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ARTHUR R. UPGREN
ASSOCIATE EDITORIAL EDITOR
MINNEAPOLIS STAR-JOURNAL

November 4, 1947

Mr. Marriner Eccles, Chairman
Board of Governors
Federal Reserve System
Washington, D. C.

Dear Mr. Eccles:

I have wanted to write to the Board for some time to urge that some very broad-gauged research be started into the question of the interest rate and of the reasons that support an increase in the interest rate to offset the many past arguments on the side of "low" or "maintained" interest rates at low levels that had their origin in the greatly depressed conditions in the United States in the '30s.

I shall proceed to state my position bluntly, and I would be grateful for any adverse criticism of it. If there is merit in the proposals, I only hope that the Board itself, responsible for "business, industrial and agricultural" conditions, will undertake the research.

Under present conditions, I should think it should be one of the Board's foremost duties in the smoothest possible way "to engineer" a rise in interest rates. The following arguments I list in very brief detail to support that position:

(1) The government has a surplus, and a distribution of a part of that surplus via higher interest payments treats a group, interest receivers, more equitably than any other group can be treated. The merits of holders of government bonds as a general class for a rise in their rate exceeds that of taxpayers for a reduction in their taxes, or for any other group to become the beneficiaries of increased government expenditures.

(2) During the war, ownership of government securities was highly "compartmentalized" so that wholly free from shock of higher interest rates would be all the holders of short-term securities and all savings bonds, and any other non-marketable issues which have specific, fixed redemption values. Therefore, that price of <u>compartmentalization</u> was paid as the very price necessary to preserve freedom with respect to the interest rate. But now the regulatory authorities deny that they have the freedom.

(3) In your own speech published in the October <u>Reserve Bulletin</u>, you refer to the increased "cost of carrying the public debt" and you say that bank selling of government securities would also "seriously endanger our entire financial structure, in which governments now occupy such an important place."

I would suggest that bank stocks themselves, for example, would rise, not fall, with a rise in interest rates. I make this suggestion because, as you once pointed out at a meeting of the Open Market Committee, the balance is struck in favor of a bank when on the one hand you add up the

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paper loss on all longer-term government securities owned by the banks that declined with a rise in interest rates against, on the other hand, all the increased revenue earned on short terms, which as soon -- and that is quickly -- as they mature are renewed as contracts at the much higher rate of interest.

Now a rise in the interest rate will occur only if there are boom times such as the present. In such times any short-run paper loss can, so to speak, "be washed out" without difficulty. Once washed out, there is not the damage to the bond markets that has been inferred. There is, to be sure, damage only while the change is occurring.

(4) The rise in cost to the government would be moderate rather than large as the rate was higher on all short terms, and then the annual cost would increase slowly as successive issues fell due and were renewed -- that is, refunded, at the new higher rates of interest.

(5) There is no possibility of using lowered interest rates to stimulate activity at a later date if they are in these days held down when all the arguments given in the '30s would call for an increase in the interest rate.

The only possible objection I can see to this point is the shock of the change in values that would come about as a consequence of the rise in interest rates. After the rise was completed, the shock would be ended.

But let us consider where the shock might fall. First the government: it certainly can afford to pay the higher rates; second, home ownership: they can certainly afford to pay the higher rates; third, corporations: they, too, can afford to pay the higher rates; and fourth, banks: the loss on government securities to banks would occur in a period of lively activity when banks can stand the strain. If a period of great ease and softness develops, I would then, of course, expect the rate to decline. Or should it develop soon, there would be no need for increasing the rate.

In the case of owners of insurance policies, there certainly would be a benefit that would much more than offset any paper depreciation. I believe these corporations own the largest share of government bonds. Twenty-two years ago, as a beginning graduate student at the University of Minnesota, I bought a $5,000 policy. I was told if I paid without taking out dividends, it would be "paid up" in 22 years, and if I did continue paying, it would "endow" in 28 years. I have now paid 22 years and, mostly by virtue of low interest rates, I am "sentenced" so to speak, for 21 more years. With higher interest rates, gradually the earnings of my insurance company might serve to commute that sentence.

Next, I happen to be a Director of Minnesota Valley Canning Co. Last year in our annual report, the President, in a very matter of fact way, pointed out that after operating expenses, the largest charge was the deduction for employees' retirement reserve. That reserve was in large part required because interest rates fell to such a low level there was not much opportunity to accumulate a competence large enough at low rates to assure retirement.

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As a result, there has been heavy pressure to increase all retirement gains that have merely put into the "fixed charges" section of corporation statements a fresh item that takes the place of the reduction in fixed charges due to lowered interest rates. (When I was with the System, I was always distressed at hearing of fresh appropriations into the retirement reserve fund due to lowered interest rates which were largely brought about by the group which benefited from such increased reserve fund appropriations.)

In other words, industry by no means escaped a burden of fixed charges; they merely re-appeared in a new form as rigidly as ever. (This is a matter not for my positive statement, but for broad research.)

(6) But I suspect most important of all is the fact that the lowered interest rate as of the past 15 years has produced a lowering in interest cost which was in effect seized upon as the source of ability to pay higher wage costs. If that is the case, very little indeed has been gained.

My illustration here would be that though much allowance should be made for changed income levels, as interest rates went down it was quite possible for wage rates to rise. I do not believe, though this is a question for research, that those wage rates required such increases.

In other words, the decline in interest rates subsidized, in the field of construction where interest rates are most important, a particular class in the community.

(7) Finally, the failure to raise interest rates weakens the ability to restrict credit in face of the very violent capital goods boom we are having at the present time. As you know, private capital formation in the second quarter of 1945 was about $14 billion, and at the present time is running about $54 billion. That is a boom of immense proportions. Further, the October "Survey of Current Business" reveals that where business a year ago contemplated plant and equipment expenditures of $11 billion, they now contemplated such expenditures for the coming year in the amount of $15 billion. That intensifies the boom and will lead for a bidding for funds on corporate issues.

Would it not be wise, therefore, to anticipate a possibly inevitable rise in the interest rates by a straight policy of engineering it with Treasury assent and with the maximum amount of protection that can be got from the risk you have stated about "when banks sell their government securities, in the absence of any other buyer, the Federal Reserve is obliged to purchase them"?

I should think that "price freedom" here would do what it has done in other fields since the war ended -- brought about a flow of resources that is rather freely determined. I should also think the low prices on governments which will not be damaging over a wide field if the ground were prepared for it, would easily induce new buyers; in fact, about the only thing that would not induce them is to hold artificial rates.

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I am certainly troubled at sending you so long a letter. But as a teacher at the University of Minnesota and a writer on topics of this kind, I am troubled about the rigidity that our monetary policy, particularly in the field of interest rates, is taking at a time of such great buoyancy that could easily float away from these rigidities.

I should therefore be grateful for any comment you or Dr. Woodlief Thomas might make on the points in this letter. I appreciate most of all adverse criticism in order to distill out any part of the argument which possesses validity. But particularly as a teacher of money and banking and a writer in the field, I wish the whole subject could be one of greater research so that we may come upon the desirable type of monetary policy.

I should make it clear that what use of any comment you may make in the classroom is, as I think the lawyers put it, of a privileged character, and any use I would make in publication would be wholly on my own responsibility with, I hope, discretion even to the attempt to which I may assume my responsibility for it.

I mention this because sometimes people in public life are a little concerned that newspaper writers may not be as cautious in these matters as they would like to have them be. Nevertheless, I still end with an uneasy feeling that the present policy is not the most desirable, and even if it is considered desirable, has not been supported with adequate research.

With very best personal regards.

Sincerely yours,

Arthur R. Upgren

cbv
cc: Dr. Woodlief Thomas

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December 3, 1947.

Mr. Arthur R. Upgren,
Associate Editorial Editor,
Minneapolis Star-Journal,
Minneapolis, Minnesota.

Dear Mr. Upgren:

This is to thank you for your letter of November 4 which I was interested to read because, as you know, I have a high regard for your comprehension of and approach to economic problems.

It seems to me that the best answer I can make is to give you the enclosed copy of the statement I presented last week before the Joint Committee on the Economic Report. You might also be interested in the revision of a separate statement which I also put in the record with regard to inflation in the housing field, and accordingly I enclose a copy.

I am always glad to hear from you and have your frank opinions. Let me reciprocate most heartily your kind personal regards.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosure 2

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