William McChesney Martin, Jr., Papers

Box 24/Folder 5

Series V, Subseries C

Misc. notes, correspondence, 1957-59

Miscellaneous

There may be those who would say that the action of this Committee has the effect of condoning or predicting a rising pattern of interest rates. This is not the case.

The Committee recognizes the importance of maintaining reasonable stability in the purchasing power of our money in order to protect the increasing number of our citizens who are dependent upon some form of savings, such as those represented by social security, retirement plans, insurance annuities, and the like. We must insure compliance with the Employment Act and maintain the continuity of employment. We must provide an economic climate in which we can achieve maximum sustainable growth. We must insure a continuation of sufficient volume of savings to meet as nearly as possible our investment requirements. We must maintain the confidence here and abroad in our currency.

The Committee recognizes the necessity of keeping our debt service charges to a minimum consistent with the foregoing objectives so as not to unduly increase the burden of taxation.

The Committee recognizes that a continuing rise in the level of interest rates is not within itself a cure for inflationary pressures and that in a complex economic society many factors must be weighed at the same time.

The public credit of the United States is clearly involved in the refusal of the Ways and Means Committee to grant the Treasury the tools necessary to effective, balanced management of its public debt. The basis of money is trust and confidence. Without it no amount of reserves are sufficient to maintain the purchasing power of a currency. This is a problem that must be faced in its entirety and cannot be handled piecemeal.

The suggestion that the present request of the Treasury be divided into two parts and permission be granted to increase the rates on savings bonds while long-term issues cannot exceed 4-1/4 per cent regardless of the market requirements can only operate to impair the market and endanger our credit. Accordingly, it would seem a lesser evil to me to drop the entire matter and continue to limp along as we are going.

It is just as important to remove the interest ceiling on long-term marketable Treasury obligations as it is on the savings bonds. It would be unwise with a debt as large as the public debt of the United States to finance too large a part of it through issue of savings bonds which are demand obligations. A proper distribution of the public debt requires that a larger proportion than at present be in long-term marketable bonds and certainly very little, if any, larger proportion than at present be in savings bonds.

Important as United States Savings Bonds are to the welfare of our economy, they represent demand obligations. To make a more reasonable rate to holders of these securities, who by and large have already been discriminated against, without taking proper steps to protect the public credit and evidence a determination to maintain the value of the currency, would be a fictitious and impractical means of dealing with the fundamental problem.

1- Basic position.

Quid pro quo: In exchange for eliminating or raising ceiling on interest rate payable on Government obligations, commitment (public) by Treasury and Federal Reserve System that (1) Congress not responsible for any rise in interest rates which may occur, and (2) Fed will contribute to maintaining an orderly, stable market for Government obligations and this can be done without an excessive or inflationary expansion of credit.

2. In support of the "quo":

a. Basic conditions in money markets will determine course of interest rate structure, not specific actions by the Congress.

(1) Supply of loanable funds depend on volume of savings and Fed policies regarding availability of credit;

(2) Demand for loanable funds consists of many demands other than those of Federal Government.

b. Evaluating these basic conditions in the money market:

Ask ~~Cost~~ Treasury to provide detailed estimates of receipts for fiscal years 1959 and 1960 in support of this contention

(1) Federal receipts are rising rapidly relative to expenditures so that deficit is shrinking at rapid rate - from $13 billion in fiscal 1959 to $-3 to $+3 billion in fiscal 1960. Hence, Federal fiscal developments will contribute during the coming year to non-inflationary conditions in money markets. Therefore, as budget situation moves toward balance or surplus, it is possible to expand credit supply in support of Gov't. debt management without inflationary expansion of total demand which would occur if Federal Government were to continue to run a $13 billion deficit in fiscal 1960.

(2) Volume of private savings likely to increase significantly during the year.

(a) Personal savings are running at a high level and presumably will expand rapidly with the increase in personal income;

(b) Corporate savings will rise reflecting very sizeable increase in profits and increase in depreciation reserves.

(3) Volume of demand for credit now reflects special situations

(a) Inventory accumulations, which presumably will ~~drop~~ top off in near future;

(b) Rise in demand for mortgage funds which presumably will slow appreciably for remainder of period;

~~Get~~ Ask from Treasury and Fed estimates of new money demands of Treasury in fiscal 1960

(c) Requirements for financing $13 billion Federal deficit, which now are rapidly shrinking as we move toward balance or surplus in fiscal 1960.

(4) Prospectively, demand for loanable funds in latter half of fiscal 1960 and in fiscal 1961 will reflect increase in plant and equipment expenditures. Does either Treasury or Federal Reserve wish to predict now that when and if this investment demand materializes, the volume of savings will be adequate for non-inflationary financing of these expenditures only if the Fed now pursues restrictive policies?

c. On the whole, is there any good reason why the Fed and Treasury cannot now reverse their advice to the public, particularly investors, and assert that the outlook on the whole is for a relatively stable price picture instead of continuing inflationary pressures? Such advice is necessary if the adverse expectations of investors - that inflation will continue - are to be replaced by expectations favorable to the Gov't bond market. Present adverse expectations are largely result of frequent pronouncements by the Administration and the Fed that prospects are for continuing decline in value of dollar. <u>Administration and Fed should now assert that prospects are for stability of the dollar and because these are the prospects, it is now safe to remove interest rate ceiling</u>.

3. Treasury has publicly stated (p.   of transcript of Anderson's testimony) that choice between long-term and short-term issues for refunding will be mindful of demands of other investors. <u>Treasury should reaffirm in public pronouncements that it will avoid use of long-terms when there is any likelihood that this would drive up long-term rates above present level</u>.

<u>In other words, Treasury, with Fed cooperation, will provide commitment to manage refundings and other debt operations so as to avoid driving rates up and are confident this can be done in the year ahead without inflationary consequences.</u>

Keogh

7 /59

Rejected

(1)

Page 2, line 20, strike out the quotation marks, and after line 20 insert the following:

"(3) Nothing in this Act shall permit--

"(A) the issuance under this section of any savings bonds or savings certificates,

"(B) the extension under paragraph (2)(A)--

"(i) for a period beyond maturity, or

"(ii) for any further period, or

"(C) the increasing under paragraph (2)(B) of rates on outstanding bonds,

under an offering made after the date of the enactment of this paragraph which (at the time of such proposed issuance, extension, or increase) would afford an investment yield for the period from the issue date to maturity, or for the applicable extension period, as the case may be, of more than 1/2 of 1 percent per annum higher than the rate of interest prescribed by the Board of Governors of the Federal Reserve System as the maximum rate payable by member banks of the Federal Reserve System on time and savings deposits."

(2) put ceiling on E & H at 3 3/4 % - rejected

9/k
11 1-5
3.9
400

4.0 5.10
1 billion over 10 years

Sec. ____. The Second Liberty Bond Act, as amended, is amended by adding a new section 25 to read as follows:

"Sec. 25. With respect to any bonds issued under this Act, the present maximum limits on the interest rate or the investment yield may be exceeded upon a ~~finding~~ formal finding by the President with respect to such bonds that the public interest will be served thereby.

18
41%
25
1.6 110

-230,000-

FEDERAL RESERVE OPERATIONS TO SUPPLY BANK RESERVES---1952-1959

In the past seven years reserves needed for credit and monetary expansion have been obtained by member banks in a variety of ways. The major operations may be summarized as follows:

1. Reduction in reserve requirements by the Federal Reserve

1953	July	$1.2 billion
1954	June-July	1.6 billion
1958	February-April	1.5 billion
	Total	$4.3 billion

These actions, which supplied reserves to all member banks, were all taken in periods of declining economic activity when it was desirable to discourage credit liquidation and encourage expansion.

2. Changes in Federal Reserve holdings of U. S. Government securities (other than those largely for seasonal purposes):

(a) May 1952 to February 1953 +$1.6 billion

To cover a gold outflow and an increase in the money supply.

(b) April to July 1953 +$1.1 billion

To relieve pressures on bank credit and the Government securities market.

(c) From mid-1954 to mid-1957 -$1.0 billion

Reserves adequate to cover further monetary expansion were obtained from a reduction in reserve requirements in 1954 and subsequently from a gold inflow and through member bank borrowing.

(d) October 1957 to August 1958 +$2.1 billion

Together with reserve requirement reductions, provided reserves to enable member banks to reduce borrowings at the Reserve Banks, to stimulate monetary expansion for economic recovery, to offset a gold outflow, and in July 1958 to ease a crisis in the Government securities market. For the last purpose, these purchases include $1.3 billion purchases of securities other than Treasury bills.

(e) March 1959 to July 1959 +$1.0 billion

Together with an increase in member bank borrowings, provided reserves for monetary expansion and to meet a gold drain.

3. Changes in member bank borrowings.

Borrowings declined in periods of economic recession when reserves were freely supplied by other means, as from May 1953 to January 1954 and from October 1957 to February 1958, and remained low until after recovery began.

They increased in periods of vigorous credit demands, when open market operations were restrained, as during 1952-53, in 1955, and from September 1958 to mid-1959, and they continued generally at a relatively high level from late 1955 to October 1957. In 1952-53, borrowings at times exceeded $1.5 billion, and in most other periods of large borrowings they generally fluctuated around $1.0 billion or less.

4. The net result of all these operations may be summarized as follows: (May 1952 - July 1959)

Reserves supplied by	(Billions of dollars)
Increase in Federal Reserve holdings of U.S. Government securities	4.2
Member bank borrowings at the Reserve Banks	.4
Reduction in member bank excess reserves	.2
Reduction in reserve requirements	4.3
Total	9.1
Reserves used by	
Increase in required reserves resulting from deposit expansion	3.3
Increase in currency in circulation (Less Treasury currency issued)	3.1
Reduction in monetary gold stock (adjusted for other related factors)	2.5
Other factors - net	.2
Total	9.1

July 23, 1959.

Summary Statement of
Objections to the Reuss Amendment
to the Public Debt Bill

Proposed amendment: Add a new section 8, as follows:

> "Sec. 8. It is the sense of Congress that the Federal Reserve System, while pursuing its primary mission of administering a sound monetary policy, should, to the maximum extent consistent therewith, utilize such means as will assist in the economical and efficient management of the public debt; that the System, to the greatest extent possible, should bring about needed future monetary expansion by purchasing U. S. securities, of varying maturities, rather than by further lowering bank reserve requirements; and that the System should promptly and fully explore methods whereby use of the power to raise reserve requirements may become a more useable and effective anti-inflationary tool."

1. The amendment is unnecessary, since the Federal Reserve in its conduct of monetary policy now endeavors to "assist in the economical and efficient management of the public debt" to the extent consistent with a sound monetary policy.

2. The provisions relating to the lowering of reserve requirements would seem to conflict with existing law and with new legislation (S. 1160), already passed by the Senate and voted out for consideration by the House, that provide for flexibility in the power of the Board of Governors to raise or lower reserve requirements. Provisions of S. 1160 might necessitate some lowering of reserve requirements.

    (a) Lowering of reserve requirements in modest amounts may be needed at times in the future to make available reserves to cover the long-term growth needs for bank credit and money or the effect of a gold outflow in reducing the reserve base.

(b) To supply additional needed reserves entirely through Federal Reserve purchase of U. S. securities with no lowering of reserve requirements would in no way increase the holdings of Government securities by the banking system as a whole (member bank and Federal Reserve Banks combined) in order to provide an appropriate money supply. And if reserve requirements were raised to higher levels, it might actually cause some reduction in such holdings, because if member banks hold higher reserves they would need fewer Government securities to cover liquidity earnings needs.

(c) Some lowering of reserve requirements may be needed to make it possible for banks to obtain sufficient earnings to provide adequate services to the public and to maintain capital positions essential for the protection of deposits.

3. The provision relating to the purchase of varying maturities of securities by the Federal Reserve would either be unnecessary or would be an attempt to prescribe operating procedures that could interfere with the proper administration of monetary policy, with debt management, and with the effective functioning of Government securities market.

(a) It would be unnecessary because the Federal Reserve System can and does operate in varying maturities whenever deemed appropriate to facilitate Treasury financing, consistent with the purposes of monetary policy and with the effective functioning of the Government securities market.

(b) Present operating procedures of confining open market opers-tions largely to the short-term sectors of the market were adopted in the light of years of experience with other procedures and after an intensive study of the functioning of the Government securities market and the impact of Federal Reserve operations on that market. The procedures now followed were adopted by the Federal Open Market Committee in 1953 and have been reaffirmed each year. They are working rules for the management of the account and are not immutable; varia-tions can be authorized by the Committee at any time.

(c) Operations in short-term securities are appropriate because the bulk of System operations to supply or absorb reserves, though very large, are for temporary purposes and are shortly reversed. Confining such operations to short-term securities keeps to a minimum their impact on the structure of prices among issues of varying maturities as determined by the market forces of demand and supply.

(d) Operations in varying maturities, while they could cause erratic short-run fluctuations, would have little long-run impact upon the structure of interest rates. Because of the high degree of fluidity as between the various maturity sectors of the market, fluctuations of any magnitude in one sector are usually transmitted with considerable promptness to other sectors.

(e) If Federal Reserve should attempt through operations in long-term bonds to have a substantial and continued impact on long-term rates, the volume of operations would have to be very large with heavy offsetting sales of short-term securities in order to avoid undue additions to the reserve supply. They would greatly increase the liquidity of the economy by (1) making outstanding bonds readily convertible into money and (2) by adding to the market supply short-term securities. Thus the inflationary potential would be enlarged even though the volume of bank reserves was not increased. In the end they would have little net effect upon either the level or structure of rates.

(f) Fundamentally, the objection to Federal Reserve operations in longer-term securities, is that they interfere with market determination of interest rates that serve to bring about adjustments in investment and saving appropriate and essential for the maintenance of growth and stability.

(g) It is preferable that variations in the structure of the market-held debt (i.e. other than those held by Government funds and the Federal Reserve Banks) be determined by the Treasury in its debt-management operations rather than the Federal Reserve.

COMMENTS ON THE REUSS RESOLUTION

(1) The increase in interest payments on the national debt reflects, in part, the failure to reduce the debt in the postwar period, and the rise in interest rates resulting from strong demand pressures for funds.

(2) The increase in Government securities held by commercial banks since 1953 reflects primarily the counter-cyclical monetary and debt management policies pursued in the Recessions of 1953-54 and 1957-58. During recessions, increases in bank holdings of Government securities are properly stimulated to promote monetary growth, liquidity, and an atmosphere conducive to recovery. Thus, bank holdings of Governments rose sharply in 1954 and again in 1958.

(3) The relatively high proportion of short-term debt is indeed of concern. This is precisely why the President has requested removal of the 4-1/4 percent ceiling on new Treasury issues of more than 5 years' maturity. The short-term debt can be limited properly only if the Treasury has flexibility in debt management and can, as conditions permit, market new issues of longer-term maturity.

(4) Reserve requirements of member banks have been reduced only during recessions. This technique of supplying greater lending and investing power to the banking system is generally recognized as the most effective technique available to the Federal Reserve. Additional reserves supplied through purchases of Governments (and such purchases were made in large volume by the System in 1953 and 1958) have less of an immediate expansive effect than do reductions in reserve requirements. Moreover, reductions in reserve requirements supply lending power to banks throughout the Nation speedily and efficiently. The banks tend to put such funds to work quickly.

(5) Reductions in reserve requirements do not make Government securities "unattractive to investors". On the contrary, by increasing availability of funds in credit markets, they stimulate demand both for Governments and other types of credit instruments. This was demonstrated effectively in both the recessions referred to above. Prices of Government and other securities rose rapidly.

Union Calendar No. 213

86TH CONGRESS
1ST SESSION

H. R. 7749

[Report No. 556]

IN THE HOUSE OF REPRESENTATIVES

JUNE 16, 1959

Mr. MILLS introduced the following bill; which was referred to the Committee on Ways and Means

JUNE 16, 1959

Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

---

A BILL

To increase the amount of obligations, issued under the Second Liberty Bond Act, which may be outstanding at any one time.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the first sentence of section 21 of the Second Liberty Bond Act, as amended (31 U.S.C., sec. 757b), is amended to read as follows: "The face amount of obligations issued under authority of this Act, and the face amount of obligations guaranteed as to principal and interest by the United States (except such guaranteed obligations as may be held by the Secretary of the Treasury), shall not exceed in the aggregate $285,000,000,000 outstanding at any one time."

SEC. 2. During the period beginning on July 1, 1959, and ending on June 30, 1960, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act, as amended, shall be temporarily increased by $10,000,0000,000.

SEC. 3. This Act may be cited as the "Public Debt Act of 1959".

Union Calendar No. 213

86TH CONGRESS
1ST SESSION

H. R. 7749

[Report No. 556]

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To increase the amount of obligations, issued under the Second Liberty Bond Act, which may be outstanding at any one time.

By Mr. MILLS

JUNE 16, 1959

Referred to the Committee on Ways and Means

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Notebook -
CEW - 6/16/59

PRESIDENT IS USING a SHORT-TERM CRISIS TO GAIN A PERMANENT CHANGE IN OUR LAWS

It has been charged that the President is in effect using a short-term crisis (specifically, the seasonal needs of the Treasury when receipts drop in the fall) to gain a long-run and what would probably turn out to be a permanent change in our laws. It is argued that once the interest rate increase is granted, higher rates would not be reversed.

Answer:

(1) Nothing has been said by the President or the Secretary of the Treasury to the effect that we are confronted with a crisis - short-term or long-term. Rather, it has been pointed out that the necessity to finance wholly within the 5-year range can only add to inflationary pressures and compound future problems. This is not something stemming from seasonal needs during the last half of this calendar year; it stems from the fact that long-term Government securities, in the market, are in many instances yielding more than the $4\frac{1}{4}$ percent maximum; and the fact that the Treasury must refinance some $76 billion of maturing securities during the next 12 months.

(2) There is nothing in the President's proposal to warrant the conclusion that interest rates will tend to move higher and higher, never to come down. It is important to understand that removal of the ceiling will not in itself cause higher rates, but in fact should work toward lower rates by contributing to diminution of the fear of inflation. Moreover, interest rates in a free market economy are quite flexible. They have gone through several waves of rise and fall since the end of the Second World War, and should continue to move flexibly in the future. Nothing in the proposed legislation would restrict this flexibility, or tend to push rates to either a higher (or lower) permanent level.

Ways & Means

Federal Reserve Operations to Supply Bank Reserves

In the past six years the Federal Reserve has taken various actions to supply reserves required by member banks to meet seasonal, growth, and other needs for money and credit. These may be summarized as follows:

(1) In periods of recession - 1953-54 and 1958 - reserves were released through reductions in reserve requirements of member banks. These amounted to about $1.2 billion in 1953, $1.6 billion in 1954, and $1.5 billion in 1958 -- an aggregate of $4.3 billion. Such reductions release reserves at all banks, enable them to reduce borrowings, and encourage them to expand loans and investments inventories.

(2) During the course of each year the Open Market Committee purchases Government securities to meet seasonal demands for currency and for reserves incidental to seasonal deposit expansion, and sells securities when these needs diminish. These operations amount to several hundreds of millions and generally net over $1 billion from the seasonal low point to the seasonal high point each year. Largely because of their temporary nature, these transactions are usually confined to Treasury bills, in which in-and-out operations are readily effected.

(3) The System supplies large amounts of reserves at times of Treasury financing operations which result in temporary increases in

Government deposits at banks and in required reserves. If the market is subject to unduly severe pressures during the period of Treasury financing operations, these purchases may be very large in order to stabilize the makket and assist the financing. For example, in the crisis that developed in July 1958 the System purchased about $1.4 billion securities, including those involved in the financing and some other notes and bonds.

(4) In periods of expansion, except for seasonal variations and amounts needed to balance gold and currency movements, much of the growth in reserve needs is obtained by member banks by borrowing at the Reserve Banks, rather than through open market operations or reductions in reserve requirements. For example, from mid-1954 to mid-1957 member bank borrowings increased by about $800 million and, after declining by a somewhat larger amount in the year ending in mid-1958, they have again increased in the past year by some $700 million.

(5) Net growth in reserve needs over an extended period of time is moderate in size compared with these more or less temporary operations of the System, but they are provided for in the course of time as a net result of all operations. For example, since mid-1957, Federal Reserve holdings of Government securities have shown a net increase of nearly $3 billion, of which about $2 billion has been in Treasury bills

and $1 billion in other types of securities. In this period, reserve requirements were reduced by nearly $1.5 billion. The aggregate amount of funds thus supplied covered a reserve drain resulting from a gold outflow as well as amounts needed for monetary expansion.

A BILL

To permit the Secretary of the Treasury
to designate certain exchanges of Government
securities to be without recognition of gain
or loss for income tax purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to common nontaxable exchanges) is amended by adding at the end thereof the following new section:

"SEC. 1037. CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS.

"(a) General rule.--When so provided by regulations promulgated by the Secretary in connection with the issue of obligations of the United States, no gain or loss shall be recognized on the surrender to the United States of obligations of the United States issued under the Second Liberty Bond Act in exchange solely for other obligations issued under such Act. For rules relating to the recognition of gain or loss in a case where the preceding sentence would apply except for the fact that the exchange was not made solely for other obligations of the United States, see subsections (b) and (c) of section 1031.

"(b) Application of section 1232.--Notwithstanding any provision of this section, section 1031(b), or section 1031 (d), section 1232 shall apply to any recognized gain to which it would otherwise apply, except that in the case of an exchange of a transferable obligation of the United States which was issued at not less than par for another transferable obligation of the United States in an exchange to which subsection (a) applies, the issue price of the obligation received by the taxpayer in exchange shall be considered to be the same as the issue price of the obligation given by the taxpayer in exchange.

"(c) Cross references.--For rules relating to the basis of obligations of the United States acquired in an exchange for other obligations described in subsection (a), see subsection (d) of section 1031."

(b) The table of sections for part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

"Sec. 1037. Certain exchanges of United States obligations."

(c) Section 1031 (b) (relating to gain from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(d) Section 1031 (c) (relating to loss from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(e) Section 1031 (d) (relating to basis in the case of exchanges of property held for productive use or investment) is amended by striking out "this section, section 1035 (a), or section 1036 (a)," in the first sentence thereof and inserting in lieu thereof "this section, section 1035 (a), section 1036 (a), or section 1037 (a),".

SEC. 2. Section 4(a) of the Public Debt Act of 1941, as amended (31 U.S.C. 742a), is amended by striking out "under the Internal Revenue Code," and inserting in lieu thereof "except as provided under the Internal Revenue Code,".

SEC. 3. The amendments made by this Act shall be effective for taxable years ending after the date of enactment of this Act.

Amended section 5 of a proposed bill
"To facilitate management of the public
debt, and for other purposes"

SEC. 5. (a) Section 3701 of the Revised Statutes (31 U.S.C. 742) is amended by adding at the end thereof the following:

"This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except non-discriminatory franchise or other non-property taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

(b) The following provisions of the Second Liberty Bond Act, as amended, relating to the tax-exempt status of obligations of the United States, are repealed, without changing the status of any outstanding obligation:

(1) Subsections (b) and (d) of section 5 (31 U.S.C. 754(b) and (d));

(2) The second and third sentences of section 7 (31 U.S.C. 747);

(3) Subsection (b) of section 18 (31 U.S.C. 753(b));

(4) The first sentence of subsection (d) of section 22 (31 U.S.C. 757c(d)).

September 11, 1959.

The Honorable Henry S. Reuss,
House of Representatives,
Washington 25, D.C.

Dear Mr. Reuss:

Since I have returned only today from attending a joint meeting of the boards of directors of the Federal Reserve Bank of Cleveland and its Pittsburgh and Cincinnati Branches, I have not had until now an opportunity to see your telegram dated September 10.

I have felt it necessary in my position to make it a practice not to comment on news stories or conclusions expressed therein, one way or another. But I could not in any event be of help to you in this instance, as I do not have any views in respect to the government's financial affairs or to monetary matters outside those I expressed to you and to other members of your committee at your recent sessions.

Sincerely yours,

(SIGNED) WM. McC. MARTIN, JR.

Wm. McC. Martin, Jr.

cc: Mr. Shay
Mr. Molony

CM:mnm

FOR FI...
M. Muchl...

COPY

Washington D. C.
September 10, 59
4:17 p.m.

William McChesney Martin
Chmn Federal Reserve Board
Washington D. C.

Please refer to front page article today's Wall Street Journal written by Editor Vermont Royster, headlined: "Fiscal Crisis, Federal Officials see Need for Drastic Action to Bar Huge Inflation, The (They) Ask Tight Budget Curb, Power to Lift Bond Interest Rates, Ike May Recall Congress, some Fear a 'Money Panic.'"

Besides frightening headlines, story attributes frightening quotation to anonymous high Administration officials. Did you, or to your knowledge, any other Federal Reserve official make any of these statements? Do you subscribe to the anonymous quotations in Royster's story?

Henry S. Reuss,
Member of Congress.

August 18, 1959.

Dear Henry:

Thanks for your sporting letter. I appreciate very much your taking our debate in such good humor. At any rate it is nice to see someone taking so much interest in monetary affairs.

With all good wishes,

Sincerely yours,

(Signed) Bill

Wm. McC. Martin, Jr.

The Honorable Henry S. Reuss,
House of Representatives,
Washington 25, D.C.

COPY

Congress of the United States
House of Representatives
Washington, D.C.

August 17, 1959.

Mr. William McC. Martin, Jr.
Chairman
Board of Governors
Federal Reserve System
Washington 25, D.C.

Dear Bill:

I thought you would be cheered by this note I have just received from one of your supporters, Mr. Thomas Flaherty of Englewood, New Jersey (copy enclosed).

While I am not necessarily prepared to subscribe to Mr. Flaherty's fifty to one value judgment, I thought you would like to be aware of it.

Sincerely,

(Signed) Henry S. Reuss

Henry S. Reuss
Member of Congress

Enclosure

COPY

My dear Congressman,

I may be only a dumb cluck but I wouldn't trade Mr. Martin of the Federal Reserve Board for fifty congressman like you. I know that my living costs have gone up 100% as the result of cheap politics. Instead of plugging for a further cheapening of the dollar you would be better advised to work to rescue the control of the Democratic Party from labor racketeers.

Respectfully

(Signed) Thos. Flaherty

(No address given--postmark on envelope Englewood, N.J.)

August 11, 1959

From the desk of
WILLIAM McCHESNEY MARTIN, JR.

August 11, 1959.

Bob --

Herewith the rough illustration I have used somewhat effectively a number of times.

Bill

Attachment

By Messenger

The Government's problem of having large amounts of debt constantly falling due on short notice will be readily understandable to anyone who will envisage the problem he would have if, in addition to charge accounts and monthly automobile payments, he had a big mortgage on his house falling due for complete payment every 90 days instead of having 15 or 20 years or more to get the money together to pay it off. And the problem for the Treasury right now is the same as it would be for the average American if the expiration of that 90 days caught him at a time when he hadn't managed yet to make his income cover all his current bills, much less put aside something extra to pay on his mortgage. Particularly if the creditor were feeling uneasy over the debtor's running in the red, the creditor might well be reluctant to renew the note at all without inducement in the form of a higher rate of interest. Of course the borrower wouldn't be under any pressure to pay higher interest if he had 15 or 20 years to pay instead of having to refinance his note every 90 days. And his other creditors wouldn't be as likely to get nervous and crowd him for immediate cash, either, if they knew his financial arrangements were on a more solid base, giving him abundant time to put aside payment funds before each payment date came due.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 6, 1959

To Chairman Martin

From Jerome W. Shay

Subject: Request for report on H. R. 8304, an interest ceiling bill.

JWS

WM

The Board has received a request for its views from the Ways and Means Committee on the bill H. R. 8304 recently introduced by Congressman Simpson of Pennsylvania "To facilitate management of the public debt, to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, and for other purposes." The main purpose of the bill is to remove the interest rate ceiling on Treasury bonds and savings bonds.

Except for perfecting changes, the bill is identical with Mr. Simpson's earlier bill (H. R. 7964), which was the subject of my memorandum to you of July 9 recommending that a request for a report on H. R. 7964 be filed without reply.

I have talked to Mr. Leo H. Irwin, Chief Counsel of the Ways and Means Committee, and also, Mr. Tom Martin, Minority Counsel to the Committee, regarding the request for the Board's views on H. R. 8304. On the basis of these conversations, and in view of your statement at the Committee's public hearings on June 11 and your attendance at the subsequent meetings of the Committee, it is recommended that the request for the Board's views be regarded as routine and filed without reply.

86TH CONGRESS
1ST SESSION

H. R. 8304

IN THE HOUSE OF REPRESENTATIVES

JULY 20, 1959

Mr. SIMPSON of Pennsylvania introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To facilitate management of the public debt, to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Public Debt Management Act of 1959".

TITLE I—IN GENERAL

SEC. 101. The first section of the Second Liberty Bond Act, as amended (31 U.S.C., sec. 752), is amended by striking out ", not exceeding $4\frac{1}{4}$ per centum per annum,".

SEC. 102. (a) Subsection (b) of section 22 of the

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Second Liberty Bond Act, as amended (31 U.S.C., sec. 757c(b) (1) and (2)), is amended to read as follows:

"(b) (1) Savings bonds and savings certificates may be issued on an interest-bearing basis, on a discount basis, or on a combination interest-bearing and discount basis. Such bonds and certificates may be sold at such price or prices and rate or rates of interest and in such denomination or denominations and may be redeemed before maturity upon such terms and conditions as the Secretary of the Treasury may prescribe.

"(2) The Secretary of the Treasury, with the approval of the President, is authorized to provide by regulation:

"(A) that owners of series E and H savings bonds may, at their option, retain the bonds after maturity, or after any period beyond maturity during which they have earned interest, and continue to earn interest upon them;

"(B) that series E and H savings bonds on which the rates of interest have been fixed prior to such regulations will earn interest at higher rates."

(b) The heading and first sentence of section 454(c) of the Internal Revenue Code of 1954 (relating to matured United States savings bonds) are amended to read as follows:

"(c) MATURED UNITED STATES SAVINGS BONDS.—In the case of a taxpayer who—

"(1) holds a series E United States savings bond at the date of maturity, and

"(2) pursuant to regulations prescribed under the Second Liberty Bond Act (A) retains his investment in such series E bond in an obligation of the United States, other than a current income obligation, or (B) exchanges such series E bonds for another nontransferable obligation of the United States in an exchange upon which gain or loss is not recognized because of section 1037 (or so much of section 1031 as relates to section 1037),

the increase in redemption value (to the extent not previously includible in gross income) in excess of the amount paid for such series E bond shall be includible in gross income in the taxable year in which the obligation is finally redeemed or in the taxable year of final maturity, whichever is earlier."

SEC. 103. Subsection (i) of section 22 of the Second Liberty Bond Act, as amended (31 U.S.C., sec. 757c (i)), is amended by inserting after the third sentence thereof the following: "Relief from liability shall be granted in all cases where the Secretary of the Treasury shall determine, under regulations prescribed by him, that written notice of liability or potential liability has not been given by the United States, within ten years from the date of the erroneous payment, to any of the foregoing agents or agencies whose liability is to be determined: *Provided,* That no relief shall be granted in any case in which a qualifying paying agent has assumed unconditional liability to the United States."

SEC. 104. The following provisions of law are amended by striking out the words "on original issue at par" and inserting in lieu thereof the words "on original issue at the issue price":

(1) Section 6 (g) (5) of the Act of March 24, 1934, as amended (22 U.S.C., sec. 1393 (g) (5)), relating to the trust account for the payment of pre-1934 bonds of the Government of the Philippines.

(2) Section 201 (d) of the Social Security Act (42 U.S.C., sec. 401 (d)), relating to the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund.

(3) Section 904 (b) of the Social Security Act (42 U.S.C., sec. 1104 (b)), relating to the Unemployment Trust Fund.

(4) Section 15 (b) of the Railroad Retirement Act

of 1937 (45 U.S.C., sec. 228o (b)), relating to the Railroad Retirement Account.

(5) Section 209 (e) (2) of the Highway Revenue Act of 1956 (23 U.S.C., sec. 173 (e) (2)), relating to the Highway Trust Fund.

SEC. 105. (a) Section 3701 of the Revised Statutes (31 U.S.C., sec. 742) is amended by adding at the end thereof the following: "This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

(b) The following provisions of the Second Liberty Bond Act, as amended, relating to the tax-exempt status of obligations of the United States, are repealed, without changing the status of any outstanding obligation:

(1) Subsections (b) and (d) of section 5 (31 U.S.C., sec. 754 (b) and (d));

(2) The second and third sentences of section 7 (31 U.S.C., sec. 747);

(3) Subsection (b) of section 18 (31 U.S.C., sec. 753 (b));

(4) The first sentence of subsection (d) of section 22 (31 U.S.C., sec. 757c (d)).

SEC. 106. The amendment made by section 102 shall be effective as of June 1, 1959.

TITLE II—INCOME TAX TREATMENT OF CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS

SEC. 201. (a) Part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to common nontaxable exchanges) is amended by adding at the end thereof the following new section:

"SEC. 1037. CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS.

"(a) GENERAL RULE.—When so provided by regulations promulgated by the Secretary in connection with the issue of obligations of the United States, no gain or loss shall be recognized on the surrender to the United States of obligations of the United States issued under the Second Liberty Bond Act in exchange solely for other obligations issued under such Act.

"(b) APPLICATION OF SECTION 1232.—

"(1) EXCHANGES INVOLVING OBLIGATIONS ISSUED AT A DISCOUNT.—In any case in which gain has been realized but not recognized because of the provisions of subsection (a) (or so much of section 1031 (b) as relates to subsection (a) of this section), to the extent such gain is later recognized by reason of a disposition or redemption of an obligation received in an exchange subject to such provisions, the first sentence of section 1232 (a) (2) (A) shall apply to such gain as though the obligation disposed of or redeemed were the obligation surrendered to the Government in the exchange rather than the obligation actually disposed of or redeemed. For purposes of this paragraph and section 1232, if the obligation surrendered in the exchange is a nontransferable obligation described in subsection (a) or (c) of section 454—

"(A) the aggregate amount considered, with respect to the obligation surrendered, as gain from the sale or exchange of property which is not a capital asset shall not exceed the difference between the issue price and the stated redemption price which applies at the time of the exchange, and

"(B) the issue price of the obligation received in the exchange shall be considered to be the stated redemption price of the obligation surrendered in the exchange, increased by the amount of other consideration (if any) paid to the United States as a part of the exchange.

"(2) EXCHANGES OF TRANSFERABLE OBLIGATIONS

ISSUED AT NOT LESS THAN PAR.—In any case in which subsection (a) (or so much of section 1031 (b) or (c) as relates to subsection (a) of this section) has applied to the exchange of a transferable obligation which was issued at not less than par for another transferable obligation, the issue price of the obligation received from the Government in the exchange shall be considered for purposes of applying section 1232 to be the same as the issue price of the obligation surrendered to the Government in the exchange, increased by the amount of other consideration (if any) paid to the United States as a part of the exchange.

"(c) CROSS REFERENCES.—

"(1) For rules relating to the recognition of gain or loss in a case where subsection (a) would apply except for the fact that the exchange was not made solely for other obligations of the United States, see subsections (b) and (c) of section 1031.

"(2) For rules relating to the basis of obligations of the United States acquired in an exchange for other obligations described in subsection (a), see subsection (d) of section 1031."

(b) The table of sections for part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

"Sec. 1037. Certain exchanges of United States obligations."

(c) Section 1031 (b) of such Code (relating to gain from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section

1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(d) Section 1031 (c) of such Code (relating to loss from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(e) Section 1031 (d) of such Code (relating to basis in the case of exchanges of property held for productive use or investment) is amended by striking out "this section, section 1035 (a), or section 1036 (a)," each place it appears in the first and second sentences thereof and inserting in lieu thereof "this section, section 1035 (a), section 1036 (a), or section 1037 (a),".

SEC. 202. Section 4 (a) of the Public Debt Act of 1941, as amended (31 U.S.C., sec. 742a), is amended by striking out "under the Internal Revenue Code, or laws amendatory or supplementary thereto" and inserting in lieu thereof "except as provided under the Internal Revenue Code of 1954".

SEC. 203. The amendments made by this title shall be effective for taxable years ending after the date of enactment of this Act.

1035(a), or of section 1036(a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036(a), or of section 1037(a),".

(d) Section 1031(c) of such Code (relating to loss from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035(a), or of section 1036(a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a),".

(e) Section 1031(d) of such Code (relating to basis in the case of exchanges of property held for productive use or investment) is amended by striking out "this section, section 1035(a), or section 1036(a)," each place it appears in the first and second sentences thereof and inserting in lieu thereof "this section, section 1035(a), section 1036(a), or section 1037(a),".

SEC. 202. Section 4(a) of the Public Debt Act of 1941, as amended (31 U.S.C., sec. 742a), is amended by striking out "under the Internal Revenue Code, or laws amendatory or supplementary thereto" and inserting in lieu thereof "except as provided under the Internal Revenue Code of 1954".

SEC. 203. The amendments made by this title shall be effective for taxable years ending after the date of enactment of this Act.

86TH CONGRESS
1ST SESSION

H. R. 8304

A BILL

To facilitate management of the public debt, to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, and for other purposes.

By Mr. SIMPSON of Pennsylvania

JULY 20, 1959

Referred to the Committee on Ways and Means

July 30, 1959.

Dear Dick:

Thank you for keeping me up to date on your correspondence with Congressman Metcalf and your points, as always, are well taken.

This has been a real battle, as you know, and it is very encouraging to have such help.

My best, as always.

Sincerely yours,

(Signed) Bill

Wm. McC. Martin, Jr.

Mr. C. Richard Youngdahl,
Vice President,
Aubrey G. Lanston & Co., Inc.,
Twenty Broad Street,
New York, New York.

AUBREY G. LANSTON & CO. INC.

July 28, 1959

The Honorable Lee Metcalf,
Congressman, First District of Montana
House of Representatives
Washington, D.C.

Dear Congressman Metcalf:

Thank you for your letter of July 24. I am happy to have your reactions and the opportunity to pursue these matters further with you because it is my belief that the manner in which Congress acts and/or fails to act thereon may bear importantly on the confidence which our people, and other peoples throughout the world, have in the lasting qualities of the economic (and the military) strength of the United States.

In your closing statement you question whether we have carefully read the amendment. Please be assured that we not only have read it carefully, but we also have worked hard trying to keep up with all of the developments that preceded and have followed its introduction. And, according to a direct statement of the language of the amendment contained in a letter sent us by Mr. Reuss (Wisconsin) last week, we were up to date -- on the language, as of then.

We cannot be as confident, however, of our appraisal of the intent of your amendment. You describe it as a "very mild amendment". Mr. Reuss described it (in his letter to me of July 21) as "a directive" to the Fed. Yet some say it is an innocuous "sense of Congress" provision. I judge, however, that since you feel your "amendment has restored to the Fed some of the flexibility in the management of money supply that it has voluntarily foregone" you view it as a directive in some degree even though you add that "the final decision would be up to the Federal Reserve System". In all events, the general reaction is that the Fed is to be coerced by the amendment into doing some things that the Federal Reserve Act as amended authorizes them to do, but which they otherwise might not do.

On this score, I think your above comments are quite clear and it was with such an assessment of the intent of your amendment in mind that we spoke of "coercion of the Fed". Webster's new international dictionary, Second Edition, offers this definition of "coercion": "... specif., the aplication to another of such force, either physical or moral, as to constrain him to do against his will something he would not otherwise have done; compulsion. Coercion may cause the act produced to be a nullaty so far as concerns legal liability. Cf. DURESS."

Regarding the next to the last paragraph of your letter: I hope you will forgive me if I wonder whether you read what we had to say with care. The third from the last sentence defines the reference for the term "appropriate enlargement". The last three sentences read as follows:

"... In such circumstances, the Federal Reserve System therefore should strive to offset such consequences and there is only one way that the Federal Reserve may do so via an enlargement in the scope of its open market operations. The appropriate enlargement — if any enlargement is truly appropriate and we firmly believe it's not — would be for the Fed to sell notes and bonds from its portfolio and to reinvest in (buy) bills. The Metcalf proposal, however calls for the opposite of this."

In other words, "appropriate enlargement" applies to an enlargement in the scope of the Fed's open market operations, and not to the money supply. For example, when the Fed shifted away from its practice of buying and selling Treasury bills to the entering into of transactions which involved the purchase and sale of Treasury certificates and/or Treasury notes and/or Treasury bonds — as it has done under exceptional circumstances in recent years — it is viewed as having enlarged the scope of its open market operations. It is such enlargement that we view, as a matter of conviction based on our experience, as unnecessary and undesirable as well as being inappropriate except in most extraordinary circumstances.

Incidentally, when we say that your proposal ".. calls for the opposite of this" we refer to the fact that if the Fed is to accommodate "needed monetary expansion" by the purchase of Treasury securities other than bills, these purchases by the Fed would give to such longer-term Treasury securities a degree of liquidity they otherwise would lack; therefore, were the Fed to so provide the necessary bank reserves it would increase the liquidity of such assets held by banks, business corporations and others. This might or might not be a desirable consequence. In addition, purchases by the Fed of these securities would do something additionally. These purchases by the Fed would distort — in one degree or another — the price and yield structure of the affected maturity sectors of the Government security market and, thereby, rob officials and the public of this valuable mirror of the public's reactions to concurrent monetary policy and business conditions. And, what would you have the Fed do in connection with "needed monetary expansion" of a seasonal nature?

May I say, Mr. Metcalf, that the public reaction to this debate (as I gauge it as a dealer in Government securities) as to whether existing interest rate ceilings on Treasury bonds shall or shall not be removed and as to whether your amendment is appropriate to such a measure — is not good. It is not good because people wonder why so much importance is being attached to the amendment by its backers; similarly, it is not good because an increasing number of people wonder what there is about the amendment that causes its backers to strive so hard to have it included in a measure to which it clearly is not germane at the expense of bypassing a Committee of the House before which an amendment dealing with the Federal Reserve Act ordinarily would be placed. I implore you, Sir, to consider whether the national welfare is best served by an attempt to deal in this manner with the discharge of the Fed's responsibilities — at the expense of the passage of an otherwise necessary, even though regrettable revision in the Second Liberty Loan Act.

Just in the last few weeks I received a letter from a well-informed Western European banker of whom I had made inquiry as to the views of his contemporaries with respect to the U.S. dollar. He told me that European bankers and business men are following the development of the purchasing power of the U.S. dollar with the greatest attention and they are concerned with the excessive short-term indebtedness of our Government. "Short-term", to these chaps, means debt with a term of five years or less.

 AUBREY G. LANSTON & CO. INC.

I will conclude with the savings bonds situation: Early in June, it was proposed that the permissible rate of interest on savings bonds be increased and that such an increase be made retroactive to June 1 on outstanding and to-be-issued savings bonds. The fact that the Committee approved this request and acceded to some relaxation in the maximum interest rate ceiling on marketable Treasury bonds does not change the fact that --to date -- the rate of interest paid to holders of savings bonds remains unchanged. It remains unchanged, apparently, because a quid pro quo has been demanded by the minority that supports your amendment. Consequently, it is the demand for a quid pro quo that is responsible for savings bonds holders being denied a proper upward revision in the rates of interest the Government pays them on their savings -- the principal value of which has been so sorely and steadily eroded.

Very truly yours,

Aubrey G. Lanston
President

AGL:t

LEE METCALF
1ST DISTRICT OF MONTANA

COMMITTEE
WAYS AND MEANS

Congress of the United States
House of Representatives
Washington, D.C.

24 July 1959

Mr. Aubrey G. Lanston, President
Aubrey G. Lanston & Co., Inc.
20 Broad Street
New York 5, New York

Dear Mr. Lanston:

Thank you for sending me a marked copy of your newsletter of 20 July 1959. I had previously read the same material in the issue you regularly send me and for which I thank you.

The marked paragraph demonstrates an interpretation of the language of the amendment that I cannot follow. You mention "coercion." I would be pleased to know what in my proposed amendment can be designated as "coercion."

As a matter of fact, my amendment would restore to the Fed some of the flexibility in the management of money supply that it has voluntarily foregone by the adoption of its "bills only" policy. At the same time, the final decision would be up to the Federal Reserve System.

In previous paragraphs you suggest that something be done about savings bonds. This proposal approved by a majority of the Ways and Means Committee gave the Treasury authority to increase interest rates on savings bonds, on long-term bonds and then contained my very mild amendment. The Treasury was going to receive all the authority it asked for. In addition, the suggestion was made to the Federal Reserve System that it aid in the economical and efficient management of the public debt to the maximum extent consistent with its primary mission of administering a sound monetary policy. Further, the amendment provided that where feasible _future_ needed monetary expansion should be brought about by purchasing U. S. securities of varying maturities.

Therefore, in your example the Fed would purchase bills under the strict terms of my amendment.

You talk of no necessity for an appropriate enlargement. That can only refer to the language of the amendment which refers to "a future needed monetary expansion" and I don't believe you mean that in your opinion there is never going to be a "needed" monetary expansion in the future.

In fact, your discussion is so full of palpable errors that I cannot believe you have carefully read the amendment or applied it to the various situations that might occur. Certainly your application of my amendment to the hypothetical case you make in your newsletter is not accurate.

Very truly yours,

AUBREY G. LANSTON & CO. INC.

SPECIALISTS IN
UNITED STATES GOVERNMENT
AND
FEDERAL AGENCY SECURITIES

CHICAGO · NEW YORK · BOSTON

C. RICHARD YOUNGDAHL
VICE PRESIDENT

TWENTY BROAD STREET
NEW YORK 5, N.Y.
WHITEHALL 3-1200

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July 28, 1959

The Honorable William McC. Martin, Chairman
Board of Governors Federal Reserve System
Washington, D.C.

Dear Bill:

With the thought that it might be useful in connection with the current hearings, Mr. Lanston, who is on vacation, has asked me to send you copies of correspondence we recently had with Congressman Reuss of Wisconsin relative to the so-called Metcalf Amendment. We have also received a somewhat similar letter from Congressman Metcalf which is being answered today. We will send copies of his letter and our reply as soon as they are available.

With best regards,

Sincerely,

Dick

CRY:t

encs.

HENRY S. REUSS
5TH DISTRICT, WISCONSIN

Congress of the United States
House of Representatives
Washington, D. C.

COMMITTEES:
BANKING AND CURRENCY
GOVERNMENT OPERATIONS
SUBCOMMITTEES ON
INTERGOVERNMENTAL RELATIONS
INTERNATIONAL OPERATIONS
GENERAL GOVERNMENT ACTIVITIES
JOINT ECONOMIC COMMITTEE
SUBCOMMITTEE ON
ECONOMIC STABILIZATION

July 21, 1959

Mr. Aubrey G. Lanston, President
Aubrey G. Lanston & Co., Inc.
Twenty Broad Street
New York 5, New York

Dear Mr. Lanston:

Thank you for your letter of July 20, calling my attention to the marked paragraph in your newsletter of the same date.

I am glad you have done so, since the paragraph to which you refer me reflects a misunderstanding of the Metcalf Amendment. This amendment provides:

> "It is the sense of Congress that the Federal Reserve System, while pursuing its primary mission of administering a sound monetary policy, should to the maximum extent consistent therewith, utilize such means as will assist in the economical and efficient management of the public debt; and that the System, where practicable, should bring about future needed monetary expansion by purchasing U. S. securities, of varying maturities."

The amendment contains a directive only in situations where the Fed decides that the money supply must be expanded; in such cases, it is to do so by purchasing U.S. securities, rather than by further lowering of bank reserve requirements, and the securities purchased should be those deemed most appropriate by the Fed, in its discretion, unfettered by any "bills only" policy (which does not, of course, prevent its buying bills if it believes that this is the best move at a particular time).

Your description of the Metcalf Amendment, therefore, is twice erroneous. First, the Metcalf Amendment does not require any enlargement whatever of the money supply -- it simply says that when the Fed decides to enlarge the money supply, it should do it in a particular way, by buying U.S. securities. Secondly, the Metcalf Amendment does not require the selling of bills and the purchase of notes and bonds from the Fed's portfolio -- it simply directs the Fed to consider each purchase on its merits, uninhibited by any doctrinaire preconceptions.

I would hope that you would address your criticisms of the Metcalf Amendment to what the amendment actually directs, as outlined above.

Sincerely,

Henry S. Reuss
Member of Congress

AUBREY G. LANSTON & CO. INC.

Hon. Wm. McC. Martin.

July 24, 1959

The Honorable Henry S. Reuss, Congressman
Fifth District, Wisconsin
House of Representatives
Washington, D.C.

Dear Congressman Reuss:

Thank you for your letter of July 21, for the outline of your understanding of the Metcalf Amendment and for your comments on our reference to this (in our weekly letter dated July 20). It strikes us as being rather significant that the meaning of this amendment has been subject to such a hue and cry. And, do you not think it significant, too, that no reference is made in the language of the amendment (as set forth in your letter) to the fact that the Federal Reserve System shall be expected (as a consequence) to facilitate future expansion of the money supply by purchasing Treasury securities (including notes and bonds) and to mothball its authority to vary reserve requirements within the limits only recently enacted by Congress? I note with some interest, also, that in the third paragraph of your letter you describe the amendment as "a directive".

In the same paragraph you explain that the securities to be purchased by the Fed (for the purpose of expanding the money supply) "should be those deemed most appropriate by the Fed, in its discretion". This raises two questions in my mind. One, isn't that precisely what the Fed has been doing, when, as a matter of practice, it has confined its purchases and sales in the open market to bills, usually? Secondly, if, as you say, the Fed is to exercise its discretion, does not your understanding of the sense of this amendment mean that the discretion heretofore granted the Fed is to be restricted henceforth?

Finally, on this score, if the purposes and objectives of the Metcalf Amendment are as you state them, should not the language of the amendment say just that? And, since the basic intent is to amend the Federal Reserve Act, might it not be better to label the proposal as such? Is it truly an appropriate part of a bill to amend the Second Liberty Loan Act?

You mention that our description of the amendment is twice erroneous. Our reaction is that this arises partly from semantics. Monetary and credit policies must take into consideration the amount, the availability, and the cost of money. Our letter of July 20 did not refer to the amount of money (the money supply) aspect at all. We referred instead to the second characteristic -- availability -- in the course of which our direct reference was to the liquidity of banks and others, i.e. of the liquidity of the economy. We pointed out that if, as a consequence, of the Metcalf Amendment, the Fed found itself obliged to buy Treasury notes and bonds, such securities would acquire a degree of liquidity they otherwise would lack. We also pointed out that in present circumstances the Federal Reserve should be striving to achieve the opposite result and, therefore, its activity in these longer Treasury securities might better consist of sales -- although we didn't think they should do either.

An inevitable end result, in our judgment, would be to bring about relatively higher rather than relatively lower interest rates.

In connection with the second point with respect to which you say we are in error, you point out that the amendment "directs the Fed to consider each purchase on its merits". Isn't that precisely what the Fed has been doing? You add that the Fed should not be inhibited by any doctrinaire preconceptions. Which of the following, in your judgment, would be the more synonymous with your descriptive phrase -- doctrinaire preconceptions? Would it be one wherein Congress becomes so preoccupied with the market yields on certain outstanding Government securities that it "directs" the Federal Reserve to purchase such securities in lieu of using another instrument (to expand the money supply) which Congress has authorized it to use? Or, would it be a situation whereby the Federal Reserve, after a careful study of the complicated technical issues involved (and some unfortunate historical experiences), has decided that the national welfare requires that it interfere as little as possible in the fluctuations in these interest rates that were brought about by the public's transactions in these securities?

May I respectfully ask if the ideas that you envision as constituting the Metcalf Amendment sprang from a careful consideration of the function performed by the interest rate, as an important price in a democratic society, or whether it stemmed from a belief that such an amendment would be one way to bring about lower interest rates? And, finally, do you believe that Congress should attempt to dictate the manner in which the Fed should discharge its responsibilities in fields as highly complicated as those involving its authorization to vary member bank reserve requirements and the conduct of its open market operations?

With kind regards,

Sincerely yours,

Aubrey G. Lanston
President

AGL:t

Note:

Congressional Record of Thursday, June 11, contained Mr. Martin's statement before House Ways and Means Committee, introduced by statement of Bruce Alger of Texas:

> "Mr. Alger. Mr. Speaker, as a further informational aid to Members of Congress and our citizens, I am submitting for the Record the statement of William McChesney Martin, Jr., Chairman of the Board of Govemors of the Federal Reserve System before the Committee on Ways and Means on the subject of debt management proposals. His sound views will be of great interest and help, I am sure, to everyone who is a student of this proposal."

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE VICE CHAIRMAN

June 29, 1959.

The Honorable James C. Oliver,
House of Representatives,
Washington 25, D. C.

Dear Congressman Oliver:

Enclosed is a photostat that you requested on the 'phone this morning.

In answer to your query as to what would be the impact of cancelling $15 billion of United States Government obligations held by the Federal Reserve Banks, I am taking the liberty of sending a copy of a letter on the same subject that was forwarded to Congressman Mills last week. Perhaps the nub of the matter can be set forth best by two questions:

(1) What is to be gained by the suggestion?

Since the Federal Reserve turns over to the Treasury 90 per cent of its earnings, the dollar effect of the proposal would be negligible. In 1958, for example, the Treasury would have paid to the Federal Reserve about $446 million less than it actually paid (interest on $15 billion at the actual average yield of 2.98 per cent). However, the Treasury would have received from the Federal Reserve about $401 million less. The apparent gain to the Treasury, therefore, would have been only $45 million. Even this would have been added to the Federal Reserve Surplus, the residual interest in which resides wholly in the Treasury.

(2) Do such amounts justify a move that would tend to undermine public confidence in the security behind the dollar?

It was a pleasure to chat with you.

Sincerely yours,

(Signed) C. C. Balderston

C. Canby Balderston,
Vice Chairman.

Enclosures.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

JUN 23 1959

The Honorable Bruce Alger,
House of Representatives,
Washington 25, D. C.

Dear Mr. Alger:

During my testimony on June 11, 1959, you asked me if any further information was available on the effect of increased taxes on net interest rates paid by borrowers and received by lenders.

We have not been able to locate any published material which develops this point fully, although it is referred to from time to time in analyses of current market developments; e.g., to explain investors preference for capital gains over interest income.

I am enclosing a brief memorandum prepared by a member of our staff, which develops the point in somewhat more detail than my statement. Also enclosed is a copy of the quotation sheet of one of the leading Government securities dealers. The fact that the "after tax" yields are carefully calculated and published for each issue evidences the fact that this is the effective rate from the viewpoint of many investors.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

GEN:gr

6/23/59

Effects of Income Taxes on Interest Costs of Borrowers and Interest Income of Lenders

This memorandum considers briefly the effect of changing income tax rates on interest costs of borrowers and on interest income of those who lend long-term funds. Because of differences in tax status, these effects vary considerably as among both borrowers and lenders. The following paragraphs relate to a few relatively simple examples.

Interest costs of borrowers - Income tax rates affect the interest cost of borrowers because interest payments are a deduction from gross income in arriving at taxable income. One of the best examples of the effect of changing tax rates on interest costs resulting from the interest deduction is in the area of corporate finance. There has been considerable discussion in economic literature concerning the effect of this deduction on the relative cost of debt and equity financing since dividends are not a deductible expense. 1/ There appears, however, to have been little discussion of the effects of changing tax rates on interest costs per se. It may, therefore, be useful to compare the situation in the mid-1920's, when interest rates on long-term corporate bonds of the highest quality were not much different than currently, with the situation today. The following table illustrates this.

1/ For example, D. T. Smith, Effects of Taxation: Corporate Financial Policy (Harvard University, Graduate School of Business Administration, 1952)

			1926	1959
	Part I			
A.	Gross revenue		500,000	500,000
B.	Deductions from gross revenue:	Interest payments	0	0
C.		Other deductions	400,000	400,000
D.	Taxable income		100,000	100,000
E.	Tax rate		13.5%	52.0%
F.	Tax liability		13,500	52,000
G.	Profits after taxes		86,500	48,000
	Part II			
H.	Gross revenue		500,000	500,000
I.	Deductions from gross revenue:	Interest payments	5,000	5,000
J.		Other deductions	400,000	400,000
K.	Taxable income		95,000	95,000
L.	Tax rate		13.5%	52.0%
M.	Tax liability		12,825	49,400
N.	Profits after taxes		82,175	45,600
O.	Difference in profits after taxes resulting from interest cost (Line G - Line H)		4,325	2,400
P.	Effective interest cost (Line O ÷ 100,000)		4.325%	2.40%

Part I of the table merely indicates the effect on corporate profits of the corporate income tax in effect in 1926 and in 1959 for a corporation with identical gross revenue and deductible expenses. Part II illustrates the effect on after tax profits of a corporation with the same income and expenses as in Part I except that it assumes the corporation has an additional deduction of $5,000 resulting from interest payments on $100,000 of debt incurred at 5 per cent interest rate. As indicated in Line O, the effect of the $5,000 interest payment on corporate profits after taxes in 1926 was a reduction of

$4,325, whereas in 1959 the reduction was only $2,400. Relating the effect on after tax profits to the $100,000 of debt, the effective interest cost to a corporation of interest payments of 5 per cent in 1926 was 4.325 per cent, while in 1959 it was only 2.40 per cent because of the higher tax rate. To put it in another way, at the current level of tax rates a corporation could pay an interest rate of 9 per cent and the reduction in profits after taxes would be no greater than it was for a 5 per cent rate in 1926.

The same principle also applies to individuals who borrow in order to purchase housing or other goods. Individual tax rates currently are, of course, much higher than in the 1920's, but it is much more difficult to illustrate the precise effect of the increase in rates because, under a system of progressive tax rates, it varies according to the level of taxable income. It is clear, however, that the net interest cost of identical interest rates to any individual in the same income class whose itemized deductions exceed the standard deduction would be considerably less today than in the 1920's.

Interest income of lenders - A comparison of after tax yield of identical interest rates currently and in the 1920's is greatly affected by the type of investor receiving the interest income. For certain types of financial institutions which are very important investors in debt instruments tax rates are not much different today from what they were in the 1920's. These include life insurance companies (at least prior to this year's change in the tax law), mutual savings banks which were tax exempt in the 1920's and are currently subject to taxation only after reserves reach a certain level, and tax-exempt pension funds. For such investing institutions the effective yield of a 5 per cent bond would be about the same today as in the 1920's. On the other hand, for financial institutions subject to the regular corporate tax rate, such as commercial banks and fire and casualty insurance companies, the after tax yield of a 5 per cent bond would be only about 2.40 per cent currently, compared to 4.33 per cent in 1926.

The change in interest income after taxes of individual investors, of course, depends on the level of taxable income. On the average, however, one study[2/] indicates that in the mid-1920's the percentage of reported interest income absorbed by income taxes was about 4 per cent while in the late 1940's it was about 17 per cent. Thus, the after tax yield of a 5 per cent bond in the 1920's would have been about 4.80 per cent, while in the late 1940's it was about 4.15 per cent.

The Federal Government is in a peculiar situation as to the effect of changing tax rates on its borrowing costs. There is, of course, nothing analogous to the deduction of interest payments from

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2/ L. H. Seltzer, "Interest as a Source of Personal Income and Tax Revenue," Occasional Paper 51 (National Bureau of Economic Research, Inc.)

gross income. However, investors pay taxes on the interest received from the Federal Government on their holdings of Treasury securities. Thus, if the holder of Treasury obligations is subject to the 52 per cent corporate tax rate, the net interest cost to the Treasury is only 48 per cent of the interest rate paid to the lender. If the holder is an individual, the net interest cost would depend on the level of taxable income; to take the average percentage of interest income absorbed by taxes in the late 1940's cited above, the average might be 83 per cent of the interest rate paid. In other words, the average interest recipient paid 17 per cent of the amount he received back in the form of income tax. It may be safely assumed that the Treasury would recover a substantially larger share of any increased amount of interest paid at the present time. The generally higher levels of income now prevailing would mean that most interest income receivers would pay a considerably higher tax on any marginal increment of income they receive. No exact information on this point is available, however.

The effective interest cost to the Treasury on securities held by investors that are exempt from income taxation or only lightly taxed, however, would be the interest rate paid on the securities or close to this rate.

RCP/GEN:gr
6/23/59

June 17, 1959.

Dear Randle:

Thanks for your nice letter of June 15 and it is good to have your understanding and backing. It is a difficult period and we are doing our best. As you request, I am enclosing a copy of my prepared statement last Thursday.

I am planning to make my annual trip to Denver in July and will look forward to seeing you there.

With all good wishes,

Sincerely yours,

Wm. McC. Martin, Jr.

Mr. R. R. Gilbert,
Vice Chairman of the Board,
Republic National Bank of Dallas,
Dallas 22, Texas.

Enclosure (Ways and Means Statement of 6/11)

REPUBLIC NATIONAL BANK
OF DALLAS

DALLAS 22, TEXAS

R. R. GILBERT
VICE CHAIRMAN OF THE BOARD

June 15, 1959

Dear Bill:

After a three months trip through South America, Mrs. Gilbert and I returned to the city at just about the time Bob Anderson recommended to Congress an increase in the Treasury debt limit, the elimination of the 4-1/4% interest rate ceiling on Treasury Bonds having a maturity of five years or more, etc. Since returning, several bank directors and other leading businessmen here have asked for an expression of my views on Bob's recommendations, and in each instance I have fully supported his position, in which, I understand, you concur.

I am sure that the legislation which has been, or will be, introduced to implement these recommendations will be used as an excuse by several well-known low interest rate members of Congress to further expound their views on that subject. While the view that low interest rates can be maintained notwithstanding heavy and frequent federal government deficits and a continued strong demand for credit from that source, as well as from municipalities, business enterprises and individuals without causing inflation, is quite popular, you and I both know that it is wholly unsound, and that none of the proposals supporting that view should be adopted.

In order that I may be fully advised of the reasons you advanced in support of your position in this matter, I shall appreciate it very much if you will have someone in your organization send me a copy of the prepared statement you presented to the House Ways and Means Committee when you appeared before it last week. I am also asking Bob to send me a copy of the statement he submitted to that committee. I am anxious to obtain as full and accurate information as possible, because newspaper accounts of such statements are frequently badly garbled. I am in complete sympathy with the recommendations that have been made, and think that their adoption by Congress is absolutely necessary in order to enable the Treasury to deal appropriately with the present situation.

Hoping to have the pleasure of seeing you at the Kansas City bank's joint board meeting in Denver on July 18, I am, with most cordial regards,

Sincerely yours,

Randle

R. R. Gilbert

Mr. William McC. Martin
c/o Board of Governors of the
Federal Reserve System
Washington, D. C.

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

SIXTY EAST 42ND STREET
NEW YORK 17, N. Y.
MURRAY HILL 2-2650

GROVER W. ENSLEY
EXECUTIVE VICE PRESIDENT

Cable Address:
Savings, New York

June 15, 1959

The Honorable William McChesney Martin, Jr.
Chairman
Board of Governors
Federal Reserve System
Washington 25, D. C.

Dear Bill:

Congratulations on your excellent testimony before the Congress on debt managements problems. You may be interested in glancing over copies of the attached letters which went over the signature of our president, John deLaittre to Chairman Wilbur D. Mills, Chairman Harry Byrd, Speaker Sam Rayburn and Majority Leader Lyndon Johnson.

Looking way ahead, our 40th Annual Conference will be held in Washington, D. C. May 9, 10, and 11, 1960. We have thought for a long time that we would like to have you as one of our principal speakers. Could you give this some thought and work it into your plans? We will be in touch with you later with respect to a specific time, but certainly it could be possible to exercise flexibility within three days.

Sincerely yours,

Grover W. Ensley
Executive Vice President

Enclosures

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS
SIXTY EAST 42ND STREET
NEW YORK 17, N. Y.

June 12, 1959

Honorable Wilbur D. Mills
Chairman
House Ways and Means Committee
House of Representatives
Washington 25, D. C.

COPY

Dear Congressman Mills:

The Federal debt is so large a part of our entire capital and credit structure that its management influences the course of activity throughout the nation's financial and industrial markets. Current Federal statutes impose unrealistic restraints on debt management operations, and hinder efforts to maintain fiscal discipline.

Accordingly, legislative action is necessary to enable the Treasury department to manage the debt more effectively through greater flexibility. The President's proposals with respect to ceilings on interest rates and on debt limits represent such constructive legislation and, thus, have the support of the savings banking industry.

It is a basic tenet of our free enterprise economy that buyers and sellers, borrowers and lenders, compete in open markets for the goods, services and financial claims, which they offer and seek. In this setting, the Federal Government, in financing its operations, must be free to compete with other types of borrowers for available funds. The only ultimate alternative to permitting the Treasury to compete freely on the basis of interest rates and other terms is to turn to Federal regimentation requiring investors directly to purchase U. S. Government securities.

Recognizing the basic importance of an effective Federal savings bond program, savings bankers have always supported this program even though it competes directly with thrift institutions for the funds of small savers. A higher interest rate on these bonds is important to restore their competitive position in financial markets and their basic role in Federal debt management.

The recommendations in this letter are based on proposals made in December 1958 by Carl G. Freese, Chairman of the National Association's Committee on Government Securities and the Public Debt. These proposals were approved at that time by our Board of Directors.

I would have no objection to your including this letter in the record of the Committee's hearings.

Very truly yours,

John deLaittre
President

P. S. I am enclosing a copy of
Mr. Freese's statement
with this letter.

Attachment

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS
SIXTY EAST 42ND STREET
NEW YORK 17, N. Y.

COPY

June 12, 1959

Honorable Harry F. Byrd
Chairman
Senate Finance Committee
Washington 25, D. C.

Dear Senator Byrd:

The Federal debt is so large a part of our entire capital and credit structure that its management influences the course of activity throughout the nation's financial and industrial markets. Current Federal statutes impost unrealistic restraints on debt management operations, and hinder efforts to maintain fiscal discipline.

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John deLaittre
President

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Attachment

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS
SIXTY EAST 42ND STREET
NEW YORK 17, N. Y.

June 12, 1959

The Honorable Sam Rayburn
Speaker of the House
House of Representatives
Washington, D. C.

Dear Congressman Rayburn:

I thought you might be interested in a copy of the letter I have sent today to Congressman Wilbur Mills and Senator Harry Byrd.

The savings banking industry feels that a flexible debt management policy is essential if our nation is to combat inflation successfully. We feel that the President's proposals regarding interest rates on Government bonds and Federal debt limits would help accomplish this purpose.

Very truly yours,

John deLaittre
President

SBK:nm

COPY

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS
SIXTY EAST 42ND STREET
NEW YORK 17, N. Y.

June 12, 1959

The Honorable Lyndon B. Johnson
Senate Majority Leader
United States Senate
Washington, D. C.

Dear Senator Johnson:

I thought you might be interested in a copy of the letter I have sent today to Congressman Wilbur Mills and Senator Harry Byrd.

The savings banking industry feels that a flexible debt management policy is essential if our nation is to combat inflation successfully. We feel that the President's proposals regarding interest rates on Government bonds and Federal debt limits would help accomplish this purpose.

Very truly yours,

John deLaittre
President

SBK:nm

COPY

Federal Debt Management and the Savings Banking Industry

Address of Carl G. Freese, chairman of the Committee on Government Securities and the Public Debt of the National Association of Mutual Savings Banks, and president and treasurer, Connecticut Savings Bank of New Haven, before the 12th Annual Midyear Meeting of the National Association of Mutual Savings Banks, Hotel Commodore, New York City, December 2, 1958

The Federal debt is so large a part of the nation's entire capital and credit structure that its management has an important influence not only on the state of Federal finances, but also on the course of the national economy. Our government now owes close to $280 billion, about one-third of the total indebtedness outstanding in this country. Reflecting recent and expected deficits, moreover, the Treasury requested an increase in its temporary debt ceiling from $280 to $288 billion which the Congress recently granted.

All things considered, there is little likelihood in the years ahead of reducing the huge Federal debt; indeed the prospects are for further increases. In addition to problems associated with raising large sums of additional new financing, the Treasury's debt management team must contend with trying problems of refinancing maturing and called issues. In meeting these problems the Treasury has a profound and continuing influence on general financial developments. Indirectly, its debt management policies influence the level and rate of savings; directly they influence conditions in capital markets, including interest rate movements and terms of lending. As savings bankers, therefore, we clearly have a special and continuing interest in Treasury activities. Sound management of savings banks' investment portfolios requires our close interest in, and understanding of, Treasury financing problems and practices.

Recent refundings and new cash offerings have, in the main, not been particularly suited to savings banks. Large Treasury operations scheduled for the early months of 1959, however, may hold greater investment opportunities for our industry.

Debt management and inflation

It is important to recognize that present burdensome Treasury problems are the result of heavy wartime expenditures together with spending programs recently undertaken. In fiscal 1958 the Federal government spent close to $72 billion, nearly $5 billion more than it took in. In the current fiscal year ending June 30, 1959, it expects to spend $78 billion, $12 billion more than anticipated receipts. Clearly, the most direct and effective way of easing debt management problems without inflation is to reduce expenditures and/or increase revenues. The deficit in fiscal 1959 may well be lower than the $12 billion anticipated because of possible higher revenues resulting from the general improvement in business activity. It is not likely, however, that Federal expenditures will soon be reduced. Yet the volume of Federal spending must be controlled if we are to avert a steady erosion of the purchasing power of the dollar.

Apart from broader economic considerations, the Treasury has a direct interest in combating the forces of inflation. Fundamentally, a sound market for U. S. Government securities depends on allaying the widespread fears of inflation. So long as consumers and investors are motivated in their actions by a belief in the inevitability of inflation, so long will it be difficult to market new Treasury securities successfully.

Coordination of Treasury and other Federal programs and policies

Clearly, debt management policy is but one of the anti-inflationary weapons available to the Federal government. Its coordination with Federal Reserve monetary and credit actions is essential and, by now, a well accepted principle. During periods when economic expansion threatens to become excessive, for example, and the monetary authorities are rightfully pursuing a policy of credit restraint, it is important that the Treasury offer securities which do not require Federal Reserve support on more than a temporary basis.

It is not as well accepted, at least in practice, that there are other federal programs in major credit areas which must, also, be coordinated with Federal Reserve and Treasury operations, if debt management is to be most effective and the battle against inflation won. In particular, Federal programs to insure and guarantee mortgage credit operate in direct competition for investment funds with the Treasury Department. Higher yielding mortgages, backed by the contingent liability of the Federal government, provide nearly as much safety as do U. S. Government securities. Indeed, their amortizing nature provides for a type of liquidity not inherent in Government bonds. When the Federal government pursues a policy of stimulating demands for mortgage credit, out of social rather than economic considerations in the housing field, at a time when inflationary forces are rampant, it is assuredly acting at cross-purposes.

It is necessary, therefore, that the huge and expanding Federal mortgage credit programs -- some $48 billion or 44 per cent of all home mortgage debt is now underwritten by the Federal government -- be subordinated to, and modified from time to time in accordance with the changing need to control inflationary forces. For, after all, if the ability of the Federal government to stabilize the value of the currency is seriously impaired, the public's confidence in Federal obligations is undermined and Federal credit guarantees become of limited value. The coordination of Federal housing credit policies with fiscal and monetary policies must include not only the Federal Housing and Veterans Administrations -- the Federal underwriting agencies -- but also the Federal National Mortgage Association, Federal Home Loan Bank System, and Public Housing Administration. Coordination must extend, also, to the nation's agricultural credit programs.

Competition for capital market funds

It is a basic tenet of our free enterprise economy that buyers and sellers, borrowers and lenders, compete in open markets for the goods, services, and financial claims, which they offer and seek. In this setting, the Federal government, in financing its operations, must compete with other types of borrowers -- both private and public -- for the funds available in financial markets. This is as fundamental a principle of sound debt management as the need to combat inflation and to coordinate all federal fiscal, monetary and credit policies.

There are no isolated or preferred markets in which the Treasury can operate. Thus, in order to attract funds away from other borrowers, and successfully to finance its debt largely outside the commercial banking system, the Treasury must compete on the basis of interest rates and other terms. There can be no other effective financing method short of Federal regimentation or statutes requiring investors directly to purchase U. S. Government securities, or banks to hold them as part of their legal reserve.

Techniques of moral suasion, and appeals to institutional investors to overlook normal market considerations in order to support Treasury financing are not realistic, short of war or grave national emergency. Fiduciaries are themselves in sharp competition for the savings of individuals and have a prime obligation and public trust to depositors, shareholders, and stockholders to earn the highest return possible on invested capital commensurate with safety and liquidity requirements. Long-run considerations of inflation are, of course, essential but the best weapons in this battle are sensible and courageous fiscal and monetary policies of the Federal government, effectively coordinated with housing and agricultural policies to preserve the purchasing power of the dollar.

To be sure, a debt management policy based on offering securities at competitive rates of interest is not without its problems. The Treasury is, for the most part, in competition with borrowers who are able to deduct interest payments from their tax bill. A corporate borrower, for example, who pays 5 per cent interest on debt securities has a net cost, after Federal income tax, of 2.4 per cent. The same principle applies to the mortgage borrower. To compete effectively with these borrowers it may be necessary at some future time for the Treasury to request an increase in the statutory rate of interest which it can pay on Government bonds.

Competing with other capital market borrowers on the basis of interest rate means, also, that the cost of interest payments in the Federal budget will be increased. It means, further, that prices on outstanding issues of Government securities may decline and fluctuate over a wider range than they have in other earlier years. This phenomenon has characterized the market for Government securities over the past year or so.

Higher interest costs on the Federal debt, while not in themselves desirable, are a necessary price for managing the huge Federal debt so as to contribute to the prevention of inflation and of an unsustainable rate of economic growth. Market instability may likewise be considered a price that must be paid to prevent economic excesses. Bankers and other investors, of course, rest more comfortably when markets are stable and risks are reduced, but this peace of mind is a luxury that must at times be sacrificed in the nation's battle against its principal internal enemy - inflation.

It must not be overlooked, on the other hand, that a higher level of interest rates - which might result from vigorous Treasury competition - may well stimulate an increased flow of savings, an essential element of an anti-inflationary program. Moreover, deferral of plans for increased investment as interest rates rise, will relieve the pressure on the limited supply of capital funds. In an expanding economy the Treasury can successfully draw funds away from marginal borrowers in both the corporate and mortgage sectors, only if it is willing to compete on the basis of rates and terms.

Treasury market techniques

While a willingness and determination to compete for capital funds in the open market must be the chief factor in a successful debt management program, other factors relating principally to techniques for offering new, and refunding outstanding U. S. Government securities should, also, be given careful consideration. Among these techniques, the following might be considered.

The technique of forward commitments, widely used in the marketing of mortgages and in the direct placement of corporate securities, may be adaptable to the marketing of U. S. Government securities.
Basic modifications, would, of course, be necessary. The extended period of

time covered by commitments in the mortgage market, for example, would be inappropriate in the Government securities market. In the corporate securities market, however, the length of time covered by commitments has been generally shorter.

Actually, a commitment technique was used by the Treasury in 1955 in connection with its offering of 3 per cent bonds due in 1995. Not many institutional or other types of investors subscribed for this issue on a commitment basis, however. This suggests that the technique may not have been well suited to investors, or that the Treasury did not appropriately publicize it. In any event, the commitment device will have to be studied more carefully and refined before it can again be employed.

One refinement which might be considered is the payment of a modest commitment fee by the Treasury. Such a fee to investors would be an added inducement to enter into contracts and would tend to offset in part the disadvantages of a possible market reduction in the price of forward contracts soon after the closing of books. If the problems associated with the commitment technique can be overcome, there will be distinct advantages both to the Treasury and to investors of permitting payment for Government securities over a limited period of time as funds become available from savings, insurance premiums, etc.

There are other marketing techniques, associated with redemption and conversion privileges, which might be considered. A limited disadvantage of these techniques is that, in most cases, the initiative for debt management is transferred from the Treasury to investors. This course is to be avoided when possible but may be a necessary price, on occasion, in order to attract new groups of investors. Privileges of redemption were granted in connection with the two 4-per cent note issues offered in 1957. These notes, it will be recalled, had definite maturities but holders were given the right to redeem them at par at about the midpoint of their contract maturity.

This redemption device need not be limited to note issues. Further, there might be one or more optional redemption dates. For example, the Treasury might offer a 30-year bond, giving the holder the right of redemption on a fixed date, after appropriate notice, perhaps at the end of two years and again after five years. The disadvantage of this type of security is, of course, that it is redeemable in cash, a fact which might be inconvenient to the Treasury or blunt monetary policy at redemption dates.

In this respect, the offering of securities with conversion rather than cash redemption privileges might be preferable. The offering of a long-term bond which, for the first several years of its life, would be convertible into any new issue of Treasury securities having a maturity, of say, more than five years, might be attractive to investors. Another possibility would be to offer a long-term security bearing a rate of interest in the early years different from that in the later years -- higher or lower depending on market conditions -- with the option of redemption at the end of the earlier period or retention for the longer period.

An approach of a different sort, directed towards increasing the participation of individuals in the market for Government securities, might operate through tax benefits. Tax exemption per se is not considered to be good public policy, and rightfully so. This is not to say, however, that there are no tax advantages associated with U. S. Government securities. Certain issues which are available at discounts, for example, may be used in payment of certain tax obligations at face value. All issues selling at discounts, moreover, offer some tax advantage in that the discount may be regarded as a potential capital gain.

In the case of individuals, a tax deduction of $1,000 is permitted, with carryover privileges of amounts in excess of $1,000 for losses sustained in U. S. Government and other types of securities. In this connection the Treasury might wish to consider the advantages of broadening this privilege by permitting individuals to deduct from taxes an additional $1,000 or more, with similar carryover privileges, for losses sustained in the sale of U. S. Government securities issued after January 1, 1959. To encourage the continuing interest of individuals in the market for Treasury securities, however, it should be provided that additional tax losses be deductible only from current or future interest earned on Treasury securities.

Consideration might also be given to similar limited tax benefits to non-bank corporate holders of U. S. Government securities.

Debt lengthening and orderly marketing

I would like to offer a brief comment about the general Treasury objectives of debt lengthening and orderly marketing. Lengthening the average maturity of the outstanding debt is important to the extent that it makes for a more orderly marketing of obligations and contributes to the fight against inflation. There seems to be a tendency at times, however, to overemphasize average maturity statistics without solving the basic problems of Treasury financing. For example, the average outstanding maturity of the debt may be lengthened without materially reducing the problem of refinancing immediately-maturing issues.

The Treasury is undoubtedly aware that an orderly scheduling of maturities can be accomplished without necessarily going into the longest maturities. In this respect, issues in the 10 to 15 year maturity range would contribute importantly to bringing about a better spacing of outstanding obligations. As market conditions permit, it would be desirable to have frequent, but relatively small amounts of, long term offerings both for cash and refunding.

Aspects of advance refunding

The Canada Conversion Loan of 1958 has created considerable interest with regard to the feasibility of a similar advance refunding operation in this country. Apart from considerations of the relative success of the Canada Conversion Loan, there is a serious question about the applicability of this type of large-scale, dramatic refunding operation to the United States. At this time such an action is hardly to be recommended.

While the near-term problem confronting the Treasury concerns the issues maturing in the period 1959-61, it does not appear feasible to undertake an advance refunding of these issues considering their large volume, relatively attractive yields, and current conditions in the capital markets. With respect to the feasibility of an advance refunding of issues scheduled to mature in later years, particularly the more than $28 billion of 2½ per cent war-time issues with final maturities in 1967-72, there would seem to be little practical advantage to the Treasury in such an action. These issues do not now present a problem to the Treasury, nor would their refunding ease the refinancing problems of the 1959-61 maturities. There are enough "in-between" dates available in the 1967-72 range to accomplish such refinancing in this maturity area if desired, when the time is appropriate.

Finally, it is open to question whether conversion of the 2½ per cent war-time issues into long term bonds bearing higher interest rates would reduce sales from investment portfolios. At current low prices, holders of the 2½'s are reluctant to take the substantial losses attendant upon sale. Conversion to securities with higher yields instead of making for more "permanent holders", might result in increased net selling as losses were reduced or perhaps converted to gains.

For all of these reasons, advance refunding of outstanding securities does not seem appropriate at this time. Because an advance refunding on a relatively small scale, offers important advantages with respect to debt lengthening and orderly scheduling of maturities, I do feel, however, that the question should be kept under continuing study in the event that subsequent market changes make it feasible to undertake such an operation.

Modification of U. S. Savings Bond Program

Since the end of the war, the public appeal of savings bonds has been considerably reduced even though the rate of return on these bonds, when held to maturity, has at times equaled or exceeded that paid by mutual savings banks and commercial banks on savings deposits, and by most savings and loan associations on share accounts. The clear indication is that savers prefer the convenience and flexibility of savings and share accounts, and the protection of life insurance to ownership of savings bonds. Only in time of war does it seem possible to sell U. S. Savings Bonds readily and in large volume.

While large-scale expansion of savings bond sales does not appear feasible, nor in fact economically desirable, the general rise in interest rates that has occurred in recent years suggests the need for a revision in savings bond terms.

The $3\frac{1}{4}$ per cent Series E Bond was first offered to the public in February 1957. Since that time yields on U. S. Government securities have advanced by approximately $\frac{1}{2}$ per cent. Rates on newly offered issues of corporate, and state and municipal securities have also advanced by about $\frac{1}{2}$ per cent or more during the intervening period. The maximum rate on savings bonds is set by Congress and it may be February or March of 1959 before Congressional action can be taken on this matter. In order to restore the competitive position of savings bonds, therefore, it would seem reasonable to have the yield on Series E Bonds raised from 3-$\frac{1}{4}$ to 3$\frac{1}{2}$ or 3-3/4 per cent. It is also desirable to shift responsibility for establishing the rate from Congress to the Treasury, which could administer the rate in accordance with market needs.

Accompanying this revision in interest rate there should be a revision in terms and prices of savings bonds. Heretofore, advances in rates have been achieved by a shortening of maturities. Thus, when the rate on Series E Bonds was raised from 3 to 3$\frac{1}{2}$ per cent in 1957, the maturity was reduced from 9 years and 8 months to 8 years and 11 months. The price at which the bond was offered remained unchanged at 75 per cent of ultimate maturity value. In revising the present rate to 3$\frac{1}{2}$ or 3-3/4 per cent, a similar device might be employed and an effective rate change achieved by a corresponding reduction in the maturity.

In view of the expense incurred by the U. S. Government in connection with the issuance and turnover of these bonds, however, consideration must be given to maturity extension in order to achieve a reduction in expenses. It is desirable, also, that the cost of the bond be a round fraction of its ultimate maturity. The present and older Series E Bonds, as you know, were offered at a price of three-fourths of their maturity value. If the cost were to be reduced to five-eighths of maturity value, then the term could be adjusted to provide a 3-3/4 per cent return. For example, a $100 Bond costing $62.50 would give a return of 3.75 per cent compounded semi-annually at a maturity of 12 years and 8 months.

A price reduction, as suggested above, would give the Treasury an opportunity to eliminate the $25 denomination and make the $50 denomination the smallest issue. This would reduce the administrative costs of the savings bond program considerably. Corresponding modifications should be made in the yield, price, and terms of the Series H Bonds.

Conclusion

The highest order of economic intelligence and political statesmanship must be brought to bear on the complexities of debt management problems. Because of its fundamental influence on the nation's economic life, debt management policy must have as its primary long run aim the contribution it can make towards achieving sustained economic growth and relative price stability. No matter the difficulties or the so-called practical problems of Federal finance, all other considerations must be subordinated to these basic objectives, lest the nation's economic health be undermined.

Mr. Martin

I mailed a copy to Mr. Du Brul, with a note saying you appreciated hearing from him.

mnm

GENERAL MOTORS CORPORATION

GENERAL MOTORS BUILDING
3044 WEST GRAND BOULEVARD
DETROIT 2, MICHIGAN

June 12, 1959

Mr. William Martin, Jr.
Chairman of the Federal Reserve Board
Federal Reserve Building
20th and Constitution Avenue
Washington 25, D. C.

Dear Bill:

Will you have your secretary mail me a copy of your formal statement before the House Ways and Means Committee which you presented yesterday? I can judge only by the newspaper reports but on that basis I am sure that you are to be congratulated on the vigor and clarity of your position.

Sincerely yours,

Steve

SMD/bh

S. M. Du Brul

June 11, 1959

1. What is likely to be the future course of interest rates?
2. Would the removal of the 4-1/4% ceiling cause the general structure of rates to be higher?
3. Do you think failure to remove the 4-1/4% ceiling would be inflationary?
4. If credit demands are high, especially in long-term market, who will be squeezed out if Treasury does enter market at higher rates? Will it cause special problems for State and local governments?
5. What can Congress do to bring about a lower level of interest rates in the period ahead and facilitate the Treasury's borrowing?
6. Are there alternate procedures which would make it possible for the Treasury to borrow at lower cost? Should they auction longer term issues?
7. Is the rise in rates since 1951 due, in part, to a restrictive bias on the part of the Federal Reserve, which has resulted in a slower growth of money supply than G.N.P.?
8. Are our present difficulties due primarily to an "irresponsible" or "spendthrift" attitude in Congress? (Note: Secretary pointed out that the major factor in fiscal 1959 deficit was decline in reserves, due to recession).
9. Why not borrow short now, when rates are high and fund later when they are low? Isn't this good business?

10. Would proposed increase in E. & H. rates be unfair competition for Mutuals and S. & L.'s? Would it encourage them or force them to push rates up to unsound levels?

11. Do you think we should do something to limit competition of other agencies who borrow with Government guarantee: F.H.A., V.A., C.C.C., Public Housing, etc.?

12. Would it be a good idea to have the removal of the 4-1/4 ceiling for a specified period -- one, two, three or more years? (Note: Secretary said "NO"!).

13. Do you feel that pressure of debt ceiling has caused Treasury to be inefficient in managing debt? Forced Treasury into market at wrong time, for example?

14. Would it be a good idea to pay individuals <u>and</u> <u>savings</u> institutions a higher rate than banks?

15. Would a debt ceiling that applied at one date only -- say June 30 -- be better? (Note: Secretary said "Yes".)

16. What would happen if Congress refuses all or part of request for higher debt ceiling?

June 11, 1959.

Dear Gerhard:

Thank you for sending me a copy of your statement before the House Ways and Means Committee. I am very interested to see it and appreciate your thoughtfulness in making a copy available to me.

With all good wishes,

Sincerely yours,

Wm. McC. Martin, Jr.

Dr. Gerhard Colm,
Chief Economist,
National Planning Association,
1606 New Hampshire Avenue, N.W.,
Washington 9, D.C.

NATIONAL PLANNING ASSOCIATION

1606 NEW HAMPSHIRE AVE., N.W., WASHINGTON 9, D. C.
COlumbia 5-7685
CABLE: NATPLAN

June 10, 1959

The Honorable
William McChesney Martin
Chairman
Board of Governors of the
Federal Reserve System
Washington 25, D.C.

Dear Bill:

I would like you to see a copy of the testimony I have prepared on request of Mr. Wilbur Mills, Chairman of the House Ways and Means Committee.

As always yours,

Gerh.

Gerhard Colm
Chief Economist

GC:jt

June 9, 1959

Chairman Martin:

Attached are two documents that might come in handy at the hearing tomorrow.

The first, entitled "PROCESS BY WHICH BANKS ACQUIRE GOVERNMENT SECURITIES," was prepared as an enclosure to a reply to an inquiry from Lyndon Johnson on behalf of a constituent and is aimed at the charge sometimes made that the Federal Reserve "gives" member banks reserves.

The other attached matter is an exchange of letters between Marriner Eccles and Senator Vandenberg, and, among other things, covers the charge that Congress has abdicated its constitutional authority over money to the Federal Reserve System and the private banks.

Both of the above are matters on which we have had some inquiries recently and on which, I understand, the Banking and Currency Committees have had several inquiries from Congressional sources.

JWS

Attachments

April 2, 1959

PROCESS BY WHICH BANKS ACQUIRE GOVERNMENT SECURITIES

It is not correct to say or imply that the Federal Reserve System gives member banks reserves on the basis of which the banks can acquire Government securities amounting to many times as much and collect interest on those securities. An individual bank can purchase newly issued securities from the U. S. Treasury and credit the Treasury's deposit balance (the so-called tax and loan account) with the amount of the purchase. A bank can and does make loans to its customers on the same basis.

In such an operation, however, the bank is subject to two obligations. First, it must maintain a reserve balance with its Federal Reserve Bank (or in case of a nonmember bank in cash or in some other required form). This required reserve, which is a fraction of deposits, may be obtained by an individual bank by drawing on its balance with some other bank, by borrowing, or by selling some asset. In the final analysis for the member banking system as a whole, the additional reserves must be obtained either by borrowing from the Reserve Bank, or they must be supplied through Federal Reserve purchases of Government securities.

The Reserve System, through the Federal Open Market Committee, decides whether or not to purchase securities to supply reserves. The Reserve Banks also decide at what discount rate advances will be made to member banks. These decisions, as explained later, are based on broad policy considerations as to the country's need for additional deposits.

The second obligation that a bank extending credit to a depositor must be prepared to meet is the withdrawal of the deposit. Such withdrawal occurs within a few weeks in the case of an increase in the Treasury balance and at varying intervals and in varying proportions in the case of additions to other deposits. When deposits are withdrawn, the bank may lose an equivalent dollar amount of reserves, while its required reserves decrease by only a fraction of that amount. The bank must then sell assets or borrow to meet this reserve drain. Thus, no individual bank can count on retaining indefinitely Government securities or other assets acquired in return for a deposit balance.

In actual practice, for the banking system as a whole, funds are constantly being shifted among banks. What one bank loses another gains. There is no net liquidation or decrease in assets for the whole system, unless the total supply of reserves is reduced, or no net expansion unless the reserve supply is augmented. An addition to the reserve supply can provide the basis for an expansion in credit by the whole banking system, though not by an individual bank, amounting to many times the amount of the addition to reserves. Correspondingly, a decrease in reserves would result in a multiple contraction of credit.

It is this multiple effect of changes in reserves, which is the basis for the statement that banks can expand assets greatly from a small amount of reserves supplied by the Federal Reserve. The additional reserves, however, as explained, are in no sense a gift. They can be acquired by a bank only by borrowing or by liquidating other assets, or as a result of a deposit of funds shifted from another bank or acquired by the depositor by sale of securities to the Federal Reserve.

Federal Reserve decisions, moreover, to add to or reduce the available supply of reserves, are based upon broad policy considerations as to the appropriate amount of credit and money that the banking system should make available to maintain a growing economy with stable prices. Federal Reserve operations are not made for the purpose of increasing the earnings of banks. They may enable banks as a group to increase their earning assets, but the effect on bank profits depends on the interest rates received and expenses of operating banks. Interest rates in turn are determined by the relation between current demands for credit and the available supply of lendable funds, including the public's savings as well as the reserve position of banks. Additions to bank reserves in the absence of demands for credit can result in declining interest rates and a decrease in bank earnings.

Z-4613

FROM THE CONGRESSIONAL RECORD--SENATE
JUNE 16, 1938, Pages 9536 et seq.

May 17, 1938.

Hon. Marriner S. Eccles,
Chairman, Board of Governors of the
Federal Reserve System,
Washington, D. C.

My Dear Mr. Eccles:

Every depression produces a substantial attack upon the American monetary system. Our present experience is no exception to the rule. My part of the country is once more full of earnest souls who insist that we should rid ourselves of the Federal Reserve Banking System and, of course, substitute greenbacks for bonds. There are always two fundamental points that are stressed by agitators in this field.

I have often wondered whether the Federal Reserve Board itself should not undertake to make available some sort of an authentic statement which might contribute to a more rational state of public information on these related subjects. I think there is a real service to be rendered in this connection, and it seems to me that it ought to come from some authoritative source like the Federal Reserve Board. Needless to say, there is not a remote element of partisanship in this suggestion.

Here are the two constant propositions which these monetary agitators always persuasively stress and with which they always win a sympathetic popular hearing.

The first proposition is that the Constitution of the United States requires the Congress that it "shall coin money and regulate the value thereof," and that Congress abdicates this constitutional function under the existing Federal Reserve System.

The second proposition is that, as a result of this abdication, private banking--operating through the medium of the Federal Reserve System--is the actual comptroller of "coinage and values," and that private banking takes a profit to itself through the exercise of this public function.

I shall be greatly interested in seeing an authentic answer to these two propositions from the Federal Reserve Board in some form or other. I should like to see the Federal Reserve System provide, abstractly, what it conceives to be the authentic answer to these attacks upon its own foundations and its own existence. The misconceptions persist and multiply, and I think there is a distinct public service to be rendered in making the constitutional theory of the Federal Reserve System authentically plain to the American people in some fashion that brings the matter to the levels of popular understanding.

If anybody has the facilities to do this sort of a job, it is certainly your Board. At the very least--for the benefit of my own purposes--I should appreciate a letter discussing these two principal propositions from your point of view.

With warm personal regards and best wishes,

Cordially and faithfully.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Washington, June 14, 1938.

Dear Senator Vandenberg:

Your letter of May 17 is of much interest to me and to the other members of the Board of Governors, for it raises fundamental questions of public interest. I appreciate, as I know my colleagues do, your interest in having a correct statement of the facts with which to meet misleading and damaging propaganda that jeopardizes not merely our banks but our entire economic structure and, in the final analysis, our democratic institutions.

You state that in your part of the country there is agitation to abolish the Federal Reserve System and to substitute greenbacks for bonds, and that the advocates of this course make two main points: First, that, although the Constitution gives Congress the power to "coin money and regulate the value thereof," Congress has abdicated this power; and, second, that in consequence of this abdication private banking, operating through the medium of the Federal Reserve System, is the actual controller of coinage and values, and thereby takes a profit to itself through the exercise of this power.

We are constantly bombarded, as you are, by those who imagine that all the complicated problems of our economic life can be solved by monetary magic. Unfortunately, the problems are not so simple. The failure on the part of many groups to understand how our economic system functions increases the difficulty of finding practical solutions to the vital problems that confront us.

One of the most conspicuous and arresting facts of the situation as it exists now and has existed since the banking holiday is that we have an abundance, not a scarcity, of money and of funds seeking investment in profitable and productive outlets. It would be supposed that in the presence of this fact those who imagine that a mere increase in the volume of money would assure full employment and prosperity would at least reexamine their arguments. I doubt whether in all history there has ever been such a convincing demonstration of the falsity of the theory that mere creation of a vast volume of funds will of itself produce or maintain prosperous conditions.

The vital point which is so strangely overlooked by the quantity of money thorists is that in order to have prosperity we must not only have an adequate supply of money but it must be put to active use for productive enterprises.

The great need now, as has been the case ever since the late twenties and, indeed, throughout much of the so-called prosperous era is to draw upon our existing human and material resources and put them to productive use. Our problem is not and has not been in any sense one of an inadequate supply of money and credit. We have today, for example, as you are aware, a larger volume of currency and bank deposits than we had at the peak of the boom in 1929. Interest rates have been and continue to be at unprecedentedly low levels. This would not be the case if there were a scarcity of money. It is a scarcity of money, together with demand for it, that makes interest rates rise.

* * * * * * * * * *

Our banking system has developed its present pattern since the beginning of the Republic, and while no one familiar with it would contend that it has attained perfection or has yet approached the ideal, it has been adapted, step by step, in accordance with American principles and traditions of democratic government and to avoid too great a concentration of or an abuse of power. So many safeguards against these evils have been established over the years as to present other difficulties, such as those arising from divided responsibilities. Yet, with all of the admitted faults, the system is infinitely preferable to one which completely abandons the basic principles upon which democratic governments were long ago established and have since been maintained. Similarly, the procedure whereby the Government issues its securities, pays interest upon them, and repays them at maturity has been established out of long experience.

The Government represents all of our people. Its debts are the debts of all of our people. When we as a people, acting through our collective medium of government, borrow money we are borrowing from ourselves, and when we pay interest on or pay back the principal of the debt thus created we are paying ourselves. The money required to pay the interest and to pay back the principal is raised by taxation levied broadly on the basis of ability to pay.

What is to be gained by doing away with this established process? If the Government is not to pay interest, then it can no longer borrow from its citizens. Certainly they cannot be asked to lend their savings without any return whatsoever--not if we are to preserve a democratic system of private capital. The Government would have to fall back, then, upon issuing currency. Currency is used only for a small part, not more than 10 percent, of our business transactions. The heart of our system is the extension and contraction of credit in accordance with the requirements of commerce, industry, and agriculture. But let us suppose that the Government were to issue more and more currency in order to meet its current obligations and also to pay off its bonded debt entirely, as some of the advocates to whom you refer have proposed. The recipients of the currency, if they are on the relief rolls, for example, would spend the money as they do the cash they receive now, but ultimately it would find its way into the hands of some merchant or producer, who would deposit it in his bank, and the bank in turn would forward the cash to the Federal Reserve bank, where it would add to excess reserves. Or, if the recipient is the holder of a Government bond which he is obliged to exchange for currency, he might possibly spend some of the currency, or he might endeavor to buy some other security which would return a yield on his capital, or he might deposit the currency in his bank, which in turn would forward it to the Federal Reserve bank; but in every case the currency ultimately would find its way to the Federal Reserve banks and add to excess reserves.

Suppose that the entire national debt were to be paid off in this fashion. About $34,000,000,000 of the Government debt is represented by Treasury securities held by banks, insurance companies, and other corporate and individual investors. To replace these securities with cash would mean that the cash would flow into the Federal Reserve banks and build up excess reserves by $34,000,000,000, or to a prospective grand total of more than $37,000,000,000. There is no way in which any such deluge of excess reserves could be kept within control to prevent them from being used as a basis for a reckless inflation. Under our system of so-called fractional reserves, for every dollar of excess reserves they have the banks can lend approximately $7. Thus $37,000,000,000 of excess reserves, if used as a basis for loans, would be capable of expanding into some $250,000,000,000 of bank loans, an astronomical figure that, if ever realized, would mean the wildest inflation imaginable. Yet the figure serves to illustrate the absurdity of the proposal to pay off the Government's debt in cash.

Assuming that the banks would not indulge in any such orgy of inflation--and, as I have pointed out, there would be no way to control the situation--then all that would be accomplished by the proposal is that the holders of Government securities, whether they be individuals or insurance companies, or savings and other banks, would receive cash for their Government securities, and this cash they would try to invest in some other interest-bearing obligation, presumably one issued by a private corporation, and if they failed to find a satisfactory investment they would deposit the cash in the bank. In any event, the currency would finally find its way back to the banking system, because no more currency will remain in circulation than the public needs for pocket, pay roll, and a few other purposes. (The reasons for this are explained in more detail in The Currency Function of the Federal Reserve Banks, copy of which is attached.) The heart of the American financing system is credit--not coins or paper money. They are the small change. The great bulk of business is done by bank checks.

After the money was deposited in the bank it would probably be added to the already redundant amount of funds that fail to find a satisfactory investment outlet. The effect would be to bid up to larger and larger premiums the existing supply of such investments, which are even now at extremely low yields.

The creation of more idle funds would not create more real wealth. It would not lead industry to produce more of the necessaries and comforts of life which our people need or want. It would not help to distribute among the people of the country the needed and wanted things--housing, clothing, food, and all the infinite variety of other products which our economy could and should produce.

Furthermore, the use of the printing press by the Government would remove all restraint on public expenditures. When the Government prints money, someone has to pay for what it buys. Production does not increase and in the exchange of goods some group in the population must bear the cost of uncompensated acquisitions by the Government. Who pays in the first instance depends on circumstances, but ultimately it is paid for by those least able to bear the cost, for inflation inevitably follows this course, and the burden of inflation, through loss of buying power of money, falls heaviest on the poor, who spend all their earnings to meet the cost of living. It is far cheaper and more equitable to pay for Government expenditures out of taxes, to which contributions are in accordance with ability to pay, than to pay for them by inflation, which destroys the value of the pay envelope, the savings account, and the insurance policy.

There is no question whatever as to the sovereign right of the Government to abandon tried and tested principles and to issue greenbacks. What is at issue, is not the right of the Government to do virtually what it pleases with its currency. The issue is whether the Government shall adhere to principles established through long and often bitter experience or throw those principles to the wind in favor of the printing press methods that we as a nation have discarded, but that have led some countries to financial ruin.

As I have indicated, the basic fallacy of the groups to whom you refer appears to be that of mistaking money for real wealth. The Government might, and certainly constitutionally could, flood the Nation with paper currency, unbacked by anything other than the air we breathe, and limited only by the ability of the presses to turn out the printed money. Yet that would not add one dollar to our real wealth. It would not better the lot of our people. It would serve only to engulf all of us in a ruinous inflation and collapse. Possibly a few shrewd speculators might benefit by that, but for the great mass of our people it would be utterly disastrous.

Stripped of the specious profundities about the constitutional right of the Government to coin money, the argument for abandonment of the established principles on which this Government has always stood leads to the same end as the bolder, franker cry for an unlimited inflation. That would be the inescapable outcome, unless it be argued that the Government would be as likely or more likely to avoid the pitfalls of reckless, inflationary issuance of its non-interest-bearing obligations, than is the case today when it is committed to pay the interest and principal on its debt. Experience disproves that argument. Governments have too often been tempted to travel this path to national bankruptcy when all restraints were removed. That is why the proponents of greenbacks also would abolish the Federal Reserve System, which was created nearly a quarter of a century ago as a means of assuring elasticity of our money system and at the same time to prevent abuses and to impose restraints against reckless inflation and speculation. It is not surprising that those who want greenbacks also want to remove even such limited restraints against inflation as Congress has given to the Reserve System.

This background serves to indicate the answer to the two propositions you set forth as characteristic of current monetary agitation: First, the argument that Congress has abdicated its constitutional right to coin money and regulate the value thereof; and, second, the contention, that as a result of this abdication, the private banking system reaps large profits. Both contentions are false.

Under the division of powers between the legislative, executive, and judicial branches of the Government provided for in our Constitution, it is not the function of Congress to execute the laws. It is the function of Congress to make the laws and the function of the executive branch of the Government to execute them.

When the authors of the Constitution provided that Congress should have power to coin money and regulate the value thereof, they did not mean that Congress should set up mints and printing presses in the Capitol and operate them itself. They meant that Congress should pass laws regarding the coinage of money and regulating the value thereof and leave it to the executive branch of the Government to execute these laws, and this is exactly what Congress has done.

The right of Congress to entrust to administrative agencies the execution of the laws which it enacts is as old as the Republic. It has never been seriously questioned. It has been so long recognized and established by the courts as to be beyond serious controversy. Similarly, the Congress has a right to assign execution of its will to whatever agency it cares to select or create. In so doing, the Congress frequently selects an executive agency of the Federal Government, such as the State, War, Navy, or Agriculture Departments. Or it may select an independent agency, for whose operations it appropriates the necessary funds, such as the Federal Trade Commission or the Interstate Commerce Commission. Congress assigns the execution of its power to coin money, for instance, to the Treasury Department, and, in recent years, has given the President a limited authority to determine the gold value of the dollar. In all such cases, Congress has not abdicated its power. Congress has only done what it constitutionally has the right to do: It has set up or used existing administrative agencies to execute its will, while retaining the power to take back the authority or to place that authority elsewhere. Abdication of a power means its surrender. Congress surrenders none of its power to coin money and fix the value thereof. It simply designates the Treasury as the instrument of its will and power to coin money.

In exactly the same way, Congress has established the Federal Reserve System as an independent agency to carry out its mandate in connection with the terms and conditions upon which member banks may create credit currency. The only important point of difference between creation of the Reserve System and creation of the Interstate Commerce Commission as independent agencies to carry out the will of Congress is that the expenses of the former are paid out of the earnings of the System, while the expenses of the latter are paid out of the Treasury. Congress ordained that this difference should exist in respect to the Reserve System as a further safeguard of its independence of action in the exercise of the delegated authority of Congress. At the same time, Congress has the power to abolish the System, to change it, to require that its expenses be paid in some other manner, and to appropriate the earnings and surplus of the System. In fact, Congress has exercised this power by appropriating to the Federal Deposit Insurance Corporation fund approximately $140,000,000 from the surplus of the Reserve System built up out of earnings. By no stretch of the imagination can this be called an abdication or surrender of a constitutional power by the Congress. It is, as in innumerable other cases, an assignment by Congress of the execution of an unquestioned and fully retained constitutional power.

As for the question of the profits of the banking system, so far as the Federal Reserve System is concerned, it is not and never has been operated with a view to making profits, and in this respect differs fundamentally from the usual commercial bank. Such profits as have accrued to the System through its operations, from which reserves have been established to cover contingencies, from which expenses of the System have been paid, on which franchise taxes have been levied at times by Congress, and which have been appropriated by Congress as in the case of the Federal Deposit Insurance Corporation fund, have been derived as an incident of and not as a result of the objective of the System's operations.

The System's operations are intended to serve the general public welfare. Such operations are a part of the financial mechanism necessary in all modern governments. To abolish the System would not do away with the necessity for creating some similar mechanism to perform the credit and supervisory functions which Congress has deputized the System to perform. Opinions may differ as to whether some other mechanism might be better, but the right of the Congress to create the Reserve System as the agency for the performance of these essential functions cannot be seriously challenged.

Accordingly there is no substance whatever to the assertion that Congress has abdicated its constitutional powers by authorizing the Reserve System to carry out its will, and, by the same token, the argument that thereby private banking improperly deprives a profit falls to the ground. The assumption that the Reserve System, created by and existing at the will of Congress, is a privately owned system springs from a misconception of the facts. The major monetary, credit, and supervisory powers of the System are exercised by a Board of Governors, nominated by the President and confirmed by the United States Senate. All national banks are required by law to be members of the System, and State banks are admitted to membership under specified conditions laid down by the Congress. All of these member banks are required by law to subscribe a proportional amount of their capital to the Federal Reserve banks in their respective districts, on which subscription a rate of return, fixed by Congress and changeable at the will of Congress, is paid. What is, in fact, a compulsory contribution by the member banks is termed a purchase of stock, but this designation is misleading since no member bank is permitted by law to trade in the stock or to enjoy various other privileges which are usually associated with stock ownership.

In any case, regardless of whether the member banks are required by law to subscribe to this unprivileged stock or whether some other device be substituted for the subscription, the matter is relatively unimportant, for it would make no real difference to the proper functioning of our economic system if this detail were changed. The effort of agitators to raise this bugaboo obscures the true meaning of their attacks, which, if successful, would undermine the foundations of our economic institutions.

They would destroy, to no purpose, the established first principles upon which our Government and all solvent governments have operated for centuries. They would do away with the Reserve System created out of long experience and adapted, step by step, over the past quarter of a century. Yet doing away with it would not do away with the necessity for a similar medium to perform essential functions for the Government and the public at large. They would, in the end, destroy our banks, our savings, insurance, and other fiduciary institutions, for the day that the Government abandoned interest paying and turned to the printing press would mark the beginning of the end of the basic principles upon which our economic institutions are founded.

Permit me to express again my appreciation of the spirit in which you write and your desire to help the public to distinguish between sound principles of government and of economics that have been established by centuries of experience and proposals which could only bring disaster to the great mass of our people.

Sincerely yours,

M. S. Eccles, Chairman.

Hon. Arthur H. Vandenberg,
United States Senate, Washington, D. C.

[CONFIDENTIAL COMMITTEE PRINT]

JUNE 30, 1959

86TH CONGRESS
1ST SESSION

H. R.

IN THE HOUSE OF REPRESENTATIVES

JUNE 30, 1959

Mr. ---------- introduced the following bill; which was referred to the Committee on --------------------------

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A BILL

To facilitate management of the public debt, to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Public Debt Management Act of 1959".

TITLE I—IN GENERAL

SEC. 101. The Second Liberty Bond Act, as amended, is amended by adding at the end thereof the following new section:

"SEC. 25. In the case of any offering of bonds issued or to be issued under this Act, the maximum limits on the interest rate or the investment yield or both may be exceeded upon a finding by the President with respect to such offering that the national interest requires that such maximum limits be exceeded."

SEC. 102. (a) Paragraph (2) of section 22 (b) of the Second Liberty Bond Act, as amended (31 U.S.C., sec. 757c (b) (2)), is amended to read as follows:

"(2) The Secretary of the Treasury, with the approval of the President, is authorized to provide by regulations:

"(A) That owners of series E and H savings bonds may, at their option, retain the bonds after maturity, or after any period beyond maturity during which such bonds have earned interest, and continue to earn interest upon them at rates which (subject to section 25) are consistent with the provisions of paragraph (1).

"(B) That series E and H savings bonds on which the rates of interest have been fixed prior to such regulations will earn interest at higher rates which (subject to section 25) are consistent with the provisions of paragraph (1)."

(b) The heading and first sentence of section 454 (c) of the Internal Revenue Code of 1954 (relating to matured United States savings bonds) are amended to read as follows:

"(c) MATURED UNITED STATES SAVINGS BONDS.—In the case of a taxpayer who—

"(1) holds a series E United States savings bond at the date of maturity, and

"(2) pursuant to regulations prescribed under the Second Liberty Bond Act, (A) retains his investment in such series E bond in an obligation of the United States, other than a current income obligation, or (B) exchanges such series E bond for another nontransferable obligation of the United States in an exchange upon which gain or loss is not recognized under section 1037 (or so much of section 1031 as relates to section 1037),

the increase in redemption value (to the extent not previously includible in gross income) in excess of the amount paid for such series E bond shall be includible in gross income in the taxable year in which the obligation is finally redeemed or in the taxable year of final maturity, whichever is earlier."

SEC. 103. Subsection (i) of section 22 of the Second Liberty Bond Act, as amended (31 U.S.C., sec. 757c (i)), is amended by inserting after the third sentence thereof the following: "Relief from liability shall be granted in all cases where the Secretary of the Treasury shall determine, under rules and regulations prescribed by him, that written notice of liability or potential liability has not been given by the United States, within ten years from the date of the erroneous payment, to any of the foregoing agents or agencies whose liability is to be determined: *Provided,* That no relief shall be granted in any case in which a qualified paying agent has assumed unconditional liability to the United States."

SEC. 104. The following provisions of law are amended by striking out the words "on original issue at par" and inserting in lieu thereof the words "on original issue at the issue price":

(1) Section 6 (g) (5) of the Act of March 24, 1934, as amended (22 U.S.C., sec. 1393 (g) (5));

(2) Section 201 (d) of the Act of August 14, 1935, as amended (42 U.S.C., sec. 401 (d));

(3) Section 904 (b) of the Act of August 14, 1935, as amended (42 U.S.C., sec. 1104 (b));

(4) Section 15 (b) of the Act of August 29, 1935, as amended (45 U.S.C., sec. 2280 (b));

(5) Section 209 (e) (2) of the Act of June 29, 1956 (23 U.S.C., sec. 173 (e) (2)).

SEC. 105. (a) Section 3701 of the Revised Statutes (31 U.S.C., sec. 742) is amended by adding at the end thereof the following: "This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

(b) The following provisions of the Second Liberty Bond Act, as amended, relating to the tax-exempt status of obligations of the United States, are repealed, without changing the status of any outstanding obligation:

(1) Subsections (b) and (d) of section 5 (31 U.S.C., sec. 754 (b) and (d));

(2) The second and third sentences of section 7 (31 U.S.C., sec. 747);

(3) Subsection (b) of section 18 (31 U.S.C., sec. 753(b));

(4) The first sentence of subsection (d) of section 22 (31 U.S.C., sec. 757c(d)).

Sec. 106. The amendment made by section 101 shall apply, in the case of bonds issued before the date of the enactment of this Act, only in th ecase of bonds issued under section 22 of the Second Liberty Bond Act, as amended. In no case shall the interest rate, or investment yield, on any bond be changed pursuant to the amendments made by this title for any period which begins before June 1, 1959.

TITLE II—INCOME TAX TREATMENT OF CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS

SEC. 201. Part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to common nontaxable exchanges) is amended by adding at the end thereof the following new section:

"SEC. 1037. CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS.

"(a) GENERAL RULE.—When so provided by regulations promulgated by the Secretary in connection with the issue of obligations of the United States, no gain or loss shall be recognized on the surrender to the United States of obligations of the United States issued under the Second Liberty Bond Act in exchange solely for other obligations issued under such Act.

"(b) APPLICATION OF SECTION 1232.—

"(1) EXCHANGES INVOLVING OBLIGATIONS ISSUED AT A DISCOUNT.—In any case in which gain has been realized but not recognized because of the provisions of subsection (a) (or so much of section 1031(b) as relates to subsection (a) of this section), to the extent such gain is later recognized by reason of a disposition or redemption of an obligation received in an exchange subject to such provisions, section 1232 shall apply to such gain as though the obligation disposed of or redeemed were the obligation surrendered to the Government in the exchange rather than the obligation actually disposed of or redeemed.

"(2) EXCHANGES OF TRANSFERABLE OBLIGATIONS ISSUED AT NOT LESS THAN PAR.—In any case in which subsection (a) (or so much of section 1031 (b) or (c) as relates to subsection (a) of this section) has applied to the exchange of a transferable obligation which was issued at not less than par for another transferable obligation, the issue price of the obligation received from the Government in the exchange shall be considered for purposes of applying section 1232 to be the same as the issue price of the obligation surrendered to the Government in the exchange.

"(c) CROSS REFERENCES.—

"(1) For rules relating to the recognition of gain or loss in a case where subsection (a) would apply except for the fact that the exchange was not made solely for other obligations of the United States, see subsections (b) and (c) of section 1031.

"(2) For rules relating to the basis of obligations of the United States acquired in an exchange for other obligations described in subsection (a), see subsection (d) of section 1031."

(b) The table of sections for part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

"Sec. 1037. Certain exchanges of United States obligations."

(c) Section 1031 (b) of such Code (relating to gain from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(d) Section 1031 (c) of such Code (relating to loss from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(e) Section 1031 (d) of such Code (relating to basis in the case of exchanges of property held for productive use or investment) is amended by striking out "this section, section 1035 (a), or section 1036 (a)," each place it appears in the first and second sentences thereof and inserting in lieu thereof "this section, section 1035 (a), section 1036 (a), or section 1037 (a),".

SEC. 202. Section 4 (a) of the Public Debt Act of 1941, as amended (31 U.S.C., sec. 742a), is amended by striking out "under the Internal Revenue Code, or laws amendatory or supplementary thereto" and inserting in lieu thereof "except as provided under the Internal Revenue Code of 1954".

SEC. 203. The amendments made by this title shall be effective for taxable years ending after the date of enactment of this Act.

[CONFIDENTIAL COMMITTEE PRINT]

JUNE 30, 1959

86TH CONGRESS
1ST SESSION

H. R.

A BILL

To facilitate management of the public debt, to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, and for other purposes.

By Mr. _____________

JUNE , 1959

Referred to the Committee on _____________________

86TH CONGRESS
1ST SESSION

H. R. 7964

IN THE HOUSE OF REPRESENTATIVES

JUNE 24, 1959

MR. SIMPSON of Pennsylvania introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To facilitate management of the public debt, to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Public Debt Management Act of 1959".

TITLE I—IN GENERAL

SEC. 101. The first section of the Second Liberty Bond Act, as amended (31 U.S.C., sec. 752), is amended by striking out ", not exceeding $4\frac{1}{4}$ per centum per annum,".

SEC. 102. Subsection (b) of section 22 of the Second

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Liberty Bond Act, as amended (31 U.S.C., sec. 757c (b) (1) and (2)), is amended to read as follows:

"(b) (1) Savings bonds and savings certificates may be issued on an interest-bearing basis, on a discount basis, or on a combination interest-bearing and discount basis. Such bonds and certificates may be sold at such price or prices and rate or rates of interest and in such denomination or denominations and may be redeemed before maturity upon such terms and conditions as the Secretary of the Treasury may prescribe.

"(2) The Secretary of the Treasury, with the approval of the President, is authorized to provide by regulation:

"(A) that owners of series E and H savings bonds may, at their option, retain the bonds after maturity, or after any period beyond maturity during which they have earned interest, and continue to earn interest upon them;

"(B) that series E and H savings bonds on which the rates of interest have been fixed prior to such regulations will earn interest at higher rates."

SEC. 103. Subsection (i) of section 22 of the Second Liberty Bond Act, as amended (31 U.S.C., sec. 757c (i)), is amended by inserting after the third sentence thereof the following: "Relief from liability shall be granted in all cases where the Secretary of the Treasury shall determine, under rules and regulations prescribed by him, that written notice of liability or potential liability has not been given, within ten years from the date of the erroneous payment, to any of the foregoing agents or agencies whose liability is to be determined: *Provided*, That no relief shall be granted in any case in which a qualified paying agent has assumed unconditional liability to the United States."

SEC. 104. The following provisions of law are amended by striking out the words "on original issue at par" and inserting in lieu thereof the words "on original issue at the issue price":

(1) Section 6 (g) (5) of the Act of March 24, 1934, as amended (22 U.S.C., sec. 1393 (g) (5));

(2) Section 201 (d) of the Act of August 14, 1935, as amended (42 U.S.C., sec. 401 (d));

(3) Section 904 (b) of the Act of August 14, 1935, as amended (42 U.S.C., sec. 1104 (b));

(4) Section 15 (b) of the Act of August 29, 1935, as amended (45 U.S.C., sec. 2280 (b));

(5) Section 209 (e) (2) of the Act of June 29, 1956 (23 U.S.C., sec. 173 (e) (2)).

SEC. 105. The amendment made by section 102 shall be effective as of June 1, 1959.

TITLE II—INCOME TAX TREATMENT OF CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS

SEC. 201. Part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 (relating to common nontaxable exchanges) is amended by adding at the end thereof the following new section:

"SEC. 1037. CERTAIN EXCHANGES OF UNITED STATES OBLIGATIONS.

"(a) GENERAL RULE.—When so provided by regulations promulgated by the Secretary in connection with the issue of obligations of the United States, no gain or loss shall be recognized on the surrender to the United States of obligations of the United States issued under the Second Liberty Bond Act in exchange solely for other obligations issued under such Act.

"(b) APPLICATION OF SECTION 1232.—Notwithstanding any provision of this section, section 1031 (b), or section 1031 (d), section 1232 shall apply to any recognized gain to which it would otherwise apply, except that in the case of an exchange of a transferable obligation of the United States which was issued at not less than par for another transferable obligaton of the United States in an exchange to which subsection (a) applies, the issue price of the obligation received by the taxpayer in exchange shall be considered to be the same as the issue price of the obligation given by the taxpayer in exchange.

"(c) CROSS REFERENCES.—

"(1) For rules relating to the recognition of gain or loss in a case where the preceding sentence would apply except for the fact that the exchange was not made solely for other obligations of the United States, see subsections (b) and (c) of section 1031.

"(2) For rules relating to the basis of obligations of the United States acquired in an exchange for other obligations described in subsection (a), see subsection (d) of section 1031."

(b) The table of sections for part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

"Sec. 1037. Certain exchanges of United States obligations."

(c) Section 1031 (b) (relating to gain from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(d) Section 1031 (c) (relating to loss from exchanges of property not solely in kind) is amended by striking out "the provisions of subsection (a), of section 1035 (a), or of section 1036 (a)," and inserting in lieu thereof "the provisions of subsection (a), of section 1035 (a), of section 1036 (a), or of section 1037 (a),".

(e) Section 1031 (d) (relating to basis in the case of exchanges of property held for productive use or investment) is amended by striking out "this section, section 1035 (a), or section 1036 (a)," in the first sentence thereof and inserting in lieu thereof "this section, section 1035 (a), section 1036 (a), or section 1037 (a),".

SEC. 202. Section 4 (a) of the Public Debt Act of 1941, as amended (31 U.S.C., sec. 742a), is amended by striking out "under the Internal Revenue Code," and inserting in lieu thereof "except as provided under the Internal Revenue Code of 1954,".

SEC. 203. The amendments made by this title shall be effective for taxable years ending after the date of enactment of this Act.

86TH CONGRESS
1ST SESSION

H. R. 7964

A BILL

To facilitate management of the public debt, to permit the Secretary of the Treasury to designate certain exchanges of Government securities to be without recognition of gain or loss for income tax purposes, and for other purposes.

By Mr. SIMPSON of Pennsylvania

JUNE 24, 1959

Referred to the Committee on Ways and Means

Misc. statements,
Anderson, etc.