TREASURY DEPARTMENT

Washington

The following address by Secretary Snyder before a luncheon meeting of the New York Board of Trade at the Commodore Hotel, New York, N. Y., is scheduled for delivery at 1:30 P.M., EST, Thursday, January 18, 1951, and is for release at 1:00 P. M.

FINANCIAL MOBILIZATION

We are facing critical times. It is especially vital that under the circumstances, we take every opportunity to exchange views on urgent national and international problems. Many of you members of the New York Board of Trade have at various times come down to Washington to give the Treasury Department the benefit of your judgment on measures under consideration in the area of Federal finance. Others of you have participated in such discussions through committee memberships. This exchange of views which we have had with individuals and groups of individuals -- not only in Washington, but on various occasions in almost every part of the country -- has been most valuable to the Treasury in making policy decisions.

More than three-quarters of a century ago, the founders of the New York Board of Trade set down certain important goals of cooperative effort. These were -- among others -- to provide useful information, to encourage needed legislation, to promote civic improvements, and to adjust differences and misunderstandings on an equitable basis.

The guides to action which were set down by your founders are in keeping with the doctrines of our American form of Government and our American system of free enterprise. It is in the spirit embodied in these principles that I should like to discuss with you today some of the issues which are involved in our present national task of mobilization for defense. I am grateful to the Board of Trade for affording me this opportunity to speak openly and frankly about the financial and economic problems that now confront us.

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I need not tell you that the destiny of a nation is not always decided on the battlefield -- nor even in the sometimes equally hazardous and difficult paths of diplomacy. In any national emergency, much depends upon our work in the factories and in the fields -- and the keystone of our production and economic effectiveness is the financial stability of our country.

Today our Nation is in a state of emergency. For the second time within less than a decade, we are being called upon to marshal our great military strength to resist the forces of aggression which seek to destroy us. Very serious days are ahead of us. The varnish of Soviet pretense to peace has worn off. Soviet imperialism is threatening the structure of world security. We have no time for illusions. We must be alert -- we must be fully aware of the peril -- and we must know wherein the hazard lies.

The danger we face is all the more menacing because of the sinister nature of the campaign which the aggressors are waging. This campaign is typical in most respects of all the campaigns of imperialist dictators, but the Soviets have added some stratagems of their own.

The Moscow plan is one of arousing hatreds -- nationality against nationality, class against class, creed against creed -- to bring about mutual destruction of those peoples on whom they cannot count to play the Moscow game. Here in America, the Communist aggressors, through their agents and propagandists, seek to stir up suspicion and strife among us -- and so to create disunity.

It is their theory that if a democracy is subjected to enough of their propaganda of confusion, its people will be unable to act swiftly and confidently if attacked. A first step which we must take in defense against such strategy, obviously, is to see through the smokescreen of propaganda, to expose their lies, and to meet their threats with a solid front of strength which is at once spiritual, economic and military.

Determined efforts and concentrated energy are needed to gain this goal. Yet, at the same time, we must maintain the basic stability and productivity of our domestic economy.

Public policies today, in every area of domestic endeavor -- fiscal and otherwise -- must be so designed as to strengthen the sinews of our productive power. We must plan in such a way as to avoid any measures -- however well adapted they may seem to a specific purpose -- which would undermine the ability of the American economy to meet the tremendous demands which are being made upon it.

The Secretary of the Treasury has far-reaching responsibilities in the formulation of fiscal policy to meet the financing needs of our Government. To fulfill these responsibilities adequately, it is necessary to have the counsel and aid of the most able financial and economic minds of our country. The successful merging of revenue measures and borrowing programs in such a way as to make the most effective contribution to the productive power of the Nation is one of the most difficult and most important problems on the domestic front.

One of the most serious threats to the strength of our defense economy is undoubtedly inflation. And it is a threat which could develop into disaster.

The essence of inflation is the uncontrolled spiraling of prices and wages. There have been manifestations of this economic disease in every period of war or defense effort of this country and of all countries. Our defense program today presents the same hazard.

The effects of pronounced price instability are diffused in many directions. One of the most dangerous results is that mobilization itself is handicapped through both direct and indirect influences. Far-reaching inequities arise from the inflationary process in the uneven distribution of income and profits. The defense burden is inequitably distributed among groups and communities by inflation. We lose productive efficiency. Inflation feeds the very fires of controversy.

To keep inflation in check, then, is the first need in our defense undertaking. As we transfer a great portion of our productive power from civilian to military output, and so reduce the supply of civilian goods, we must put brakes on the purchasing power of consumers. This means that a substantial part of both business and personal incomes must be diverted from the consumer markets. The alternative of allowing prices to move higher and higher would vitally damage the defense effort.

Without question a most effective over-all fiscal measure for avoiding the evils of deficit financing, and thereby combating an inflationary spiral in prices is a revenue system which enables the Government to pay its current bills out of current income. No one welcomes heavy taxes. But in a time of unprecedented national danger like the present, I am certain that all groups of our population will soon realize that very much higher taxes -- for themselves, as well as for others -- are a necessary defense measure.

While adequate revenues are an essential safeguard against the development of inflationary tendencies, they cannot do the job alone. Measures for allocating essential materials have been adopted in order to assure priority for our military needs without increasing the strain on the price structure. Selective credit controls such as those embodied in the Defense Production Act passed by the Congress last July are also of definite help. Other measures of demonstrated effectiveness in curbing inflationary tendencies, such as price and wage controls, are under consideration and will assuredly be adopted soon.

You will note that I have not included the use of fractional increases in interest rates on Government securities as one of the measures of effectively controlling inflation. The Treasury is convinced that there is no tangible evidence that a policy of credit rationing by means of small increases in the interest rates on Government borrowed funds has had a real or genuine effect in cutting down the volume of private borrowing and in retarding inflationary pressures. The delusion that fractional changes in interest rates can be effective in fighting inflation must be dispelled from our minds.

In the absence of new legislation, the Federal deficit will amount to $16.5 billion in the fiscal year 1952.

This deficit is a result largely of our defense requirements. In non-defense spending, as the President has noted, the only major new public works projects included in the Budget are those directly necessary to the defense effort. Construction of many public works projects now under way has been substantially curtailed. Many other activities have been abbreviated.

The revenue requirements which the defense situation demands need no comment. These requirements can be met without damage to the economy if our citizens have mutual willingness to make the necessary sacrifices.

Along with adequate revenues and specific controls required for curbing price and wage rises, there is a weapon of great importance available to us for keeping inflationary forces under control. That is a debt management program which is directed toward placing the largest possible proportion of Federal securities in the hands of nonbank investors -- individuals, insurance companies, mutual savings banks, and other investors outside the banking system -- and reducing the proportion of Federal securities held by commercial banks and Federal Reserve Banks.

This program is a powerful weapon in combating inflation. There seems to be a lack of sufficient public knowledge or understanding of what the Treasury has achieved in this area during the postwar period. It should be pointed out, therefore, that as a result of specific Treasury debt management policies, holdings of Government securities by private non-bank investors have increased substantially since the end of the war, and have reached an all-time peak during the last half of the calendar year 1950. This activity has been accompanied by a decline in the holdings of the commercial banking system, which reached new postwar lows during the last half of 1950. Three years ago the public debt was the same as it is now. But the Government security holdings of the commercial banking system have dropped nearly $10 billion; and approximately $4 billion of this reduction took place during 1950.

The importance of this anti-inflationary accomplishment can not be overestimated. This reduction in the money supply of the country holds particular significance at the present time when it is vitally important to the well-being of the economy that the inflationary potential of commercial bank assets be kept at a minimum.

There are two other important matters relating to debt management policy which hold particular interest at the present time and which have been given extensive consideration in the financial community and elsewhere in recent months. The first is the place of savings bonds in the Government financing picture, and the actions that will be taken to refund maturing "E" bonds. The second is the rate of interest that the Treasury is going to pay on long-term Government bonds in refunding and new borrowing programs. I want to take up each of these two questions in turn.

A moment ago, I stated that an important anti-inflationary action could be accomplished by placing the largest possible proportion of Federal securities in the hands of non-bank investors. As part of the Treasury Department's endeavor toward this end, the Savings Bond Program has been of outstanding value. It has been both dramatic and effective. It has been dramatic because it is sustained on practically a volunteer service basis. It has been effective because today, the total of outstanding Savings Bonds represents approximately 25 percent of the entire Federal debt.

It is really inspiring to know that there are about $10 billion more Savings Bonds outstanding today than there were at the end of World War II financing. The tremendous selling program involved in achieving this remarkable record is due in the main part to the volunteer efforts of individuals, business groups and all organizations who have contributed time, money, and ingenuity to the promotion and sales of Savings Bonds.

There are only about five hundred paid employees in the Savings Bond Division of the Treasury. These employees plan and coordinate the program. The real volume of the work, however, is done through the generous efforts of those volunteers who have sold Savings Bonds to over eighty-five million purchasers.

Of the $58 billion total of outstanding Savings Bonds, nearly $35 billion is in "E" Bonds. This is a noteworthy accomplishment -- for no one would have been rash enough to predict at the end of World War II hostilities that five years later there would be a $4 billion increase in the total of outstanding "E" Bonds. Most of us were sure in 1945 that there would be a heavy cashing of Savings Bonds as soon as war scarcities and restrictions were over. On the contrary, however, the "E" Bond total has gone up every year because of the organized promotion by volunteers in bringing the merits of the Savings Bond investment to the attention of the public. As a matter of fact, in the calendar year just ended, the volume of "E" Bonds outstanding rose by three-quarters of a billion dollars, notwithstanding the fact that there were increases in redemptions as a result of the scare buying immediately following the outbreak of the Korean crisis. It is interesting to observe in this connection that the redemption of "E" Bonds -- in relation to the amount outstanding -- was less percentagewise than other comparable forms of savings. So it becomes readily apparent that the Savings Bond is, in fact, a very popular form of savings.

It was this last fact that led to the conclusion on our part, after consulting with many individuals and business groups, that the Treasury should continue the Savings Bond Program after World War II as a major effort to encourage the promotion of thrift. It is this same conclusion that leads us to announce that the Treasury will continue to offer the "E" Bond, in its present form, to the public as a Defense Bond during the mobilization period. The aim now is not only to promote thrift, but to act as an anti-inflationary force and to help further distribution of the ownership of the public debt.

As you know, beginning in May of this year, a portion of the Savings Bonds bought during the war years will mature. While some of the holders of these bonds may desire to cash them upon maturity, it is our belief that the majority will desire to continue their investment in United States Savings Bonds. Therefore, the Treasury is adopting the following plan for handling the maturing bonds. The holder may have his choice of: one, accepting cash if he so desires; two, continuing to hold the present bond with an automatic interest-bearing extension; and three, exchange his bond for a current income savings bond of Series G.

Under Option 2, the bond would be automatically extended, bearing interest at the rate of 2-1/2 percent for the first seven and one half years and interest at a rate sufficient thereafter so that the aggregate return for the 10-year extension period will be 2.9 percent compounded. The term of the extension would be limited to 10 years after maturity. The existing option of paying taxes on interest on Series E bonds currently or at maturity would be retained. Necessary Congressional legislation to authorize this option will be requested immediately. Once the plan is placed in effect, it will apply to all outstanding E bonds as they mature, and will apply by right of contract to all new Series E savings bonds that are issued.

These decisions with respect to the refunding of savings bonds and their future place in the Federal securities structure have been reached after long deliberation and extensive consultation. Among those who have given us the benefit of their thought and judgment are representatives of the Federal Reserve System, which has done such a magnificent job in facilitating the smooth functioning of the savings bond mechanism throughout the Program's entire history.

Almost a year ago, at the annual Fiscal Agency Conference held in San Francisco, various alternatives with respect to the refunding of savings bonds were fully discussed by representatives of the Federal Reserve System and the Treasury. Following that conference, other groups and individuals continued to meet with officials of the Treasury and to give time and thought to the refunding measures which would be in the best interests of both the Government and the bondholders. The program which I have outlined to you today is the result of this cooperative effort. As soon as the necessary Congressional legislation is completed, full details of the extension Savings Bonds Program will be released to the public. I believe that we have adopted a good program.

Now let us go on to the subject of interest rates. It is my view that a 2-1/2 percent rate of interest on long-term Treasury bonds is a fair and equitable rate -- to our Government which is borrowing the money, to the purchaser of Government bonds who is lending the money, and to the taxpayer who has to pay the interest on the money borrowed.

The 2-1/2 percent rate of interest on long-term Government securities is an integral part of the financial structure of our country. During the past ten years -- a period in which we fought our most costly war and made a most extensive reconversion to peacetime activities -- the 2-1/2 percent rate has become a most important influencing factor in financial policy in the country. It dominates the bond markets -- Government, corporate, and municipal. Moreover, it dominates the operations of financial institutions. Most of these have already adjusted themselves to the 2-1/2 percent rate -- and after so doing, have become more prosperous than ever before.

Most life insurance companies, for example, have changed the guaranteed interest provisions of their new policies during the past decade to conform with the 2-1/2 percent rate, so that today about 85 percent of the new life insurance premiums received by insurance companies are on policies written at interest rates of 2-1/2 percent or less. Mutual savings banks also have tied their current interest rate on funds of depositors to the Government rate.

Any increase in the 2-1/2 percent rate would, I am firmly convinced, seriously upset the existing security markets -- Government, corporate, and municipal.

We cannot allow this to happen in a time of impending crisis, with the heavy mobilization program to finance. We cannot afford the questionable luxury of tinkering with a market as delicately balanced as the Government security market. Now is no time for experimentation.

We have not hesitated to draft our youths for service on the battlefront, regardless of the personal sacrifice that might be entailed. Neither can we hesitate to marshal the financial resources of this country to the support of the mobilization program on a basis that might, in some instances, require a degree of profit sacrifices.

In the firm belief, after long consideration, that the 2-1/2 percent 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.

I have outlined for you the highlights of our financial mobilization program. I believe that with vigorous, cooperative effort, we can make it a successful one.

The democratic processes and the free institutions of our country enable us to do just that. We are a Nation of strong individuals, united in our belief in American principles and in our determination to defend them. We do not expect - and we do not wait to be told what to think and what to do. We will not govern our actions according to decrees which represent thinking done for us by someone else. Every American citizen today is searching his mind and heart for answers to the challenge of aggression. We do this because we know that in a free Nation such as ours, decisions on matters of national import must be made by the citizens themselves.

The formulation of a successful policy of financial mobilization is not easy. It must, of necessity, be one that will require sacrifices from every one of us. Let me make on thing clear. Even a short period of weakness in the financial stability of the United States could mean a generation of disaster to us and to the world.

The Communist regime knows this -- and ever since the close of the Second World War, it has sought to undermine the structure of peace and stability we have tried so patiently, and with so marked a degree of success, to help build in the free world. Red Imperialism has taken the offensive against the free world in almost every area of human cooperation where civilization might again be made secure. It has coupled with a bellicose avowal of peace the most flagrant and most insidious forms of human sabotage.

Let there be no mistake about it. We want real peace in this world. To seek this, we set up a forum in which men might work out their differences and arrange for solutions of common problems. We tried very earnestly to win an honorable peace across the council table. But the Russians have tried to make a mockery of the vital work and procedure of the United Nations. While we have tried to restore economic and financial stability to nations suffering from the ravages of war, the Soviet Union has sought to dissipate the effects of our unprecedented and successful aid to free nations and are now trying to destroy the fruits of our aid with the blight of urgent and costly need for self-defense.

As the economic and financial stability of our friends and allies in Western Europe became more certain -- Soviet Imperialism became bolder and laid down a barrage of direct and indirect assaults on the free world.

It is but a natural reaction to hope, in an emergency, that we can preserve our freedom, and save ourselves from danger, without sacrifice. Any such hope runs counter to all of human experience. Readiness to sacrifice for freedom is the first requisite of life in a free land.

I have every confidence that whatever sacrifices are required of our people to repel the aggressors will be willingly, earnestly, and confidently made.

What we face is obvious. What we must do is plain.

We shall diligently continue our efforts with free nations to help establish peace and prosperity in the world. But in the meantime, we shall face realities -- face them in the knowledge that our pride in America's past and present, and our confidence in her future, permit no passive acceptance of the dictates of a foreign aggressor.

We are going ahead with our military and our financial mobilization measures to whatever extent the unfolding disclosures of Communist intentions make necessary. In justice to ourselves and to all other believers in freedom, we can follow no other course.

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