February 6, 1951

To: Board of Governors

From: Mr. Thomas

Attached hereto is a summary, prepared by Miss Harris of the Business Finance and Capital Markets Section, of a roundtable discussion on debt management problems before the Joint House-Senate Committee on the Economic Report, February 2, 1951.

W. T.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

February 5, 1951

To: Board of Governors

From: Division of Research and Statistics

Subject: Discussion of debt management problems before the Joint House-Senate Committee on the Economic Report, February 2, 1951

The problems of debt management and the role of selective and general credit controls were discussed by a group of six economists before the Joint House-Senate Committee on the Economic Report on February 2, 1951. The need for effective monetary controls, in addition to taxation and direct controls, was emphasized although wide differences of opinion existed with respect to the types of monetary and debt measures best suited to restrain inflationary pressures during the current "emergency" period.

(1) Interest rates and the Federal Reserve System

The role of interest rates was debated at considerable length. Lawrence Seltzer, of Wayne University, stated that moderate changes in interest rates would have little or no effect upon the volume of private borrowing from the banking system. However, rate increases large enough to deter the private demands for credit and at the same time induce the market to retain the securities now held by the banks would, he said, have a severely damaging effect upon the Federal Government bond market.

Wesley Lindow, of the Irving Trust Company, added that a moderate increase in rates on the long-term public issues from, say, 2-1/2 to 3 per cent would probably not increase their net ownership by the public substantially and would therefore be ineffective. Harold Bowen of the University of Illinois also supported this view with respect to the ineffectiveness of interest rates as a medium of restraint.

Walter Spahr, of New York University, on the other hand, insisted that in order to avoid "dictatorship" all interest rates should be determined in a free market. Albert Hart, of Columbia University, and Paul McCracken, of the University of Michigan, also appeared to favor more flexibility in interest rates although their views were somewhat less outspoken than those of Mr. Spahr. Mr. McCracken emphasized the importance of restricting the availability of credit and the fact that rising interest rates would be a result of rather than the objective of such a policy. Senator Douglas in a question to Mr. Lindow brought out this same point. Mr. Hart, too, agreed that the emphasis should be placed upon the availability, rather than upon the cost, of credit.

Mr. Taft asked how far below par the price of Federal bonds might go if the support program of the Reserve System were abandoned altogether in pursuit of a flexible interest rate policy. Mr. Hart,

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

to whom this question was directed specifically, suggested a figure in the low nineties, which seemed "reasonable" to Mr. Taft. However, Mr. Bowen maintained that a price decline even to 92 would be "troublesome."

Mr. Bowen added the point that the professional investors, the savings institutions and trust funds, and not the commercial banks or individuals, have been most "nervous" about the effects of any prospective declines in the price of Federal Government securities and the most eager to sell in order to avoid a book loss.

(2) Debt management requirements

Debt management requirements were also debated. It was agreed that as much of the debt as possible should be placed in the hands of non-bank investors in order, as Professor Paul McCracken of the University of Michigan pointed out, to reduce the private rate of spending and to increase the rate of saving.

Various schemes designed to increase the amount of debt held by the non-banking public were discussed. Among them was Mr. Spahr's suggestion that a large portion of the public debt be funded into permanent long-term debt, or consols, at a rate of interest sufficiently high to attract non-bank investors. Senator O'Mahoney asked whether the other witnesses would support Mr. Spahr's suggestion and, speaking for the group, Mr. McCracken said he would favor the plan if and only if such issues would be acceptable to prospective purchasers.

Mr. Lindow recommended that the Treasury "tailor" the new securities issues to meet the special needs of various non-bank investor groups. He favored the sale of more savings bonds to individuals and of special "deposit type" non-marketable instruments to other non-bank investors. He commended the recent changes proposed by the Treasury for savings bonds and expressed the belief that the rate of interest announced on the extension of maturing savings bonds was satisfactory. Mr. Hart suggested the consideration of new non-marketable securities with more restrictions on redemptions.

So called "escalator" clauses in savings bonds and the "forced savings" schemes were discussed briefly by Mr. Bowen, who regarded them with favor, and by Mr. Hart. Mr. Hart suggested that if an "escalator" clause were adopted, benefits should only be granted if the owners held the savings bonds to maturity. It was stated that these or other debt provisions, designed to increase the sale of non-marketable debt to the public, would permit more freedom in the fluctuation of the marketable rate.

In the cross-examination Mr. Seltzer pointed out that the sale of bonds to "reluctant" purchasers would not reduce the volume of

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

spending but would, instead, reduce savings bank deposits and other types of personal savings which would have been held idle in any event; he grouped together Government securities, deposits, and currency as similar liquid assets. Senator O'Mahoney wanted to know whether or not the witnesses considered that the debt holdings of individuals and institutions had in fact been stable. Mr. Seltzer hedged somewhat but replied that they had probably been "fairly" stable.

(3) The use of selective and general credit controls

Similarly, there was wide disagreement with respect to the role of selective and general credit controls. At one extreme, Mr. Spahr recommended that the Congress establish the "independence" from Treasury domination of the Reserve System, which, he said, should be free to use both selective and general credit controls as it saw fit and that the power to issue "irredeemable" currency be repealed.

At the other extreme was Mr. Bowen's suggestion that qualitative credit controls be broadened to include the virtual rationing of all types of bank credit to the most essential uses. Existing agencies including the FDIC and the Comptroller of the Currency, in addition to the Federal Reserve System, would administer credit allocation under the scheme, which would extend over all banks including banks not in the System as well as to the non-banking financial institutions. Dr. Clark of the Council of Economic Advisors also endorsed this proposal.

Mr. Lindow and Mr. Seltzer, adopting an intermediate position, indicated that they would favor the use of selective credit controls such as Regulations W and X; however, they pointed out that the use of strong general credit control measures at this time would have serious repercussions upon the Government bond market.

(4) Proposals to create new monetary powers

Finally, the witnesses discussed the problem of how best to "insulate" the public debt from the market for private credit. Various proposals to "freeze in" a part of the bank-held debt were discussed, including increased cash reserve requirements and the secondary reserve and the ceiling reserve plans. For the most part there was substantial support for one or more of the plans; Mr. Spahr, the exception, was flatly opposed to all such proposals.

Mr. Bowen and Mr. McCracken warned that certain non-banking institutions, particularly the insurance companies, have periodically unloaded Federal securities on the market, and have thereby created difficult debt management problems. They stressed the fact, therefore, that if this approach were followed it might have to be extended generally and warned of the probable loss of freedom involved.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

(5) The position of the Council of Economic Advisors

Dr. Clark of the Council of Economic Advisors concluded the session with an extended speech in which he criticized severely recent "policy maneuvers" of the Federal Reserve System. He said that it was not clear what the System wanted to do. He quoted a recent statement of the University of Chicago economists to the effect that the recent price rise could have been prevented if the Federal Reserve had stopped buying Government securities. He added that Governor Eccles apparently held the view that prices could be controlled by monetary measures. This, he said, was contrary to the view expressed by the Board in 1939.

The System in recent months has embarked upon the "sophisticated" and in his opinion fallacious theory that bankers will be dissuaded from disposing of Federal Government securities if they are forced to take a capital loss. Dr. Clark maintained that interest rates must be looked upon as a cost of production; they must be kept as low as possible throughout the "emergency" period. "If the extension of bank credit is leading to a situation of dangerous inflation, we must not attack the problem by the use of awkward, indirect, and indiscriminate credit controls. Instead, direct controls must be applied to the volume of credit."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis