract authorizations, footed up to $94.4 billion, part of which will be spent in 1952 and the balance in subsequent years. In addition, the President asked for $4.1 billion in appropriations to liquidate prior year contract authorizations. Thus the grand total new spending authority requested comes to $98¾ billion.

As against these vast spending totals, the President estimated 1952 receipts from present tax rates at approximately $55 billion. Large as this is, it still indicates a deficit—compared with actual expenditures—of $16¼ billion. To avert this deficit, the President sees no room for cutting expenditures, but proposes only raising taxes.

Already, as shown in the table following, the presently expected yield of taxes for '52 far exceeds the total of any previous year. Yet the President proposes to pile on another $16½ billion to balance the budget at $71½ billion—and to ask for more money if expenditures go higher. According to figures given in the budget message, the program announced will mean raising the federal tax load to 26 per cent of the national income; and adding in some $16 billion of state and local taxes will bring the ratio to