The Washington Post Business
MONDAY, JANUARY 25, 1960

Our Changing Economy

An Easy Way Out For Mr. Anderson

By Phillip Stoddard Brown

THAT monetary policy should be the big issue of the day is strange. Surely there are debatable economic problems far more important to our present and future welfare.

But there is no denying that in Washington today this subject is the most controversial. Mere mention of it often causes a visible rise in blood pressures. Last week, Chester Bowles told the Women's National Democratic Club that this was "the first question" to be dealt with by the Democrats when they take office a year from now.

Brown

The focus of this controversy is the President's request that Congress abolish the 4½ per cent interest-rate ceiling on obligations having a maturity of five years or longer from date of issuance. This statutory limit dates from the Third Liberty Loan Act, and calls to mind the almost forgotten role of Congress, prior to World War I, in specifying not only the coupon rate of new bond issues but also the size of the issue, its maturity and other terms.

At present, investors demand a return of nearly 4½ per cent a year on Treasury issues maturing in 15 to 20 years. Since the Treasury isn't permitted to pay this going rate, it can't sell bonds. Instead, it sells bills, certificates and notes —obligations that fall due in less than five years.

As a result, short-term interest rates are higher than long-term rates. Also, more and more of the public debt has to be funded each year. About 80 per cent of the marketable portion of the debt will mature before 1966. This violates the accepted (but perhaps questionable) canons of debt management.

The Bigger Issue

By itself, the ceiling is arbitrary and senseless. But this isn't the way it's considered. It is looked upon as an opportunity to dramatize the conflict over monetary policy—or, as some might say, to blackmail the Administration into making concessions in its "tight money" policy.

Many people believe that high interest rates have reduced the rate of economic growth and haven't done much to prevent inflation. Sen. Paul H. Douglas (D-Ill.) thinks that the effective way to achieve price stability is to not to rely on high interest rates but to attack the problem of administered prices directly and "to plug tax loopholes." Many economists agree with him. Others deny that high interest rates have caused a slower rate of growth and believe that commodity prices would have risen much more if the supply of money had been further increased.

The "Liberals" are getting support from those in the construction industry and others who don't like "tight money." the coalition is bizarre but that is not unusual. Strategists take support where they find it.

Happily the immediate controversy over the 4½ per cent ceiling— unlike other bitter controversies of recent years—could be compromised easily. There have been many proposals.

One compromise would be to let the Treasury pay whatever coupon rate is necessary to sell long-term bonds, but to require that any such bonds be callable after five years. If interest rates fell below their present levels, any time after five years, the bonds could be paid off and others bearing a lower coupon issued.

The Civil War was financed in large part by the issuance of 25-year bonds callable after five years. In fact, until five or six years ago, Treasury bond issues were always made callable, but the call date did get pushed ahead to within five years of the maturity date. In the 1930s, bonds were called and refunded at considerable saving.

Government's Double Standard

Federal and State regulatory agencies have followed a firm policy of requiring immediate callability, or a short deferment, in conjunction with a low premium, in bond issues subject to their jurisdiction. Moreover, experience has proven that this right of redemption before maturity has not raised the interest cost appreciably.

One public utility executive recently said: "We would look pretty silly to our stockholders a few years later if we had given up the complete right to refund in exchange for a concession of, say, a fraction of 1 per cent in the interest rate." This is the attitude of almost all corporate borrowers and for many years few corporate bonds have been sold without the call privilege.

There is little to the argument that this is unfair to the investors in government bonds. The investing public is virtually the same for government as for corporate bonds. Taxpayers benefit directly from any saving by the Treasury in interest costs. In the case of corporations, savings go partly to consumers and partly to stockholders.

For some reason, the call is greatly undervalued by investors. A comprehensive study by the Wharton School, sponsored by the Life Insurance Association, shows that in the period 1945 to 1958 corporate borrowers paid surprisingly little for this privilege.

Treasury and "Fed" officials, on the other hand, stress the expense of the call privilege, though I could not find any that had studied the matter. Those with whom I talked had never heard of the Wharton School study, reported in the Journal of Finance for May, 1959.

I have no doubt that in the present period of high interest rates—high only by comparison with rates of the past 25 years—the call privilege would require a higher coupon rate, possibly ½ of 1 per cent higher. But, after all, this is a small cost to pay for protection against the possibility of having to pay a 1 or 2 per cent higher coupon over much of the life of the bond than may turn out to be necess.