

LCCN 68-61200

GOV. DOC.

PURCHASE OF TREASURY SECURITIES AND INTEREST ON SAVINGS DEPOSITS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING AND CURRENCY

UNITED STATES SENATE

NINETIETH CONGRESS

SECOND SESSION

ON

S. 2923 and S. 3133

TO AMEND SECTION 14(b) OF THE FEDERAL RESERVE ACT, AS
AMENDED, TO EXTEND FOR 2 YEARS THE AUTHORITY OF
FEDERAL RESERVE BANKS TO PURCHASE U.S. OBLIGATIONS
DIRECTLY FROM THE TREASURY, AND TO EXTEND FOR 2
YEARS THE AUTHORITY FOR MORE FLEXIBLE REGULATION
OF MAXIMUM RATES OF INTEREST OR DIVIDENDS, HIGHER
RESERVE REQUIREMENTS, AND OPEN MARKET OPERATIONS
IN AGENCY ISSUES

APRIL 3, 1968

Printed for the use of the
Committee on Banking and Currency



U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1968

02-31662

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1. The first step in the process of the investigation is to identify the problem. This involves a thorough review of the available information and a clear definition of the issue at hand. Once the problem is identified, the next step is to gather data. This can be done through various methods, including interviews, surveys, and experiments. The data collected should be analyzed to identify patterns and trends. Finally, a conclusion should be drawn based on the findings of the investigation. This conclusion should be supported by the data and should provide a clear answer to the original question.

PURCHASE OF TREASURY SECURITIES AND INTEREST ON SAVINGS DEPOSITS

WEDNESDAY, APRIL 3, 1968

**UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, D.C.**

The subcommittee met at 10:05 a.m., pursuant to notice, in room 5302, New Senate Office Building, Senator William Proxmire, chairman of the subcommittee, presiding.

Present: Senators Proxmire and Brooke.

Senator PROXMIRE. Today, the Subcommittee on Financial Institutions will hold hearings on S. 3133 and S. 2923. S. 3133 extends for 2 years the authority for more flexible regulation of maximum rates of interest on dividends, higher reserve requirements, and open market operations in agency issues. S. 2923 extends for 2 years the authority of Federal Reserve banks to purchase U.S. obligations directly from the Treasury.

One of the main issues in S. 3133 deals not with the authority to regulate interest ceilings on savings deposits, but rather with the authority of the Federal Reserve Board to purchase the obligations of Federal agencies such as the Federal National Mortgage Association (FNMA) or the Federal home loan banks. The aim of this authority was to require the Federal Reserve Board to support the mortgage market during periods of severe monetary restriction.

A considerable controversy has ensued over the manner in which the Board has carried out this authority. There are some in Congress who have been extremely critical over the Board's failure to utilize more substantially its authority to purchase agency issues. The 1968 report of the Joint Economic Committee said that:

We recommend renewal of the authority given to the Federal Reserve to purchase and hold obligations of the Federal National Mortgage Association and the Federal Home Loan Banks and strongly urge that the Federal Reserve use this authority consistent with congressional intent.

In responding to this criticism, the Federal Reserve Board has argued that there was no clear congressional intent to use the authority to deliberately peg interest rates on mortgages or to provide any fixed flow of funds into housing. Moreover, the Board points out that they only have the authority to purchase Federal agency obligations in the open market. There is no guarantee, according to the Board, that a purchase of a Federal agency obligation from a bank or other investor will necessarily channel funds into the mortgage market.

The Board also argues it is inappropriate for the central bank to attempt to influence the structure of interest rates in the conduct of

monetary policy. If the Board were to buy Federal agency obligations in sizable amounts in order to reduce interest rates on mortgages, it would have to offset these purchases by sales of Federal securities. Thus, the return on Government bonds would rise while the rate on mortgages would fall.

The argument is reminiscent of Operation Twist carried out in the early 1960's, wherein the Board attempted to influence the structure of interest rates by purchasing long-term Federal bonds while selling short-term Treasury issues. This had the effect of lowering long-term interest rates and thus accelerating investment spending at a time when the economy was weak. At the same time, short-term rates were raised, thus bolstering our balance-of-payments position, particularly with respect to short-term capital outflows.

Operation Twist was apparently carried out by the Board only with extreme reluctance and after much controversy. I believe that it is fair to say the Board has consistently preferred the bills-only doctrine which holds that open market operations should be carried out only in the short-term sector of the Federal securities market. The Board claims that the bills-only doctrine insures the overall neutrality of monetary policy on specific sectors of the economy.

The basic policy issue, it seems to me, can be stated as follows: Should the Board assume some responsibility for allocating the impact of a restrictive monetary policy upon different sectors of the economy? For a variety of reasons, the Board has been unwilling to assume this responsibility. Its basic posture is that it affects monetary policy only in the aggregate and that the impact of this policy should be allocated to different sectors by natural market forces. To interfere with these market forces would, according to this argument, distort the allocation of capital.

The Board also claims it has purchased nearly a billion dollars of Federal agency obligations since October of 1966. Although this is technically true, it has also sold nearly the same amount within the same month of purchase under short-term repurchase agreements. On balance it has only purchased \$147 million in Federal agency certificates and only half of those have been housing related. The impact of this on the mortgage market is infinitesimal.

Today the subcommittee looks forward to exploring with the Federal Reserve Board, the Treasury, and the Home Loan Bank Board the general situation in the mortgage market and what action may be necessary to insure that the severe impact of a tight money policy on the housing sector is not repeated.

We are delighted to have with us three outstanding, distinguished, and extraordinarily able Federal officials this morning. I would like to ask Governor Robertson, the Vice Chairman of the Board of Governors of the Federal Reserve System to proceed with his statement. I would like all of you gentlemen to make your statement initially in any way you want and then we will question you when you complete your statement.

(The bills and agency reports follow:)

90TH CONGRESS
2d Session

S. 2923

IN THE SENATE OF THE UNITED STATES

FEBRUARY 5, 1968

Mr. SPARKMAN introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

A BILL

To amend section 14 (b) of the Federal Reserve Act, as amended, to extend for two years the authority of Federal Reserve banks to purchase United States obligations directly from the Treasury.

- 1 *Be it enacted by the Senate and House of Representa-*
- 2 *tives of the United States of America in Congress assembled,*
- 3 That section 14 (b) of the Federal Reserve Act, as amended
- 4 (12 U.S.C. 355), is amended by striking out "July 1,
- 5 1968" and inserting in lieu thereof "July 1, 1970" and by
- 6 striking out "June 30, 1968" and inserting in lieu thereof
- 7 "June 30, 1970".

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, D.C., March 1, 1968.

HON. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request of February 6, 1968, for the Board's views on S. 2923, a bill "To amend section 14(b) of the Federal Reserve Act, as amended, to extend for two years the authority of Federal Reserve banks to purchase United States obligations directly from the Treasury." The current authority expires June 30, 1968.

Normally, Federal Reserve purchases of Government securities are made in the open market. Since its original enactment in 1942, the \$5 billion direct-purchase authority of section 14(b) has been used sparingly, from the standpoints of frequency, amount, and duration alike.

Nevertheless, the Board believes that such authority furnishes a desirable degree of protection to the Treasury against inevitable uncertainties in estimates of receipts and expenditures and in borrowing operations. Its continuing availability permits more economical cash and debt management and assures the availability of an immediate source of funds in the event of a national emergency. Also, timely use of the authority—for example, during periods immediately preceding tax payment dates—can avoid the creation of unnecessary financial strains that might occur if the Treasury were required to draw heavily on its accounts at such times.

Accordingly, the Board favors enactment of S. 2923.

Sincerely,

J. L. ROBERTSON.

90TH CONGRESS
2d Session

S. 3133

IN THE SENATE OF THE UNITED STATES

MARCH 11, 1968

Mr. SPARKMAN introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

A BILL

To extend for two years the authority for more flexible regulation of maximum rates of interest or dividends, higher reserve requirements, and open market operations in agency issues.

- 1 *Be it enacted by the Senate and House of Representa-*
- 2 *tives of the United States of America in Congress assembled,*
- 3 That section 7 of the Act of September 21, 1966 (80 Stat.
- 4 823), as amended by the Act of September 21, 1967 (81
- 5 Stat. 226), is hereby amended by striking "two-year" and
- 6 inserting in lieu thereof "four-year".

II—The Council of Economic Advisers, created by Executive Order of September 12, 1946, and continued by Executive Order of September 12, 1950, and Executive Order of September 12, 1955, and Executive Order of September 12, 1960, and Executive Order of September 12, 1965, and Executive Order of September 12, 1968, is hereby directed to prepare and submit to the President a report on the operation of the Council of Economic Advisers, and to submit such report to the President on or before March 28, 1968.

Hon. JOHN SPARKMAN, Chairman, Committee on Banking and Currency, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Council of Economic Advisers recommends enactment of S. 3133, a bill "To extend for two years the authority for more flexible regulation of maximum rates of interest or dividends, higher reserve requirements, and open market operations in agency issues."

The Council's comments with respect to a similar proposal last year remain valid. The more flexible rate authority, which was originally enacted in 1966, has proved very valuable in permitting the regulatory authorities to restrain, in a coordinated manner, excessive rate competition among different kinds of financial institutions during periods of exceptional pressures in financial markets.

As we have stated before, we do not believe that continuous use of interest ceilings on savings accounts is desirable. But interest rates in the open market remain high and continue to threaten the competitive position of many thrift institutions. And so long as enactment of the President's proposed tax surcharge continues to be delayed, the dangers for these institutions and indeed for our whole economy only increase. Thus, we believe that further continuation for a limited period of the present flexible authority to regulate interest rates on savings deposits is a prudent course of action.

We are opposed to making permanent the existing authority to regulate interest rates on savings deposits. The Council has already set down in its 1967 *Annual Report* (p. 67) its views concerning the proper course of action with respect to permanent legislation governing regulation of interest rates on savings accounts. The necessary regulatory authority "could be provided for in either of two ways: (1) through standby authority to impose rate ceilings under particular circumstances; or (2) through permanent ceilings set sufficiently high that they would become effective only in unusual instances."

It is also our view that the existing flexible authority for adjusting reserve requirements and for conducting open market operations in agency issues constitutes a useful supplement to our tools of monetary and debt management and should be continued.

The Bureau of the Budget has advised that it has no objection to the submission of this report and that enactment of S. 3133 would be consistent with the Administration's objectives.

Sincerely yours,

ARTHUR M. OKUN, *Chairman.*

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, D.C., March 29, 1968.

Hon. JOHN SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Corporation with respect to S. 3133, 90th Congress, a bill "To extend for two years the authority for more flexible regulation of maximum rates of interest or dividends, higher reserve requirements, and open market operations in agency issues".

The Act of September 21, 1966 (80 Stat. 823), among other things, provides a statutory flexible basis for regulating interest and dividend rates which may be paid by insured banks and insured savings and loan associations on time and savings deposits or shares or withdrawable accounts. Additionally, the Act authorizes the Board of Governors of the Federal Reserve System to increase reserve requirements on time and savings deposits to a maximum of 10 percent and authorizes Federal Reserve open-market operations in obligations of agencies of the United States Government.

The provisions of the Act originally were effective only during the one-year period which began on September 21, 1966, the date of enactment of the Act. The authority conferred by the Act was extended for an additional one-year period by the Act of September 21, 1967 (81 Stat. 226). S. 3133 would extend the authority conferred by the Act for an additional two-year period.

The greater flexibility accorded to the banking agencies by the Act to vary interest-rate ceilings on time and savings deposits on different bases and the extension of interest-rate ceilings for the first time to insured institutions of the Federal Home Loan Bank System and to mutual savings banks insured by the Federal Deposit Insurance Corporation have strengthened significantly the ability of the financial supervisory agencies to moderate excessive competition between various types of financial institutions for savings. The actions taken by the regulatory agencies pursuant to the authority contained in the Act of September 21, 1966, have served to limit escalation of interest rates paid by commercial banks and other financial institutions in the competition for consumer savings.

If the added authority to regulate rates paid by savings and loan associations as well as by banks and the more flexible authority with respect to bank interest rates are retained, the supervisory agencies will continue to be able to take prompt and appropriate action in this area in the future, whenever necessary. It is essential, in our opinion, that the authority not be permitted to lapse. The Corporation therefore favors the enactment of S. 3133.

The Corporation believes that the advantages of the flexible interest-rate authority have substantially been demonstrated since enactment of the original legislation and that consideration should be given to the need for permanent legislation and its appropriate scope and form. We understand that the Department of the Treasury has been requested to work with the other interested agencies, including the Council of Economic Advisers, toward developing a legislative proposal along these lines for possible transmittal to the Congress early next year.

The Bureau of the Budget has advised that it has no objection to the submission of this letter and that enactment of S. 3133 would be consistent with the Administration's objectives.

Sincerely yours,

K. A. RANDALL, Chairman.

FEDERAL HOME LOAN BANK BOARD,

Washington, D.C., March 28, 1968.

HON. JOHN SPARKMAN,

*Chairman, Committee on Banking and Currency,
U.S. Senate.*

DEAR MR. CHAIRMAN: In response to your request, the Federal Home Loan Bank Board submits its views as to S. 3133 of the present Congress.

This bill would amend section 7 of the Act of September 21, 1966 (80 Stat. 823), which, as amended by the Act of September 21, 1967 (81 Stat. 226), provides that the authority conferred by the Act of September 21, 1966, shall be effective for a two-year period beginning on that date. S. 3133 would change the two-year period to a four-year period, thus extending the authority for an additional two years.

The Act of September 21, 1966, conferred standby rate-control authority on the Federal Home Loan Bank Board with respect to interest and dividends on deposits, shares, or withdrawable accounts of Federal Home Loan Bank members (other than those whose deposits are insured under the Federal Deposit Insurance Act) and of institutions insured under title IV of the National Housing Act. The Board was authorized to prescribe different rate limitations on the basis (among others) of the amount of the account, or on such other reasonable bases as the Board might deem desirable in the public interest.

In the banking field, the act converted the then existing mandatory rate-control authority of the Board of Governors of the Federal Reserve System and the Board of Directors of the Federal Deposit Insurance Corporation into standby authority and authorized those agencies to differentiate on the same bases as those provided the Federal Home Loan Bank Board.

Each of the three agencies was directed to consult with the other two before exercising this authority. In addition, the act provided stronger provisions as to reserves of member banks of the Federal Reserve System and authorized the Federal Reserve banks to buy and sell in the open market, under direction and regulations of the Federal Open Market Committee, any obligation which is a direct obligation of or is fully guaranteed as to principal and interest by any agency of the United States.

The Federal Home Loan Bank Board considers it essential that the standby authority conferred on it by the Act of September 21, 1966, as amended, be continued. Further, the Board believes that continuance of the authority thus granted to the Federal Reserve banks to buy and sell agency obligations would be in the public interest.

While we would prefer that there be no time limit, we regard the provisions of the bill as definitely desirable, even on the basis of an additional temporary extension, and recommend that the bill enacted.

The Bureau of the Budget has informally advised us that there is no objection to the presentation of this report and that enactment of S. 3133 is consistent with the Administration's program.

With kindest regards, I am,

Sincerely,

JOHN E. HORNE, Chairman.

**STATEMENT OF J. L. ROBERTSON, VICE CHAIRMAN, BOARD OF
GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Mr. ROBERTSON. Thank you, Mr. Chairman.

I appreciate this opportunity to present the views of the Board of Governors on S. 2923 and S. 3133. Senate bill 3133 would extend for 2 additional years the provisions of Public Law 89-597, which would otherwise expire September 21 of this year. This statute provides the authority for coordinated regulation of the maximum rates payable by federally insured financial institutions to attract savings funds. It also fixes a 10-percent statutory maximum on reserve requirements for member banks on time and savings deposits—in place of the former 6-percent maximum, and authorizes the Federal Reserve banks to buy and sell in the open market obligations of any Federal agency. Senate bill 2923 would extend for 2 years the authority for Federal Reserve banks to purchase up to \$5 billion of obligations of the United States directly from the Treasury.

In the 6 months or so that have passed since the Congress voted to extend Public Law 89-597 for 1 year the need for continuation of the rate ceiling authority provided in that statute has increased rather than diminished. Interest rates in the money market have risen, and banks have had to raise their offering rates on large negotiable certificates of deposit. Banks are paying the 5½-percent ceiling rate on shorter and shorter maturities in an effort to avoid sizable runoffs in funds. The rise in yields available on market instruments also has contributed to a marked slowing over recent months in the inflows of consumer savings to banks and other depository-type institutions, compared with the very high rates of increase experienced last spring and summer.

Under these conditions, the competition for savings funds has tended to intensify. From the January 31 survey of time and savings deposits at insured banks we have thus far been able to process returns for the 700 banks that are most active in this business. The survey shows that the great majority of those banks are paying the maximum permissible rate for consumer-type deposits—4 percent on savings accounts and 5 percent on most varieties of time deposits under \$100,000. And we have the impression that the same situation exists with respect to savings banks and savings and loan associations—that most active competitors, desiring to protect their existing funds and stimulate the maximum inflow of new savings, are offering the maximum rates allowed currently by the regulations.

The situation obviously is one in which some institutions, if unrestrained by rate ceilings, would see an advantage in offering somewhat higher returns to savers. And if such competition were permitted, I have no doubt that a rate war would develop. Furthermore, I see no reason to expect a diminution of pressures on the funds position of banks and savings institutions any time soon. It may become necessary to adjust the structure of ceiling rates if financial markets continue to tighten, in order to make it possible for the institutions to compete with the market and attract a reasonable share of new savings flows. But if such a change does become necessary—and I hope it will not—surely it would be best to limit the extent and nature of

the rate increases, and thus to avoid the threat of competitive rate escalation.

If the legislation before you were permitted to expire, of course, the Federal Reserve and the Federal Deposit Insurance Corporation would retain authority to establish ceiling rates on the interest rates offered on savings and time deposits by member and nonmember insured banks, respectively. But we would lose a great deal of flexibility in distinguishing among types of deposits, and it was this flexibility that permitted us to establish a lower rate ceiling on time deposits under \$100,000. No matter what you think of such a distinction philosophically—and I, for one, find it objectionable—the realities of today's market absolutely require some scaling in maximum rates by size of deposits if banks are to compete for funds in the money market without at the same time disrupting the more traditional markets for small savings. Moreover, as a practical matter, I think that we would find it very difficult to continue limiting the interest rates paid by banks for savings if their competitors—the savings banks and savings and loan associations—were left free to post any rate they wished.

For these reasons, the Board believes it essential that Public Law 89-597 be extended, and we recommend that the authority be made permanent. The need for effective rate limitation is especially acute under present circumstances, but the case of extending this legislation need not rest on current market conditions. Indeed, it is difficult to envision circumstances under which the Congress would find it advisable to allow this statute to terminate. If the underlying causes of today's stresses in financial markets are corrected, and rate ceilings are no longer needed, the statute contains authority for their suspension. On the other hand, as long as ceilings are needed, it seems advisable to continue the flexible, coordinated approach embodied in the statute for establishing them.

If the rate ceiling authority is made permanent, the present statutory exemption for foreign official time deposits should be allowed to expire as scheduled on October 15 of this year. This exemption was originally adopted in 1962, before enactment of the present flexible authority over rate ceilings, and it was intended to permit banks to compete for foreign official funds and thereby to help alleviate the balance-of-payments situation. Since that situation has not improved during the intervening years, the exemption of foreign official deposits from interest-rate ceilings continues to be justified. In recent amendments of their regulations, the Federal Reserve and the Federal Deposit Insurance Corporation have made clear their conviction that in present circumstances foreign official deposits should be free from interest-rate ceilings. As improvements in the international payments position of the United States are achieved, however, the need for special treatment for foreign official deposits should be reviewed from time to time in order to make sure that the discrimination involved is continued only as long as it is needed. If Public Law 89-597 becomes permanent law, the Board will then have the authority to continue, modify, or terminate this exemption administratively in the light of changing circumstances.

The authority in Public Law 89-597 for Federal Reserve purchases and sales of agency issues in the open market should also be made permanent. The objectives of this authority—to “increase the potential

flexibility of open market transactions and * * * make these securities somewhat more attractive to investors" (S. Rept. 1601, 89th Cong., second sess.)—are long range, and would be better served by eliminating uncertainty as to how long the authority may be exercised.

The Board proposes also that two minor related amendments be added to S. 3133. The first would amend the eighth paragraph of section 13 of the Federal Reserve Act to permit advances to member banks to be secured by any obligation eligible for rediscount or for purchase by Federal Reserve banks. This would broaden such lending authority to include as eligible collateral all of the direct obligations of Federal agencies, as well as obligations fully guaranteed as to principal and interest by such agencies. Since the Federal Reserve banks are authorized by Public Law 89-597 to purchase all such Federal agency obligations, we can see no reason why similar authority should not be granted as to their use as collateral for advances by Reserve banks to member banks.

The second amendment we propose would broaden in similar fashion the types of collateral authorized for Federal Reserve bank loans to individuals, partnerships, and corporations under the last paragraph of section 13 of the Federal Reserve Act. The collateral for such advances now may consist only of the direct obligations of the United States, and we propose to include also the obligations of Federal agencies. This provision of the act is seldom used, but it could provide important protection to the business community under highly unusual or emergency conditions in financial markets. In June 1966, for example, we had made arrangements for the possible extension of credit to mutual savings banks, savings and loan associations, and other depositary-type institutions under this authority, though none proved to be necessary. Addition of Federal agency issues would give wider latitude in such contingency planning, and we can see no reason why the types of assets made eligible for collateral should not, in this instance also, parallel the Reserve banks' purchase authority.

I have suggested reasons for making permanent the rate ceiling and open market authority in Public Law 89-597. The Board believes also that the authority in that statute to raise reserve requirements on time deposits should be made permanent if it is to be effectively exercised. Statutory expiration dates confront the Board with the prospect that if they should raise reserve requirements on time deposits about 6 percent, the action might be automatically reversed, thereby reducing reserve requirements, at a time when such a reduction would have undesirable consequences.

Let me turn now to S. 2923, which authorizes the Federal Reserve System to purchase up to \$5 billion of U.S. obligations directly from the Treasury. As your committee has heard before in the course of numerous extensions of this authority over the past 26 years, the authority has been used sparingly but affords the Treasury a useful measure of leeway in managing its cash balances and borrowing operations. Although one may question whether any purpose is served by the 2-year limitation on this authority, presumably it has become so much a part of our traditions that there is little prospect that it will be abandoned. Moreover, a 2-year extension has passed the House and I recognize that your committee may be reluctant to adopt a different version. Therefore, even though a forceful case could be made for

striking out the expiration date, I recommend, on behalf of the Board, that you report S. 2923 without amendment.

AMENDMENTS TO CARRY OUT FEDERAL RESERVE RECOMMENDATIONS

1. To make Public Law 89-597 permanent: Strike out section 7 of that statute (S. 3133 as introduced amends section 7 to extend expiration date).

2. Collateral for advances by Federal Reserve banks:

(a) Advances to member banks: Amend the eighth paragraph of section 13 of the Federal Reserve Act by striking out "secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal Reserve Banks" and inserting "secured by such obligations as are eligible for rediscount or for purchase by Federal Reserve Banks."

(b) Advances to individuals, partnerships, and corporations: Amend the first sentence of the last paragraph of section 13 of the Federal Reserve Act by inserting after "secured by direct obligations of the United States" the following: "or by any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States".

Senator PROXMIRE. Thank you very much.

Secretary Deming?

I should identify Secretary Deming. He is Under Secretary of the Treasury for Monetary Affairs. We are glad to have you.

STATEMENT OF FREDERICK L. DEMING, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

Mr. DEMING. I have a short statement which I should like to read.

Senator PROXMIRE. Very good.

Mr. DEMING. The Treasury Department strongly urges that favorable action be taken on S. 3133 which would extend for 2 more years the flexible authority under which the appropriate financial agencies can regulate maximum rates of interest or dividends payable on savings accounts. This legislation has amply demonstrated its worth. In view of the present and prospective pressures on financial markets, a further temporary extension of this valuable authority would be an act of ordinary prudence. In the absence of this legislation, we could face a return to the potentially destructive form of competition among financial institutions which contributed to mortgage market difficulties and the escalation of interest rates during 1966.

This bill would also extend the authority of the Federal Reserve to (a) vary reserve requirements on time and savings deposits between 3 and 10 percent, and (b) conduct open market operations in securities issued or guaranteed by any agency of the United States. Both are valuable potential tools to promote financial stability and the efficient functioning of our financial markets. Some limited use has already been made of the broadened authority to conduct open market operations. While reserve requirements on time and savings deposits have not been raised beyond the 3- to 6-percent range permitted under earlier legislation, the reserve required on time deposits in excess of \$5 million is presently at 6 percent. The broader latitude inherent in the 3- to 10-percent range is clearly desirable.

This same legislation was originally enacted September 21, 1966, for a period of 1 year. A request for its extension for 2 years was favorably reported by your committee last July and the bill passed the Senate in that form. As finally enacted, shortly before it was to expire, the extension was for 1-year period, with no other changes in the basic legislation. A 2-year extension is again requested. A permanent extension is not requested because the interest-rate ceiling part of the authority was only intended initially to meet a special set of circumstances. The need for, and desirability of, such ceilings under more normal circumstances remains an open question.

There is no need to review in any detail the circumstances which initially brought this legislation into being. During 1966, a very aggressive competition for funds developed among financial institutions. This aggravated an already difficult situation in the money and credit markets. Thrift institutions could not, in all cases, safely pay the higher rates on savings which were required to attract new funds and hold old ones. The flow of savings into mortgage markets fell off abruptly, and the housing industry suffered a sharp decline. Not all of these difficulties were due to uninhibited interest-rate competition, but it was an important factor in the total picture.

These interest-rate ceilings were one part of a coordinated program which successfully alleviated strains and reduced upward rate pressures in the financial markets by late 1966. As soon as the enabling legislation was passed, the regulatory authorities moved promptly to apply interest-rate ceilings. They found it possible to reduce some of the highest rates that had developed during 1966. At the same time, care was taken not to press the ceiling rates down in a fashion which might have choked off the reflow of funds to thrift institutions. The regulatory agencies, themselves, will be in a better position to comment upon the details of their experience with the administration of these ceilings.

During 1967, there was a remarkable improvement in savings flows. The total inflow at commercial banks, mutual savings banks, and savings and loan associations was around \$39 billion. This was about double the inflow in 1966 and exceeded the \$32 billion inflow in 1965 and the \$29 billion inflows in the previous 2 years. As a result, the position of lending institutions was greatly improved. Savings and loan associations were able to repay a large volume of advances to the Federal Home Loan Bank System which is, itself, now in a much better position to render assistance to member associations.

With the improvement in savings flows, the housing industry made a vigorous recovery. New private housing starts rose from a seasonally adjusted annual rate of a little over 900,000 units in the fourth quarter of 1966 to a rate of more than 1,400,000 units in the fourth quarter of 1967. Residential construction expenditures rose from a seasonally adjusted annual rate of \$20.9 to \$27.6 billion—a rise of nearly one-third. Housing starts and permits have shown further strength this year.

But there is another side to the story. The rate of gain in savings inflows slackened more or less steadily during the course of 1967 although monetary policy was generally expansionary. In January of this year, while savings and loan associates fared better than many had expected, they did experience a net outflow of some \$250 million,

the largest on record for a January. Mutual savings banks and commercial banks did somewhat better in January. Savings flows held up rather well in February. But, in view of recent financial developments here and abroad, it would be foolish to assume that this will necessarily last. Market interest rates have been rising significantly and in many areas are already nearing, or have passed, the peak yields of August-September 1966. The threat of a large-scale movement of funds into market instruments and a competitive scramble among financial institutions is by no means remote.

As your committee is well aware, the legislative authority for ceiling interest rates is far from a panacea, and ceilings may not be a desirable long-term feature of the financial landscape. In particular, these ceilings will not prevent rising market rates of interest from exerting their pull. It is possible to conceive of a situation in which market rates were rising so significantly that the regulatory authorities would have little option but to make some upward adjustments in ceiling rates. But, even then, this authority could be used so as to promote an orderly adjustment.

The best insurance against further rises in market rates and a tightening credit situation would be prompt enactment of the President's tax proposals and rigorous restraint of expenditures. In the absence of that broader action, this particular legislative authority, while still useful, cannot be expected to work wonders. We would be better off with this authority than without it, but the home financing and housing industries would still face difficult adjustments.

With fiscal restraint and reasonable balance in financial markets, a substantial savings inflow to mortgage lenders should continue. In such a setting, the extension of authority in S. 3133 will provide the regulatory authorities with tools that have proven their value in the past year and a half. If a more difficult situation is encountered, these tools will still be useful. Your prompt and favorable action is requested on a 2-year extension of the existing authority.

With respect to S. 2923, Mr. Chairman, I have a short statement here. I think the point of it is that we have had this authority since 1942, renewed at 2-year intervals. It has proved useful, and has been exercised with restraint. In the last 2 years we have had it, it has been used four times.

The maximum outstanding at the Federal Reserve held on direct purchase from the Federal Treasury was \$169 million for a period in 1966. We used it three times for a total of 7 days in 1967, and so far not at all in 1968.

It is a very useful adjunct to the Treasury. I hope you will renew it for 2 years.

I will put the statement in the record, Mr. Chairman, if it is agreeable.

Senator PROXMIRE. Thank you very much.

(The statement referred to follows:)

STATEMENT OF FREDERICK L. DEMING, UNDER SECRETARY OF THE TREASURY FOR
MONETARY AFFAIRS

I am very happy to appear before you this morning in support of S. 2923, which would extend until June 30, 1970, the present authority of the Federal Reserve Banks to purchase public debt obligations directly from the Treasury up to a limit of \$5 billion outstanding at any one time.

My statement is quite brief, since I do not believe that provision of the necessary means for the efficient management of the public finances is or ought to be controversial.

This authority, which would otherwise expire on June 30 of this year, was first granted in its present form in 1942 for a temporary period. It has been renewed on 13 separate occasions since that time. While used only very sparingly during these past 26 years, I strongly share the conviction of my predecessors that maintenance of this authority is essential to the proper and economical management of the finances of the Government.

As shown in the table attached to my statement, the direct purchase authority was used on four occasions since it was last extended by the Congress two years ago. The authority was used only for a few days at a time, and the maximum amount outstanding at any one time was \$169 million. These borrowings occurred just prior to tax payment dates thus permitting the Treasury to operate with lower cash balances than would otherwise be required.

The figures in the table show clearly that the authority has not been abused. I firmly believe that our borrowings should meet the test of the market and that the direct purchase authority is not intended to allow the Treasury to circumvent the authority and responsibility of the Federal Reserve System in its Open Market Account operations. Any use of the authority, moreover, is clearly subject to the discretion of the Federal Reserve System and, thus, it can serve as an added instrument of Federal Reserve monetary policy. I might also add that these borrowings, like any other Treasury borrowings, are subject to the statutory debt limit.

Continuance of the direct purchase authority is essential for three reasons.

First, it permits us to allow our cash balance to decline to unusually low levels during times when our revenues are seasonally low. We are, thus, enabled to keep the public debt to a minimum and to save on the interest costs of the Government. Without the potential ability to borrow directly from the Federal Reserve, these low balances could not prudently be maintained even for very brief periods. Rather we would be compelled to enlarge our cash balances by borrowing additional amounts in the market even though these amounts might be needed only for a short while.

Second, there is always the possibility that temporarily unfavorable conditions in the money and credit markets may make it desirable, both from our own point of view and that of the Federal Reserve System, to postpone for a short time a planned Treasury market borrowing. The possibility of direct access to the Federal Reserve provides the flexibility required in such a situation.

Finally, I need not stress that the direct purchase authority is a key element in our financial planning for a national emergency, such as might result from a nuclear attack on the United States. In such circumstances our financial markets could be seriously disrupted at a time when large amounts of cash were necessary to meet emergency requirements. It is for this reason that an authority as large as \$5 billion is required although such a large amount has never been used.

I might add that it would be advantageous in this uncertain world, if the temporary authority were to be made permanent. We are not, however, proposing that this be done although this committee might wish to discuss the question.

DIRECT BORROWING FROM FEDERAL RESERVE BANKS, 1942 TO DATE

Calendar years	Days used	Maximum amount at any time (millions)	Number of sepa- rate times used	Maximum number of days used at any one time
1942	19	\$422	4	6
1943	48	1,320	4	28
1944	None			
1945	9	484	2	7
1946	None			
1947	None			
1948	None			
1949	2	220	1	2
1950	2	108	2	1
1951	4	320	2	3
1952	30	811	4	9
1953	29	1,172	2	20
1954	15	424	2	13
1955	None			
1956	None			
1957	None			
1958	2	207	1	2
1959	None			
1960	None			
1961	None			
1962	None			
1963	None			
1964	None			
1965	None			
1966	3	169	1	3
1967	7	153	3	3
1968 to date	None			

Senator PROXMIRE. Our next witness is the distinguished chairman of the Federal Home Loan Bank Board, an old friend of the committee, the Honorable John Horne.

STATEMENT OF JOHN E. HORNE, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD

Mr. HORNE. Thank you very much, Mr. Chairman.

Members of the subcommittee, if I may, I want to read my statement. I think there are some things in it that I can explain a little bit better by reading my prepared testimony and ad-libbing on them.

It is a pleasure to appear before you.

The original act, as has been pointed out, which is S. 3133 would extend the provisions of, conferred on the Federal Home Loan Bank Board, the authority to limit by regulation, the rate paid on deposits, shares, or withdrawable accounts by members of the Federal Home Loan Bank System (other than those that have deposits insured by the Federal Deposit Insurance Corporation). It also provided authority for the Board of Governors of the Federal Reserve System and the Board of Directors of the Federal Deposit Insurance Corporation to prescribe different interest rate limitations for deposits of different dollar amounts in commercial banks, and authority for the Federal Deposit Insurance Corporation to establish limits on deposit rates paid by mutual savings banks with accounts insured by that agency.

In addition, the act provided for consultation among the previously named agencies in the exercise of this legislative authority. Moreover, it permitted the Federal Open Market Committee of the Federal Reserve System to buy and sell in the open market any securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the U.S. Government.

The basic purpose of the 1966 legislation, as members of the committee very well understand, was to reestablish a more typical allocation of savings flow among deposit-type institutions, by preventing undue rate escalation and by prescribing limits within which institutions could compete for funds that were consistent with both their short- and long-range purpose, and to increase the availability of funds to home buyers and home builders.

The situation that led to the need for this legislation is too recent and too familiar to require any lengthy analysis. Yet, it seems advisable to recall that during the first 9 months of 1966 the net inflow of savings to savings and loan associations dropped three-fourths from that of the same period of 1965. Indeed, associations experienced net withdrawals of funds in January, April, and July 1966, which amounted to \$1.5 billion in July alone. As a result, mortgage lending by associations fell very sharply. This development was reflected in the precipitous drop in housing starts from a seasonally adjusted annual rate of 1.4 million units in January 1966 to only 845,000 units in October 1966.

The effect of the 1966 act was almost immediate, as I indicated last year in testimony in support of the prior extension of this legislative authority. Each of the three agencies authorized to do so issued, after appropriate consultation, regulations pursuant to the act within a few hours after it was approved, and savings flow to savings and loan associations began to increase, particularly after October. While a decline in market interest rates undoubtedly contributed substantially to this, it appears in general that the better relationship between bank and savings and loan rates that resulted from the rate ceilings established by the regulatory agencies was the principal reason for the improvement I noted.

The rebound in savings flow to savings and loan associations that began in late 1966 following the establishment of these ceilings continued into 1967, and during the spring and summer months savings inflow to associations was in record or near-record volume. Mortgage lending by associations also rose sharply, although with some lag, and by summer had stabilized at a monthly volume close to that achieved in the years prior to 1966. Housing starts also rose and, while showing considerable month to month fluctuation, have averaged on an annual rate basis over 1.4 million units in recent months.

The effectiveness of this legislation, and the regulations issued pursuant to it, in reestablishing more typical allocation of funds among deposit-type institutions was evidenced by the fact that during the first 9 months of 1967, savings flow to savings and loan associations represented about one-fourth of the total flow of time money to deposit-type institutions. This was about the same share as in the first 9 months of 1965, and up sharply from the 10 percent recorded during the corresponding period of 1966.

More recent developments suggest both a limitation and the continued usefulness of the 1966 act in achieving its basic purpose. After late summer of last year, rising market interest rates and other economic and financial developments produced a marked slowdown in savings flow to associations. Indeed, in January of this year associations had a net outflow of funds for the first time since October 1966, although I should hasten to add that the February experience was rela-

tively quite favorable. Savings and loan associations have not been alone in experiencing a sharp dropoff in savings flow since last summer. The other major deposit-type institutions—commercial banks and mutual savings banks—have had a roughly similar experience during this 5-month period. In contrast to 1966, therefore, savings and loan associations have maintained a fair share of total savings flowing into deposit-type institutions.

This recent experience thus indicates the vital need to extend the present authority of the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System to regulate rates on savings accounts. This experience also suggests that this authority cannot prevent, under all circumstances, a decline in the aggregate flow of funds into savings accounts caused by competition from marketable securities or other influences.

As indicated earlier, the act provides for consultation among the agencies and this injunction has been followed faithfully and with good will. In any consultative procedure, of course, some issues are likely to prove less easy to resolve than others. Nevertheless, these consultations have proven to be a vitally useful part of the continuing effort of this agency and the bank regulatory agencies to solve problems as they arise, and I might say, to understand problems as they develop, and to be able to take into consideration what effects, adverse or otherwise, one agency's action may have on the other agencies.

For all these reasons, the Board endorses wholeheartedly the proposal that the act of September 21, 1966, be extended for an additional 2 years.

As this subcommittee is aware, the Board favors permanent legislation in this area. We understand that consideration is being given to the development by interested agencies of a proposal for such legislation to be submitted to the next Congress. In the interim, a 2-year extension at least will provide us with the authority that will be vitally needed during what appears to be a trying period ahead.

We have been informally advised by the Bureau of the Budget that there is no objection to the presentation of this testimony and that enactment of S. 3133 would be consistent with the administration's objectives.

Mr. Chairman, as to S. 2923, I respectfully defer to the Department of the Treasury, and the Federal Reserve Board, because that legislation is much more in their area and much more understood by them, than by those of us in the Federal Home Loan Bank Board.

Thank you very much.

Senator PROXMIRE. Thank you very much, gentlemen.

I must say that in a complex and controversial area you have made some very helpful, thoughtful, and useful statements.

Governor Robertson, on the assumption that the present situation is inflationary, the economic situation generally—this seems to be the view of the chairman of the Board of Governors of the Federal Reserve Board—I am interested in your statement on page 2 that:

It may be become necessary to adjust the structure of ceiling rates if financial markets continue to tighten, in order to make it possible for the institutions to compete with the market and attract a reasonable share of new savings flows.

I assume you are referring in part to the problem of the large money market banks whose 90-day certificates of deposit are already selling in the open market at 5.70 percent, whereas all banks are restricted to 5.50 percent on new CS's. It is obvious that these banks are finding it difficult to attract new inflows at 5½ percent.

But why should the Federal Reserve Board be concerned about raising the rate to relieve the banks? In the interest of counter cyclical monetary policy, shouldn't the rate be maintained level or even reduced? If less money flows into the banks, wouldn't this force the banks to curtail their lending activity to the business sector? And wouldn't this reduce the level of investment spending and reduce inflationary pressure?

Mr. ROBERTSON. The purpose of restrictive monetary policy would be to reduce the amount of money extended. Consequently, the ceilings in my personal opinion should not be raised to enable banks to obtain more funds, purchased funds, for the purpose of making more loans. The question is whether or not if monetary policy becomes more restrictive, there would be such a large drain on the banks by virtue of market rates, that this would cause a panicky situation, resulting in banks dumping Government securities out of their portfolio into the market in order just to maintain their position.

Consequently, there is a possibility that if the situation arose whereby banks were losing funds that you might have to raise those ceilings merely to enable them to retain what they have rather than to gain more.

Senator PROXMIRE. And if you sold the Government securities and in anti-inflationary—

Mr. ROBERTSON. That is the reason they hold Government securities. This is their liquidity.

Senator PROXMIRE. And if you sold the Government securities and the price of Government securities drops, the interest rate increases?

Mr. ROBERTSON. That is right.

Senator PROXMIRE. Yield increases. And this slows down investment and slows down the economy, which you want to achieve?

Mr. ROBERTSON. That is right. But you don't want it in great gobs.

Senator PROXMIRE. What you are talking about is not a matter of providing more overall investment to stimulate the economy more, but the reverse. You recognize the wisdom at the present time of slowing it down. But you say it should be more orderly?

Mr. ROBERTSON. That is exactly so.

Senator PROXMIRE. So as not to upset the present situation?

Mr. ROBERTSON. Exactly.

Senator PROXMIRE. A kind of selective intervention. Maybe you can do the same for the housing market.

I would like to ask Chairman Horne whether the existing interest rate differential between banks and savings and loan associations enable savings and loans to compete for savings? Your testimony and the record of what has happened in the last few months suggests that they are having difficulty now. I notice a substantial dropoff in inflows for savings and loan, and as you said, a negative inflow in January. This concerns us because of course this committee is not only interested in financial institutions but we are very deeply interested in housing.

Mr. HORNE. Unquestionably, Mr. Chairman, the differential that exists, and which the Federal Reserve Board and FDIC have agreed to establish, has enabled the savings and loan associations to compete much more successfully than would otherwise have been the case. As I pointed out in my testimony, there are other sources that compete with savings and loan associations for savings other than just the deposit type institutions. That is one of the reasons that I so strongly urge that this particular legislation be extended because it would make it possible for us to consult as we are presently doing. It would make it possible for the bank and regulatory agencies to maintain a slight differential similar to what we presently have. And it would enable the savings and loan associations to enjoy a more competitive situation than would otherwise be the case with their chief competition.

But also, as I indicated, this legislation is not a panacea for all the difficulties that savings and loan associations might have. There are other instruments that people sometimes invest in, which pay a higher rate of return. These instruments provide for more of a differential over what associations pay for savings than is the differential between associations pay for savings and what banks pay for savings.

Senator PROXMIRE. Do you think this is enough? It seems to me that, whereas if it has helped, and you have all made a case, looking at the record from the time this was enacted in 1966, the situation improved—I am not sure this was the major factor but undoubtedly a factor—is this enough? We are all disappointed that our housing starts are still at a level of 1.5 million or so. It is still far below the potential. On the other hand, we do recognize we are in an inflationary situation. Housing uses up scarce resources.

Is this enough? Should we have more?

Mr. HORNE. I think in all fairness, Mr. Chairman, I would have to say that the present differential is a fair differential. We have to keep in mind here that both the banks and the savings and loan associations have different tools that they use. I am talking primarily of the fact that both have what we think of as a regular passbook savings and they have what banks call certificates of deposit or time accounts. We began giving out to people 2 or 3 years ago a certificate. So far as the outright differential between savings accounts are concerned, our ceiling is 4.75. The ceiling for the banks, so far as passbook accounts are concerned is 4 percent. This is a .75-point spread.

So far as CD's used by banks and certificates used by associations, there is a .25-point spread.

Senator PROXMIRE. In favor of S. & L.'s?

Mr. HORNE. In favor of S. & L.'s. It is true that the banks, many of them, make use of what they call the golden passbook. They call it a golden passbook. It is a 90-day notice account. We are thinking very seriously—and we have already consulted with the other agencies about it—of giving the associations a similar tool which they can use at 5 percent if they want to. It is not an in and out situation like a regular passbook, but the 5-percent rate and the term passbook, even though qualified, do have psychological effect.

I give you this explanation so that you would have a full background, Mr. Chairman.

To get back specifically to your question, is there enough differential presently in existence, I think I would have to say in fairness that we think that there is.

Senator PROXMIRE. Isn't it possible for some mutual savings banks which are not insured by the Federal Government to circumvent ceilings on savings deposits?

Mr. HORNE. That is true as regards mutual savings banks, that neither have FDIC insurance nor belong to our System. You can have FDIC insurance or you can belong to the Federal Home Loan Bank System. Quite a few don't have either. So they do escape the ceiling. By the same token there are quite a few savings and loan associations that are State chartered that do not have our insurance.

Senator PROXMIRE. This looks like a real loophole. Can you recommend legislation or an amendment that would help us cover that so that all institutions would be treated alike?

Mr. HORNE. I will be glad to try to provide you with what we think would be appropriate legislation for this purpose.

Senator PROXMIRE. Very good.

I would like to ask Mr. Deming: I have an ad here from the Wall Street Journal: "Earn an unbeatable 6.5 percent with 5 percent savings bonds." I would like to ask in that connection, the 6.5 percent is apparently derived from the fact that cumulative interest payments are also reinvested at 5 percent. Do you think that kind of advertising is appropriate?

Mr. DEMING. Mr. Chairman, I think that kind of advertising is misleading.

Senator PROXMIRE. Does the Treasury quote the yield on its securities on the assumption that periodic interest payments will be reinvested?

Mr. DEMING. No, sir; we don't quote on the basis used in the advertisement.

Senator PROXMIRE. Why should the savings public be treated any different? They shouldn't, I take it, on the basis of what you say?

Mr. DEMING. That is right.

Senator PROXMIRE. The advertisement also indicates the payment of 5 percent is guaranteed for 5 years. I would like to ask Governor Robertson, is there anything in the law which prevents you changing the regulation to reduce the maximum rate which banks may pay on outstanding obligations below 5 percent so that the guarantee in that event would be meaningless?

Mr. ROBERTSON. Under the regulations which the Board has issued since 1933, we have taken the position that there are no limits upon the time in which they can continue to pay any given rates to meet their contractual obligations. Even if we change the rate from say 4 down to $3\frac{1}{2}$, they could still on outstanding contracts continue to pay. Consequently, there is nothing in the law as we see it—

Senator PROXMIRE. Nothing in the regulations?

Mr. ROBERTSON. Nothing in the regulations.

Senator PROXMIRE. You have the legal authority to change the regulations, do you not?

Mr. ROBERTSON. We have authority to change the regulations. We don't have authority to change the law.

Senator PROXMIRE. Do you have legal authority to change regulations so that you could reduce below 5 percent on outstanding CD's?

Mr. ROBERTSON. Yes; we do. There is a question about this in the minds of lawyers who have explored this as to whether we really have the right in view of the legislative history of the statute enacted in the first instance.

Senator PROXMIRE. This guarantee hinges on the goodwill or attitude of the Federal Reserve Board; that is, on speculation?

Mr. ROBERTSON. I don't think so. I think the question really is whether or not the use of the term "guarantee" is misleading. I think not, because really it means a promise to pay this rate of interest for as long as this obligation is outstanding. This is exactly what the Treasury does on its bonds, of course. It uses the same words, savings bonds. The interest is guaranteed. In this same sense it seems to us that it would be inappropriate for us to say that you cannot say that you are guaranteeing the rate of interest.

Senator PROXMIRE. I would like to ask each of you gentlemen if you intend to tighten up the regulations issued in 1966 on advertising of this kind that Mr. Deming recognizes is deceptive?

Mr. ROBERTSON. Mr. Chairman, may I answer that first since I guess I was the father of the action that has been taken.

Senator PROXMIRE. Yes.

Mr. ROBERTSON. There is no clear authority in the law today giving us the power to determine what the advertising of any particular bank shall be, whether it is fair or unfair. But we decided that what we ought to do is to take the issue in hand and try to lay down guidelines which we thought would be in the interest of the entire banking industry and would benefit people as a whole.

Senator PROXMIRE. Should there be a change in the law, or would you recognize the antifraud provisions of the 1934 Securities and Exchange Act as useful in this regard?

Mr. ROBERTSON. This is a possibility. That isn't vested in us. But we did lay down general principles to guide banks and savings and loans. We took this up in the coordinating committee, and as a result of these discussions the four supervisory agencies put out guidelines with respect to advertising. We went as far as we felt we should go. It may be that we can go further in this direction. I think something should be done.

Senator PROXMIRE. This ad is obviously deceptive.

Mr. ROBERTSON. That is right. And I think the truth-in-lending legislation, which does now cover advertising, may give us a leg up in coping with this problem. I must say that we have made real progress in the field of advertising, although there are still some who take advantage of it. By and large, a great deal of good has been accomplished by the guidelines we have put out.

Mr. HORNE. Mr. Chairman, I would agree that there is some misleading advertising. And you have given that: you have shown evidence of it. In connection with what Governor Robertson has said, we did have a committee to study this matter. We did bring suggestions to the regulatory agencies after consultation. We did issue these guidelines. We are not satisfied with the guidelines, none of us, completely. And at one of our recent meetings we reactivated the further study by the staffs of the agencies which will come back to us within time, making perhaps additional recommendations.

I think Governor Robertson is right when he makes reference to the fact that there is some question as to how much authority exists in the law for us to do this. I know as you do very well that the SEC has shown an interest in this problem and I think—I want Mr. Cohen to speak for himself—I think he has taken the position that there is

some unfair advertising, that maybe he might someday himself try to correct if we don't find ways and means of correcting it within the financial institutions.

Senator PROXMIRE. Here again I think it would be very helpful to this committee if you gentlemen could consider this problem and recommend what changes, if any, you consider desirable in the law to give you the authority to prevent this deceptive advertising. Truth in lending is one real possibility.

Mr. McLean suggests we ought to have truth in savings. At any rate, I think that the legislation could be relatively noncontroversial and we could probably pass it quite easily.

I have a few more questions, but I have taken a long time. I will proceed as rapidly as I can.

I want to come to something, Governor Robertson, that is at the heart of the monetary and economy policy that confronts us. I ask these questions because I think one of the great quandaries we have is what we are going to do in the coming months in the event, as I expect, this economy is going to cool off sharply. I think we have a real overkill in the kind of action Congress is going to take. I may be wrong. I know Secretary Deming disagrees, and I think all you gentlemen do. But I think by the end of the year we could have some unemployment problems, with a 10-percent surtax, a \$6 billion cut in expenditures, and the high interest rates. The argument is that while you get the 10-percent surtax and you get the reduction in spending, the interest rates will come down. But I am not sure they can in view of the international situation. If that were out of the picture, if we didn't have to worry about outflow of capital, I think that it might be much more logical. Under these circumstances, I would like to ask Governor Robertson these questions, because I think it is very important that we do all we can to create a situation which, if we had to try to maintain interest rates because of the international situation, we could still give the housing industry the green light so they could move ahead and help us prevent the kind of unemployment which I fear.

Why has the Federal Reserve Board elected to buy agency issues through short-term repurchase agreements rather than direct purchases?

Mr. ROBERTSON. May I first say that I don't agree with your assumption that we ought to gear monetary policy, which has an effect on interest rates, to our international problems without considering the effect at home. I think this is the wrong way to go about it. If you want to prevent outflows of funds, you can do it through different instruments than monetary policy. Assuming for any—

Senator PROXMIRE. That is an interesting observation, very interesting. Everything I have read has suggested monetary policy is probably much more effective in the short run at least than fiscal policy in our balance-of-payments situation. If, for example, we have low-interest rates compared to the interest rates abroad, money is going to flow out.

Mr. ROBERTSON. I think that is right. But it doesn't mean to me that you ought to use monetary policy in a different way than is called for by the domestic economy.

Senator PROXMIRE. Do you let the balance of payments deteriorate?

Mr. ROBERTSON. Not at all.

Senator PROXMIRE. How do you prevent it?

Mr. ROBERTSON. I would impose an interest equalization tax, a flexible interest equalization tax. And I would have it applicable to all outflows of credit, whether bank credits, or whether direct investments. And I would have it flexible geographically so that you could differentiate between the less-developed countries and the developed countries, and between export credits and nonexport credits.

Senator PROXMIRE. You want selective exchange control?

Mr. ROBERTSON. Not at all. It isn't exchange control.

Senator PROXMIRE. Why isn't it?

Mr. ROBERTSON. No. It would simply be a tax so that the profit mechanism could work and people could decide whether the funds were to flow out depending entirely on the profitability of the transaction to them. Under my proposal, Congress would give to the administration the power to set rates which would be adequate to prevent an outflow of dollars. And as that outflow diminished so that we weren't sending more dollars abroad than foreigners were willing to hold, you would reduce that tax and hopefully you would keep it at zero always. You would have that flexibility.

Senator PROXMIRE. In other words, a partial selective kind of devaluation of the dollar?

Mr. ROBERTSON. It is a selective control, definitely.

Senator PROXMIRE. It would have the same implications?

Mr. ROBERTSON. Yes, it would.

Senator PROXMIRE. No. 2, it would take, would it not, legislation which we may or may not be able to get through Congress?

Mr. ROBERTSON. Yes; definitely so.

Senator PROXMIRE. Absent that—

Mr. ROBERTSON. Absent that you have to use some other controls.

Senator PROXMIRE. If the international financial situation is as serious as we are told it is, and if it is as important that we correct our balance of payments—and many people feel it is our No. 1 economic problem—we still have the problem of what we are going to do about a situation in which we may have economic slack. We may have growing unemployment and high interest rates.

Mr. ROBERTSON. My answer to that, Mr. Chairman, is simply that you don't permit a recession in this country because of the way in which monetary policy is functioning. Because if you have a recession in this country you are going to have a recession everywhere else in the world. You are going to do no one any good. I would not from my own point of view ever use monetary policy for the purpose of raising interest rates here to keep dollars from flowing abroad if it will cause unemployment and a full recession.

Senator PROXMIRE. I am glad to hear this, and that you represent one of seven votes on the Federal Reserve Board. But you don't represent all seven. I am not so sure that we are going to have policies that are going to be that domestically directed, or that we are going to get a response from Congress that will enable us to insulate the economy from the serious balance-of-payments problem.

Mr. ROBERTSON. I don't want to deemphasize the importance of the international problem. I think it is a great problem. But I think it ought to be dealt with in a manner which does not react against domestic economic conditions.

Senator PROXMIRE. How about this question: Why has the Federal Reserve Board elected to buy agency issues through short-term repurchase agreements rather than direct purchases?

Mr. ROBERTSON. No. 1, what we hope to do through our operations in Government agencies—

Senator PROXMIRE. I am talking about housing, FNMA and so forth?

Mr. ROBERTSON. Yes. We would hope that through our operations we can help establish viable markets in these agency issues. We have engaged, as you know, since 1966, as you stated—and you correctly summarized the view of the Board—we have used repurchase agreements to acquire agency issues. I think this has been helpful. I think outright purchases now and then might also be helpful in eliminating the gap between the rates on agency issues and the rates on Treasury obligations. But we also have to worry very much about going into these markets—which are relatively small markets—in a manner which will affect the price. If you affect the price in one way you can affect it the other way and you can diminish the desire of outsiders to come into that market. So that by buying directly in a manner which would really eliminate the gap in those interest rates, we could very well diminish viability of that market, keep people out of the market, and this would do much more harm than good.

As a result, we have been very reluctant up to this point to go into those markets on an outright purchase-and-sale basis, because you never can sell very well, you are always on the purchase side of these, really, if you are going to be helpful rather than harmful. But we have been reluctant to do that, not with the view that we never would go into it, but that we ought to be very careful that we don't do more harm than good in those particular markets.

We still have the matter under consideration. It was the subject of a study just yesterday by members of the Board, some of the members of the Board, some of the presidents of the Federal Reserve banks, and by representatives of the Treasury, including Mr. Deming. The matter is under consideration, has been under consideration, will continue to be under consideration, but we want to be very cautious in the actions we take in this direction.

Senator PROXMIRE. Suppose we gave you the authority to make purchases direct. Would that solve the marketing problem?

Mr. ROBERTSON. I don't think we should possibly get into that area, Senator. I think we ought to be using our power to purchase and sell securities for the purpose only of implementing monetary policy and on a very broad basis, not selected.

Senator PROXMIRE. Do you think the Federal Reserve Board has any responsibility for allocating the impact of a restrictive monetary policy among different sectors of the economy—and most specifically, the housing sector? You think you have to follow the monetary policy that in general will help stimulate the economy but not recognize a deficiency in the housing compared to an overexuberance in business?

Mr. ROBERTSON. I think that is right. I don't think the problem should be ignored. I think the Congress should deal with that on a selective basis rather than use a general instrument like monetary policy.

Senator PROXMIRE. How would the Reserve Board counter another round of "disintermediation" similar to 1966? The records show that savings and loan associations were hardest hit with a disastrous fur-

ther impact on the housing market. Why couldn't this be prevented by vigorous use of the agency purchase authority?

Mr. ROBERTSON. There might be situations where we could do that. We have power under the legislation we are discussing right now, which I think was a big factor in eliminating the outflow from the S. & L.'s and the mutual savings banks in 1966. We do have that power. We can adjust the ceiling rates. We also can function under the authorization to purchase the securities of agencies. I think we have to be very careful. Disintermediation itself is not a dirty word in my opinion. You have to have some disintermediation at times. I am not as fearful of this as some people are. I just don't want too much of it. And I don't want it to be all out of the financial institutions that finance the housing markets, either. We can, by adjusting the ceilings, keep it fairly evenly distributed except for the extent to which the market forces on the outside pull funds away from all types of financial institutions. This would be bad. And this would mean that we would have to adjust our ceilings. And of course there are limits to the extent you can raise the ceilings on the S. & L.'s because of the nature of the assets which they have and the fixed interest rates on them.

Senator PROXMIRE. Interest rate could go much higher. This isn't an effective tool. Banks can go higher but S. & L.'s can't. Is that correct?

Mr. ROBERTSON. You are right. S. & L.'s are limited practically in the extent to which they can increase their rates and therefore we have to hold down the rates on banks.

Senator PROXMIRE. There is a lot of feeling that the discount rate was not raised enough. Nevertheless the interest rates will have to go higher?

Mr. ROBERTSON. That is right.

Senator PROXMIRE. This is going to mean a real blow to the S. & L.'s and to the housing industry.

Mr. ROBERTSON. This is what we have to avoid. But you can't avoid some impact on the housing industry.

Senator PROXMIRE. And the purchase authority becomes much more important than the rate authority?

Mr. ROBERTSON. It may very well. This depends entirely on how the situation works out. I don't expect that situation to arise. I don't think we are in the kind of a jam that many people think we are. I think we are in the position with the authorities, the tools we have, to prevent the kind of disastrous disintermediation that took place in 1966.

Senator PROXMIRE. You recognize, I take it, that the Federal Reserve Board is a creature of the Congress?

Mr. ROBERTSON. Very much so.

Senator PROXMIRE. And that it pursues the policies—rather, the Congress can re-create it, abolish it, and so forth?

Mr. ROBERTSON. Absolutely.

Senator PROXMIRE. What would Congress have to do to indicate that it wishes the Board to change its policy and give greater support to the housing market? Would you recommend a change in the law or would committee report language and subsequent legislative history be sufficient to have an impact on the Board?

Mr. ROBERTSON. I think the only way to do this, Senator, is to change the law to specifically direct the Board to do this or that. I think that this would be an unwise move.

Senator PROXMIRE. It would be an effective move but an unwise move?

Mr. ROBERTSON. That is exactly so. I think the legislative history wouldn't be sufficient because the views of the Board, and they think they are carrying out the best judgment which they possess, are very much in the opposite direction, that you should not use monetary policy in a selective way to take care of agriculture, housing, or any other specific area. The feeling is that if you do that you ruin the effectiveness of monetary policy as a whole, and this we think would be bad.

Senator PROXMIRE. That is apparent in looking at the record. What criteria does the Board now follow in deciding whether or not to utilize its agency issue purchase authority? In looking over your record for the past 17 months, the few agency purchases you made bear little if any relationship to mortgage interest rates, savings inflows into savings and loan associations, or general monetary policy. Precisely what is the Board seeking to affect when it does buy agency issues?

Mr. ROBERTSON. What we are trying to do at the moment is to help the markets in agency issues in the same way in which we help the market for direct Government securities when we enter into repurchase agreements on them. We take agency securities temporarily off of the hands of the dealers who enter into the repurchase agreements with us. We are recommending now, that you amend this bill in order to make it possible for member banks to borrow from Federal Reserve banks on the security of these agency issues. I think this is needed. We also suggest that you amend the legislation to enable individuals, partnerships, and corporations in emergency situations to pledge these agency issues to the Federal Reserve as collateral. This in part arises out of the need which we recognize to come to the assistance of S. & L.'s, for example. In 1966 we had made arrangements and established mechanisms whereby we would come to the assistance of S. & L.'s, mutual savings banks, et cetera, if needed. But under the law now we have to require collateral in the form of U.S. Government securities. We are suggesting that you change this legislation so that agency issues too could be pledged for that same purpose. All of these tie in to an overall view that we ought to do everything we can do to enhance these markets, reduce the gap in the interest rate on these agency issues as compared with other Government issues, but not to go in and try to peg the rate in any one of these areas for fear that we will destroy the market in that area and create more problems than we solve.

Senator PROXMIRE. Secretary Deming, how has the Board and the Treasury used the \$5 billion direct purchase authority for Treasury securities?

Mr. DEMING. We have used it, Mr. Chairman, very sparingly. There are three purposes to this legislation. It lets us operate with a somewhat lower cash balance at particular times when our revenues are seasonally low; it gives us an escape valve so that we don't have to make a borrowing at that particular point in time when we are anticipating revenues in the very near future. Most of the time it doesn't have to be used but it is there if we need it. We have used it, as I said,

four times in the last 2 years. We have never regarded the \$5 billion figure as anything except really a war emergency kind of figure. That is the third purpose for having this sort of thing.

I think the biggest number we ever had in borrowing in the whole history of this thing was \$1,320 million in 1943. In the period since 1954 the biggest number has been \$424 million outstanding at one time. We didn't use it at all in 1955, 1956, or 1957. We didn't use it at all in 1959-65. But it is useful to us so that we don't have to borrow in anticipation of revenues that will be coming in in a short period of time. It is used almost always over the tax payment days.

The Federal Reserve of course has the authority not to extend that credit if they don't wish to give it, but we have never had any problem with respect to this. And it counts against the debt ceiling as any borrowing of the Treasury does. It is a 1-day, usually a 2-day, and I think the longest in the last 2 years has been a 3-day borrowing period.

Senator PROXMIRE. Are direct sales, Secretary Deming, of Treasury securities of the Federal Reserve Board, treated as part of the national debt subject to the debt ceiling?

Mr. DEMING. Yes, they are. It is no way for us to escape the debt ceiling.

Senator PROXMIRE. Governor Robertson, for the record could you provide a complete month by month breakdown of agency issue purchases and sales by type of issues?

Mr. ROBERTSON. I would be very glad to.

(The following material was received by the committee:)

SYSTEM REPURCHASE AGREEMENTS AGAINST AGENCIES, DECEMBER 1966-MARCH 1968

[In millions of dollars]

	Total	FICB	Coops.	FLB	TVA	FHLB	FNMA
1966—December.....	197	22	27	8	-----	76	63
1967—January.....	11	-----	-----	-----	-----	4	7
February.....	187	6	15	34	24	33	76
March.....	175	3	8	42	10	29	83
April.....	88	13	6	6	10	12	41
May.....	12	-----	-----	2	3	-----	7
June.....	6	-----	-----	-----	6	-----	-----
July.....	33	6	1	17	5	4	-----
August.....	3	3	-----	-----	-----	-----	-----
September.....	33	1	1	5	23	-----	3
October.....	56	3	1	-----	18	4	30
November.....	68	2	8	1	32	1	25
December.....	43	3	1	8	6	9	16
1968—January.....	53	13	3	1	13	6	16
February.....	18	8	6	-----	2	2	-----
March.....	117	5	-----	26	24	25	37
Total.....	1,099	87	76	150	176	205	404
Percent.....	100	7.9	6.9	13.6	16	18.6	36.8

Note: A repurchase agreement involves both a purchase and a sale. The securities covered by the agreement are automatically sold back to the dealer at the termination of the agreement.

Senator PROXMIRE. Gentlemen, thank you very much.

Senator BROOKE, you have been very patient.

Senator BROOKE. Thank you, Mr. Chairman.

Deming, both the Federal Home Loan Bank Board and the Reserve System are on record now as being in favor of the authority rather than merely a 2-year extension. I notice Department has not proposed to make it permanent

authority and only favors the 2-year extension. The reason as I understand, from page 2, is that the extension was requested only because the interest rate ceiling power authority was only intended initially to take care of a special set of circumstances. How strongly is the Treasury actually opposed to permanent authority?

Mr. DEMING. The Treasury isn't really strongly opposed to making it a permanent piece of legislation. We have no adverse feeling at all with respect to the permanency of certain parts of it. It was designed to meet what was then regarded as an emergency situation; then renewed for a year. We have requested renewal of it for 2 years.

The question as to whether you should have permanent legislation for ceilings on rates paid for savings and time deposits is still, I think, an open question. Some people believe that you shouldn't have them at all. Governor Robertson makes the point, a very valid point, that you can have it on a standby basis and consequently not have a ceiling operative at all. In the light of his position here, I don't think the Treasury has a strong position in opposition to permanent legislation. As a practical matter we thought it would be simpler to achieve a 2-year extension and look at it as the 2 years went by.

Senator BROOKE. Governor Robertson said in the statement it is difficult to envision circumstances under which Congress would find it difficult to allow this statute to terminate. He wants the standby authority for it. You can't envision it; can you?

Mr. DEMING. Senator, only in a sort of broad and conceptual sense. I may be too idealistic. I would hope that you could come one day to a period of time when you didn't need controls of this sort and that you could rely on the forces of competition to adjust more smoothly than they seemed to adjust in 1966. That is the only reason for saying that you might look at this at the end of another 2 years. The Treasury doesn't have a strong position on this at all.

Senator BROOKE. Mr. Horne, in response to Senator Proxmire's request for legislation to cover these financial institutions that are taking advantage of the loophole, did you intend to leave the impression that you could take care of these financial institutions which are not insured by the Federal Government by such legislation?

Mr. HORNE. We believe—and this is something that we have to check into, Senator, that it can be taken care of. If it isn't taken care of, there is a gap, as the chairman pointed out, both as regards mutual savings banks and also as regards savings and loan associations. If they aren't insured by the FDIC or by us, or if they don't belong to us as members, then they are free to do, under existing law, what they want to as regards the setting up of dividend ceilings. There have been quite a few that have withdrawn from the Federal home loan bank system in order to avoid our having authority to impose dividend ceilings. And there are others that are threatening to do so if certain things aren't done so far as their getting the kind of dividend ceiling that they want. Of course, when we start setting dividend ceilings we have to take into consideration the national picture and we can't pick and choose on an association or mutual savings bank on a case-by-case basis. We have to give consideration to the geography involved, whether nationwide or at least regional-wide or statewide. So unquestionably there is a gap that exists here that hasn't up until this moment caused great trouble but can cause great trouble in the days ahead if the gap isn't closed.

Senator BROOKE. How many such financial institutions would you say there are that fall in this category?

Mr. HORNE. Taking the mutual savings banks and all the savings and loan associations, there are in excess of 1,300 nationwide.

In addition, there are approximately 422 uninsured members of the Federal Home Loan Bank System which can escape regulation merely by withdrawing from membership.

Senator BROOKE. You say that number is growing?

Mr. HORNE. It is growing to some degree because some who belong to our system have withdrawn in order to avoid our having authority to impose dividend ceilings on them.

Senator BROOKE. You think that Congress can pass legislation that will cover them even though they are not under FDIC or the Federal Reserve System?

Mr. HORNE. In an exploratory conversation with my general counsel, he believes that this could be done. I would have to take another look at it and endeavor to comply with the chairman's request that we submit proposed language that we think would do it.

Senator BROOKE. You don't recall the basis on which your counsel suggested it could be done?

Mr. HORNE. No, sir; I do not recall. I guess it could come under the commerce clause, or it might come under the clause to coin money and regulate the value thereof. I am thinking off the top of my head now. I am not a lawyer and I would like a chance to discuss it further.

Senator BROOKE. If you could give the committee the benefit of counsel's advice, and also the number of the financial institutions we are talking about, it would be very helpful.

Mr. HORNE. Yes, I should be glad to do so. If I may, Senator, make one further comment about the permanency of ceilings on dividend or interest rates. I would like to point out that what all three of us are talking about is that it be on a standby basis, that it be made permanent but on a standby basis so that the agencies could determine among themselves when they apply the dividend ceiling and when they don't. If the law that we are talking about today should not be extended, in any form, then there would be no dividend ceiling at all that could be imposed on savings and loan associations. I think the same thing would apply with regard to mutual savings banks. We would revert then to Federal Reserve Board authority which is mandatory that they apply but which they can also raise to a level that it has no meaning.

I can conceive of a situation like the one in 1966 when we didn't have the authority that we now have, and when, understandably, it takes a little time for Congress to take action. So while we had proposed such authority reasonably early in 1966, it was not enacted for several causes until September 1966. It was during this period of time when disintermediation became an extremely serious problem. Our hands were tied and none of us could do anything about it until after this legislation was enacted.

Senator BROOKE. So you want to avoid the necessity, you and Governor Robertson and Mr. Deming, of coming before this subcommittee every 2 years or worse, every 1 year, asking for an extension of this authority?

Mr. HORNE. I just agree with Governor Robertson that it would be better. So far as our wanting to avoid coming before the committee I would like to say, sir, that I am always glad to come before the committee. It is not a question of trying to avoid it at all.

Senator BROOKE. Thank you.

Senator PROXMIRE. Do I understand that you favor permanent legislation, Mr. Horne? I understood that you favored the 2-year provision in the bill.

Mr. HORNE. I said in my statement, sir, that personally I would prefer that the legislation be made permanent on a standby basis.

Senator PROXMIRE. I understand the chairman of the House Banking Committee wants it on a 1-year basis.

I can see a lot of benefit in these hearings. I think I have learned a lot this morning. I think perhaps the Congress should have some regular systematic method of getting our viewpoint to these agencies. For that reason I think that a 2-year renewal, in view of the fact that a renewal is going to be made, could serve a useful purpose, a permanent action would mean that we would probably lose sight of the agencies' performance. So that I think it does serve a very useful oversight.

Thank you, gentlemen, very much. Your testimony has been, as I said, most useful and helpful to us.

Our next witness is Mr. Raleigh W. Greene, Jr., chairman, legislation committee, National League of Insured Savings Associations, an old friend of the committee.

You are Mr. McKenna?

Mr. McKENNA. Yes, sir.

Senator PROXMIRE. We are glad to have you.

Mr. McKENNA. Mr. Greene asked me to express his very great thanks to the subcommittee for allowing me to present his statement. He was here last Friday and had to return to Florida and unfortunately did not feel well enough yesterday to make the trip back up again. He is very thankful that you allow me to place his remarks in the record. So, although my accent is not the same as Mr. Greene's, I trust you will take these remarks as being his rather than my personal remarks.

STATEMENT OF RALEIGH W. GREENE, JR., CHAIRMAN, LEGISLATION COMMITTEE, NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS, AS READ BY WILLIAM F. McKENNA, GENERAL COUNSEL

Mr. McKENNA. Mr. Chairman and members of the subcommittee, my name is Raleigh W. Greene, Jr. I am president of the First Federal Savings & Loan Association of St. Petersburg, Fla., and chairman of of the legislation committee of the National League of Insured Savings Associations. The National League is a nationwide trade association serving the savings and loan industry. The National League appreciates this opportunity to testify on S. 3133, a bill to extend for 2 years the authority for more flexible regulation of maximum rates of interest or dividends, higher reserve requirements, and open market operations in agency issues.

Two provisions of the act of September 21, 1966—Public Law 89-597—amended by S. 3133 are of direct interest to savings and loan associations.

Section 4 of that act empowers the Federal Home Loan Bank Board to limit by regulation the rates of dividend payable by Federal Home Loan Bank System members or by savings and loan associations having savings accounts insured by the Federal Savings and Loan Insurance Corporation. Before taking action under this grant of power, the Board is to consult with the Federal Reserve Board and the Federal Deposit Insurance Corporation.

Section 6 of that act empowers Federal Reserve banks to buy and sell in the open market, under the direction and regulation of the Federal Open Market Committee, any obligation that is a direct obligation of or fully guaranteed as to principal and interest by a U.S. agency. This includes obligations issued by the Federal Home Loan Bank System.

RATE CONTROL

Historically as a matter of principle the National League has opposed the idea of exercise of control over dividend rates on savings by any governmental agency. Philosophically in a mutual savings and loan association this is a decision for management, to be made after considering association assets available for paying dividends on savings.

In the light of the then instability of the savings markets, the National League agreed to support enactment of the act of September 21, 1967, it agreed to support a further extension of the life of that act, but requested that appropriate administrative or legislative action be taken to authorize savings and loan associations to accept time deposits as a method of meeting the growing competition for savings resulting from so-called "golden passbook" accounts offered to savers by commercial banks. The House Committee on Banking and Currency did not adopt such an amendment, but some members suggested that it be determined whether the Federal Home Loan Bank Board would grant the power administratively. The Board has not seen fit to take such action. The House committee decided to recommend extension of the act of September 21, 1966, for only 1 year instead of the 2-year extension contained in the bill as passed by the Senate without hearings. The bill passed in the form of a 1-year extension, keeping the act of September 21, 1966, in effect until September 20, 1968.

The National League supports S. 3133 which would extend the act of September 21, 1966, for an additional 2-year period through September 20, 1970. But in so doing it requests that the Federal Home

Loan Bank Board be directed by the Congress to authorize Federal savings and loan associations to accept time deposits for as short a period as 90 days subject to regulatory control of the Board. It seems apparent that the Board is reluctant to take action along this line without direction from the Congress.

The time deposits in commercial banks continue to pose a substantial competitive threat to the ability of savings and loan associations to attract an adequate supply of savings dollars. In support of this fact, the following statement is quoted from an article entitled "Changes in Time and Savings Deposits, July-October 1967" at page 42 of the January 1968 issue of the Federal Reserve Bulletin prepared by Miss Caroline H. Cagle of the Federal Reserve Board's Division of Research and Statistics:

The most rapid increase in any of the forms of time and savings deposits in the July-October period was in small denomination open-account time deposits (presumed to be mainly the 90-day-notice passbook deposits), which increased by 13 percent—also less than in the preceding two quarters. These deposits amounted to \$3.2 billion on October 31—75 percent more than the amount outstanding on January 31, 1967. While these instruments are offered by both large and small banks, the bulk of the deposits are in very large banks, where the offering rate is generally 5 percent.

The article continues on page 43 to state:

Among Federal Reserve districts the largest increase in consumer-type deposits in the three months ending October 31 occurred in the Boston District (4.6 percent) where the increase in savings and consumer-type time deposits topped all other Federal Reserve districts, reflecting in part aggressive promotion of new consumer-type open-account time deposits.

In commercial banks in the United States, total holdings of savings and time deposits increased by over \$12.6 billion from January 31, 1967, to October 31, 1967, to \$129.5 billion (January 1968 Federal Reserve Bulletin, p. 42, table 1). During that same period all operating savings and loan associations in the United States increased their savings accounts by only \$8.1 billion to \$118 billion (October 1967 Federal Home Loan Bank Board, table 2, Flow of Savings and Mortgage Lending Activity—All Operating Savings and loan Associations).

Mr. Chairman, if I may at this point, I would like to top the exhibit you put in the record earlier by offering this advertisement of the Republic National Bank of New York, which has a 5-percent per annum rate advertised on the 90-day account, and then in equally large figures, 7.21-percent average rate of interest in 13 years, 10 months, 11 days. This is from a very recent issue of the New York Times, March 28.

Senator PROXMIRE. Very well. It is good to have that.

(The advertisement follows:)

Double your money with Republic National Bank Double-Dollar Bonds.

5% rate guaranteed up to
13 years, 10 months, 11 days,
with interest compounded daily.
per annum

7.21% average annual rate of
interest in 13 years,
10 months, 11 days.

- You will receive twice as much as your original deposit, after 13 years, 10 months, 11 days.
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Mr. McKenna. The National League also urges that the following action be taken by the Congress to hasten the day when the Federal Home Loan Bank Board's statutory authority over dividend rates payable on savings can be allowed to expire.

The Congress should adopt as soon as possible a 10-percent surtax on Federal income taxes to last as long as the Vietnam war continues and should coordinate with the executive branch of the Federal Government in reducing Federal Government expenditures to the extent necessary to achieve a balanced budget in the coming fiscal year ending June 30, 1969. A balanced budget in fiscal 1969 is essential if we are to restore confidence in the dollar.

I realize that it is never an easy task for the Congress or the administration to reduce Federal expenditures. But I sincerely believe that it is time to substitute gumption and brains for discussions about guns and butter. If we do not set about putting our economic house in order by using fiscal measures as well as monetary measures, perhaps we had better triple the appropriations for our space exploration programs so we can all go to some other planet and start anew.

We are now facing the realization that unless we can restore free world confidence in the dollar, it will adversely affect world trade and industrial expansion.

We still have the world's major source of gold—some \$11.4 billion worth.

We still are producing goods and services at a rate of \$800 billion a year. We still have a full work force capable of producing even faster—faster, at any rate than any other nation.

We still have a good strong financial system in this country, and as we have historically always been a trading nation, our trade position still is good.

No other country can match the stability of our currency, despite our increasing inflation.

Despite all this, we face a crisis unmatched in the history of our Nation. What is the answer?

I do not pose as a monetary or economic expert. But I do want to express—as one citizen—my deep concern over this predicament which we face, and urge what I believe are specific solutions:

First, it is imperative that we balance our national budget even if we have to make cuts across the board.

It is not possible for us to achieve all our goals at one and the same time. We must have the political courage to admit that we are once again on a war economy.

This means we must make drastic cutbacks in our domestic programs. We must make wartime demands on our citizens. I realize this is an unpopular position to take in a time of seeming prosperity.

I realize this could mean that such programs in Florida as the Cross-State Barge Canal, the space program at Cape Kennedy, even the badly needed Federal highway program must be curtailed or postponed. But if this must be, then we as citizens should face this fact and urge such curtailments.

I also believe that it is vitally necessary for the Congress to approve the 10-percent tax surcharge.

It is imperative that the administration take positive, identifiable steps to redress the balance-of-payments deficit immediately.

Perhaps, if these steps are taken concurrently and together with a continued restriction on credit, then we can hope to restore world confidence in the dollar. Perhaps then we can establish a normalcy which will endure until such time—next spring or summer we hope—as the International Monetary Fund can put its new world money plan into effect.

The free world is wondering whether we are about to crucify the American dollar on the cross of complacency.

If we as a nation are not willing to take these steps to drastically reduce spending—then I fear the consequences. I am afraid that we face a worldwide plunge into financial chaos from which we will all be a long time recovering. And while we recover, the advantage will lie with those who are not of the free world.

FEDERAL RESERVE PURCHASES

By extending the life of the act of September 21, 1966, S. 3133 would also extend the authority of every Federal Reserve bank to buy and sell in the open market, under the direction and regulations of the Federal Open Market Committee, any obligation that is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States.

Federal home loan banks are agencies created by the Congress pursuant to the Federal Home Loan Bank Act. (Act of July 22, 1932, 12 U.S.C. 1422 et seq.) Section 11(b) of that act authorizes the Federal Home Loan Bank Board to issue consolidated Federal Home Loan Bank debentures that are joint and several obligations of all Federal home loan banks. This is the major borrowing technique used by the Federal Home Loan Bank System to obtain borrowed funds that in turn can be loaned to savings and loan associations that are members of that System.

Making the Federal open market activities of the Federal Reserve System available as a purchaser of Federal Home Loan Bank debentures supplies a welcome additional means of obtaining funds for the Federal Home Loan Bank System. In turn, this should make more funds potentially available for home finance, even in a period when general monetary policy tends to dampen the availability of home finance funds.

This authority should definitely be extended. In fact, it should be made permanent.

Thank you for the opportunity of presenting these views.

Senator PROXMIRE. Why should it be made permanent in view of the desirability of congressional oversight and in view of the fact that you state earlier that historically as a matter of principle the National League has opposed the idea of exercise of control over dividend rates on savings by any governmental agency. I can understand why you think exigencies of the present require these—you made a good case—limitations, but I can't understand why you want them forever if you are against the principle.

Mr. McKENNA. I am not asking for the rate controls forever in this testimony, Senator. What we are asking for is the extension of the authority of the Federal Reserve banks to purchase obligations in the open market.

Senator PROXMIRE. Good. I am glad you made that clear. I misunderstood it. That is different.

Mr. McKENNA. I might hasten to add it seems to me if the Federal Reserve Board is loath, as it appears to be, to try to use its monetary powers in a selective manner to help out the housing and construction industry, then perhaps some thought should be given to utilizing the Federal Home Loan Bank System as a means toward this end. I realize it would take a rather substantial change, probably including a grant to the Federal Home Loan Bank System of some of the money-creating authority—

Senator PROXMIRE. It would be easier for Congress to assert its authority over the Federal Reserve Board which is clear, which Mr. Robertson and Mr. Martin always say we have, and it is in the Constitution.

Mr. McKENNA. It would be a much easier method as far as administration goes; that is true, Mr. Chairman.

Senator PROXMIRE. When you say you oppose as a matter of principle the idea of exercise of control over dividend rates on savings by any governmental agency, you are not talking about control over banks, are you?

Mr. McKENNA. I am talking about savings and loan associations. As you know, before 1966 there was no such authority in the Government agency as far as savings and loan associations are concerned. The banks on the contrary had a mandatory control under regulation Q. In turn for making control over banks standby, savings and loan associations also received standby authority over dividend rates in the Federal Home Loan Bank Board. So the situation is entirely different.

Senator PROXMIRE. Thank you very much.

Senator BROOKE?

Senator BROOKE. You stated that you believe that if Congress were to pass the 10-percent surcharge, and to reduce domestic spending which, of course, the Senate passed yesterday and now goes to the House, that you believe you could hasten the day when there would be no statutory authority over dividend rates.

Mr. McKENNA. Yes, Senator.

Senator BROOKE. Suppose this passes Congress. Do you think that this authority should not go beyond the 2-year period that you are now supporting?

Mr. McKENNA. We would hope that the market would settle down and calm down enough and that interest rates in general would lower enough so that possibly at the end of that 2-year period this would be possible.

Senator BROOKE. Do you think we would have to come back in 2 years if the House passes what the Senate passed yesterday?

Mr. McKENNA. Yes, sir. I think the point I am trying to get across on behalf of Mr. Greene and on behalf of the National League is that basically the declaration of earnings on savings should be a management decision, not necessarily a governmental agency decision. We have gone along with the idea of arbitrary—I withdraw the word "arbitrary"—with planned dividend rate controls by the Government only because of the instability in the market itself. When that instability is removed, we would hope that again it could become a management decision rather than a governmental agency decision as to the rate of dividends to be paid for savings.

Senator BROOKE. Then you think that the financial institutions had no part in creating this crisis which gave rise to this authority?

Mr. McKENNA. I don't think much can be laid on the doorstep of the savings and loan associations, Senator, in that respect. We operate of course, as you know, on the spread between what we pay for money and in turn what we can receive from the yield on the investment of money. Very frankly speaking, every member I have talked to would much rather operate in a range down between 2 and 4 percent than between 5 and 7 percent, which is about the range we are in now. It makes it much more difficult in our field, as you can appreciate, with State usury laws to contend with and other things. And really it is only the spread between what we pay for money and what return we can get from investing it that sustains the savings and loan system.

Senator BROOKE. So you are definitely opposed to Governor Robertson's and Mr. Horne's suggestion that this authority be made permanent?

Mr. McKENNA. Very definitely; yes, Senator.

Senator BROOKE. And that is the League's position?

Mr. McKENNA. Yes, sir.

Senator PROXMIRE. I am very interested in your economics. I know there is the traditional economic prescription. What you do is hike taxes, cut spending, reduce demand strongly and the result is interest rates will come down. We had a lot of testimony before the Joint Economic Committee on this and there was a difference of opinion by the economists. Some said the prices wouldn't be slowed at all. Some said the prices would begin to be slowed up in maybe a year. It is my understanding that it would have a slight effect. It might have a substantial effect. The effect on interest would be a combination of two factors. One, higher taxes reduce demand, perhaps, from the nonhousing sector of the economy and therefore tend to slow up the requirement for investment. But at the same time higher taxes slows the supply of funds as well as the demand. If this slowdown is great enough interest rates remain the same. Higher taxes slow down the economy and may or may not, in a year or more, begin to ease interest rates.

Mr. McKENNA. Yes, sir.

Senator PROXMIRE. It is interesting to notice in the past how long it has taken before this has gone into effect. I notice, for example, what happened in 1958, when in 1957 we followed a decisive policy of trying to stem economic activity. The result: increased unemployment over 7 percent, and we still had substantial inflation. I am speculating on what price we have to pay, how many people we have to throw out of work, how serious an impact we have to have on the economy to reduce interest rates.

It is very hard to make these economic judgments because of the unfortunate effect they may have on so many millions of Americans.

Mr. McKENNA. It is difficult, Senator, I realize that. Obviously this testimony must be taken as presented from the standpoint of the members of a specific segment of the economy; namely, the savings and loan industry itself. It is the hope that these measures would restore a system where, as I said, the general interest rate would be lower, the general interest levels could be lower. This then would make

it more easy to operate in what we might call a return to normalcy, I hope.

Senator PROXMIRE. The notion is also of course if you reduce the deficit by increasing taxes and reducing spending, reduce the Federal demand for funds, you therefore reduce interest rates.

Mr. McKENNA. Yes, sir.

Senator PROXMIRE. The difficulty is as you raise taxes you may reduce economic activity so much that revenues drop rather than increase. That is perfectly possible. It happened in the past. It happened in reverse as recently as 1964 when we reduced taxes and then revenues increased. It is difficult to make dogmatic judgments on this. It seems to me that the argument that we have to operate in the area of trying to get more funds available into housing by such techniques as the bill that is before us now, and by trying to urge the Federal Reserve Board through some kind of legislation, some kind of congressional decision to act to provide more funds for the housing industry.

Mr. McKENNA. Senator, I think you put your finger on one of our big elements of competition. We could, it is true, have competition with our friends in the commercial banking field. We have even more competition with the Federal Government. When you take an example of the participation certificates that were floated recently, FNMA, with rates up in the 6.34 bracket, that is way above what we can economically offer for savings in today's market. It is true that an increase in taxes would make it less necessary for the Government to go to the public market and create that demand for high interest rates. This is one of our hopes, obviously. And in the other field, if the Federal Reserve does not make more use of the authority that it now has, even though the authority technically is good, it seems to me we must search for some other method of getting money into the home finance field.

Senator PROXMIRE. Thank you very much, Mr. McKenna, for your very helpful testimony.

Mr. McKENNA. Thank you.

Senator PROXMIRE. Senator Brooke?

Senator BROOKE. Your group has profited from this legislation?

Mr. McKENNA. From the legislation?

Senator BROOKE. Yes.

Mr. McKENNA. That is a debatable issue. The Chairman of the Home Loan Bank Board feels very sincerely that is true, by potentially, I guess, allowing more savings to flow into the savings and loan system but many of our members don't agree with that theory.

Senator PROXMIRE. There isn't a question about it. Without this legislation the banks would be able to offer rates that would be higher. They would attract savings to the banks. You have a differential. You are able to offer a higher rate than the banks.

Mr. McKENNA. We have a differential but in spite of the differential, because of the other strings tied to it, it doesn't seem to attract money from the public as much as the bank 90-day time deposit.

Senator BROOKE. Wouldn't the situation be worse without the benefit of this legislation?

Mr. McKENNA. It is difficult to say. I realize that I am at the moment defending the opportunity for the savings and loans to show in the market what they can do. There are many in-built regulations. Usury

laws are one of them. You can't lend above the State usury limits and in some States the limit is low. However, the request for the rate control in the first place was made because some savings and loan associations were offering higher rates even than the banks. I think sincerely that our main problem came not from the banks but from the higher competitive yields, higher competitive interest rates that came to pass on the Government obligations.

Senator PROXMIRE. You seem to indicate you would take the ceiling off everything.

Mr. McKENNA. As far as savings and loan associations go I would be happy to go back to the situation before 1966, sir, where the banks had mandatory regulations and we did not.

Senator PROXMIRE. Thank you very much.

Our next witness is Dr. Preston Martin, who could not be here. He has an excellent statement. He is the commissioner of savings and loan for the State of California. His statement will be inserted in the record.

Before we adjourn I want to place in the record a statement by Mr. Stanley Barber, president, and Ralph Zaun, chairman, of the Independent Bankers Association of America, a statement by Chairman K. A. Randall, Federal Deposit Insurance Corporation, and a statement by the American Bankers Association.

(The statements follow :)

STATEMENT OF PRESTON MARTIN, SAVINGS AND LOAN COMMISSIONER,
STATE OF CALIFORNIA

Mr. Chairman and members of the committee, March 1968 is a particularly appropriate period to consider a measure to bring housing credit policy into the mainstream of monetary policy. The acute stress on money and capital markets which characterized the last half of 1966 remains in the future. The signs of some impending tightness in money supply, availability, and cost are unmistakable. Action now by this committee and by the Federal Reserve Board can head off the extreme cutoff of housing which occurred in 1966. Both the savings and loan industry and the Federal Home Loan Bank System have ample liquidity for the moment, yet net savings flows into the Nation's savings and loan associations are dropping sharply. The January-February 1968 gain of \$365 million was down 66.2 percent from 1967. The U.S. Savings & Loan League has indicated the probable results of the first quarter as follows:

"The first quarter gain will be the smallest for any January to March period since the current business expansion got under way in 1961. It would require a record gain in savings to produce a more favorable result at associations."¹

Almost every leading indicator in the money and capital markets points toward a continuation of relatively unfavorable savings experience for the Nation's primary mortgage lenders—the savings and loan associations. The money supply is presently growing at a rate of 3.1 percent, compared to perhaps 8 percent per year for the gross national product. At times during March 1968 the excess free reserves in the Nation's commercial banks has dropped to the neighborhood of minus \$353 million. Future availability of funds is cast into grave doubt thereby.

Present increases in the cost of money point out the possibility of disintermediation, commencing with the April 1968 reinvestment period for savings and loan associations which is now under way. FNMA participation certificates at 6.4 percent, U.S. Treasury new 1-year bills at 5.475 percent, and Union Electric's AA-rated 7-percent bonds due in 30 years at 6.91 percent, all during the week of March 27, point toward high money market instrument rates. Under savings rate control, savings and loan associations cannot adjust to this competition.

¹ U.S. Savings & Loan League, Savings and Mortgage Lending Trends, March 1968.

The point is that the industry and its bank system is in a position of negotiating from strength, not from crisis, contrary to 1966. Yet we have 1966's record fresh in our minds; more important, we have its analysis by the Nation's principal credit agencies before the Subcommittee on Housing and Urban Affairs of this committee in "A Study of Mortgage Credit" (90th Cong., first sess., May 22, 1967). That analysis strongly supports the position that we cannot afford the instability in the flows of mortgage funds and in the construction industry which characterized the periods of 1963-66, of 1956-57, and of 1959-60. Instability adds costs to housing, costs associated with moving economic resources into and out of construction every 3 or 4 years. The background music is one of builder bankruptcies, with the surviving builders marking up their homes \$1,000 and \$2,000 per year, and passing on land price increment plus 15 percent. New housing is pricing itself out of the market.

The construction industry was singled out by the Council of Economic Advisers for special attention in the 1968 Economic Report of the President because of its rapidly rising cost configuration (op. cit., p. 118). In the same report, the construction industry was called upon to increase its new housing output by one-third to meet private market demand and by 300,000 units for low and lower middle income families in the coming fiscal year (op. cit., pp. 151 and 152). In California and in many other States, the information within our office indicates that vacancies have plummeted below the normal level. Present levels of housing starts are so depressed that the new housing inventory is falling farther and farther behind new demand. By mid-1969, it is clear that many metropolitan areas widely distributed around the United States will suffer actual housing shortages. My estimate is that California has a production of up to 60,000 housing units per year short of demand.

Housing credit policy must be brought into relationship with general monetary policy because of its inhibiting effect. This committee's "Study of Mortgage Credit" indicates clearly that housing credit is most substantially affected by monetary policy, especially policy which leads to extreme tightness in money and capital markets. The lesson of 1966 is that our society cannot shackle Federal Reserve monetary policy with the expectation of a crack-the-whip effect on housing credit. It is clear that these flows are not insulated from other money and credit flows. Quite the contrary, changes in availability and cost of money have their maximum impacts on housing credit. Yet monetary policy is carrying the major burden of stabilizing the economy, and it is already shackled by balance of payments considerations. Prof. Jack Guttentag, of the University of Pennsylvania, testified (in "mortgage Credit") that Federal Reserve policy now affects housing so strongly because of the present dearth of "idle balances" in the economy. Whatever the reason, monetary policy today is in fact being exercised by the central bank with full awareness of its effect upon housing and housing credit.

The Federal Reserve-MIT econometric model was summarized in the January 1968 Federal Reserve Bulletin. That summary quantifies several policy variables in their relationship to housing. Mr. Frank de Leeuw and Edward Gramlich made the following comment after discussing the small effect of income changes on housing expenditures: "Yet there is a very sharp effect of interest rates. This effect reaches its peak of \$2.8 billion six quarters after the interest rate change, and then gradually recedes * * *" (p. 20). On page 21, the effect of a 1-percent interest rate increase in cutting housing expenditures is immediate and substantial. Even by the third quarter after such an interest increase, housing expenditures are cut over \$2 billion. We are presently witnessing just such an increase in interest rates as the "model" utilizes.

Monetary policy, therefore, in fact subsumes housing credit policy as it must if it is to be effective in minimizing economic fluctuations. That this is a financial fact of life in our time was attested to by Prof. Paul Samuelson at the recent American Bankers' Association meeting, as follows:

"* * * I am purposely defining monetary policy broadly to include attention to credit conditions as well as to the supply of money. I am thus explicitly rejecting the view that it should be concerned only with achieving some desired pattern of behavior in some defined magnitude of 'money,' such as currency plus demand deposits or the latter plus certain categories of time deposits * * *

"And hence the central bank, as an important and indispensable arm of the modern state, has a responsibility in conducting overall macroeconomic activities

to take into account alternative effects upon sectors. Ours is a pluralistic society and properly so. In a pluralistic society it makes no sense to set up institutions with a monistic function and then have to set up new superagencies to coordinate them * * *²

Let me state my proposal to you plainly. I urge action by the committee and a commitment from the Board of Governors of the Federal Reserve System to supporting housing credit in times of severe money tightness: 1966 and perhaps late 1968, support which may run contrary to policy toward tightness in general. Chairman John Horne, of the Federal Home Loan Bank Board, has already indicated that such "offsetting" policy may be necessary for housing credit in times of extreme monetary stress. I further propose that this commitment be implemented through the purchase and sale of Federal home loan bank consolidated obligations in the open market. Such a commitment is inevitable because it is the only acceptable means to provide the resources for the Federal Home Loan Bank Board to carry out its full responsibilities in housing credit. Let us have it now. Announcement of such a commitment would in one move sweep away the scare talk regarding possible FHLB System illiquidity and of the potential illiquidity of the whole savings and loan industry. Relative to the Federal Reserve's other money and capital market responsibilities, the amounts of agency securities which might be purchased or sold in marginal amounts to affect the market would probably not be large: dealer positions in all agency securities during the past "credit crunch" peaked at \$560 million in January 1967, compared to like positions in governments of \$4.86 billion.

The Federal Home Loan Bank System is the primary agency charged with the housing credit task. Now it must go to the market, often during low-availability, high cost periods. Three of its issues today have coupon rates of 6 percent. Unsupported, the agency market has limitations on the resources there available. Let me paraphrase the FHLB annual report covering 1966, page 50.

"* * * The requirement that withdrawal advances be repaid out of net savings receipts was necessary to preserve the liquidity pool of the Bank System. Particularly in a period of heavy savings losses, it was essential that members whose losses were recovered should repay their withdrawal advances to the extent of their net savings inflow. Only in this way did it seem possible to generate a sufficient flow of funds to the several Federal home loan banks to meet successive waves of withdrawals * * * [It was] desirable that withdrawal advances be repaid out of savings to avoid the unintended conversion of withdrawal advances to expansion advances. While this policy clearly meant that institutions having withdrawal advances outstanding could not use net savings inflow to make mortgage loans, it did avoid the depletion of the resources of the Bank System."*

Federal Reserve support of the agency market in times of very tight money is needed also because of the linkage between rates on new agency securities sold, and the statutory requirement on FHLB that it pass on the average rate to savings and loan associations, thus discouraging borrowing at the "advances window." The following Federal Home Loan Bank Board testimony (in "Housing Credit") is in point:

"* * * the Federal home loan banks last year [1966] increased their outstanding loans to savings and loan associations by \$938 million. As a result, the bank system provided the funds for almost one-fifth of last year's increases in association mortgage loan portfolios (net of loans in process), the largest percentage in any period in history. However, net mortgage lending by associations dropped by over \$4 billion last year, when compared with 1965, even including that permitted by Federal home loan bank advances. The bank system was precluded from providing more of an offset to this decline in mortgage lending because existing statutory authority requires it to raise funds by selling securities in money and

² Samuelson, before a symposium on money, interest rates, and economic activity, Washington, D.C., Apr. 6, 1967.

* Federal Home Loan Bank Board annual report for 1966, p. 50.

capital markets; and in periods of monetary restraint the system, like other issuers of securities, is limited in the amount of funds that it can raise in such markets in a short period of time. Moreover, even had it been possible for the bank system to raise additional funds in financial markets, the cost of such funds to the banks, and hence the rate they would have been required to charge associations for advances, would have limited their use by associations, because such rates exceeded the return that some associations could obtain on new mortgage loans."⁴

Last week's FHLB hike in the rate on advances to 5¾ percent was apparently prompted by its money costs.

I am arguing for purchases and sales of agency securities to offset to some degree the amplitude of the swings of availability and of rate on mortgage credit when monetary conditions change markedly. The funds would flow through the existing home credit agency, the FHLB. "Offsets" limiting conventional mortgage rate swings should, in turn, dampen the fluctuations in housing, employment and production. The importance of mortgage rates was underlined by the Federal Reserve Governor, Sherman Maisel, in a recent address:

"Governor Maisel estimated that high interest rates and the shortage of mortgage credit accounted for 55 to 75 percent of the housing depression in 1966—a loss of some 580,000 dwelling units and about \$6 billion in spending. Shifts in monetary conditions are reflected in housing starts activity about 6 months later, he said, explaining that every increase of 1 percent in interest rates reduces housing starts by an annual rate of 120,000 units and every decline of \$1 billion in savings available for mortgage investment means a drop of 33,000 in housing starts."⁵

I would extend this recommendation to cover any maturity of FHLB obligations. You are aware that this authority was given by Congress in the passage of Public Law 89-597 effective September 21, 1966. The need is for the action of this committee in the savings and loan legislation before it and for a Federal Reserve policy statement and for implementation. This is a strongly needed step beyond the present "standby" position of that distinguished body.

The National League of Insured Savings Associations, in testimony recorded in the "Study of Mortgage Credit" (p. 341), supported Federal Reserve purchase and sale of FHLB agency obligations. In the same study, the National Association of Home Builders advocated Federal Reserve purchase and sale of Federal National Mortgage Association obligations.

Let me assure you that I am not here speaking just as a Californian, but rather as a housing economist concerned with national conditions. Heavy withdrawals of savings, necessarily limited availability of credit from FHLB, and high and rising rates were a national phenomenon in mid-1966. The high withdrawals were across the board and not particularly concentrated in out-of-State savings. Milwaukee, Detroit, Atlanta, among other areas, and the mutual savings banks in New York, all felt the pressures along with California. In the first 2 months of 1968, the national ratio of withdrawals to receipts was 95.7 percent. Were the Federal Reserve to provide funds through the market to the FHLB, the administration of those funds would still be feasible via the regional FHL banks. The advantage would be that the Federal Home Loan Bank Board could more fully exercise policy according to the President's program and policy determined through its own and its bank president's evaluation of their regional mortgage markets even during a very tight money period. It is surely not appropriate to have the Congress and the President urging a policy of housing credit expansion and lower mortgage rates as in 1966 without giving the chief housing credit authority the means to implement it. Let me paraphrase a quotation of Winston Churchill's asking for U.S. military assistance in World War II: "Give them the tools so they can finish the job."

⁴FHLB testimony, "A Study of Mortgage Credit", Subcommittee on Housing and Urban Affairs, Committee on Banking and Currency, U.S. Senate, pp. 30 and 31.

⁵Aug. 31, 1967, speech before a Long Island University faculty meeting.

SUPPLY AND DEMAND FOR FUNDS IN THE NATIONAL MARKET (1968 PROJECTED)

	1964	1965	1966	Estimate, 1967	Estimate, 1968
Net demand for funds:					
Real estate mortgages, publicly held.....	25.6	25.2	17.7	19.5	20.0
Corporate bonds.....	6.6	8.1	11.1	16.2	11.0
State and local securities.....	5.6	7.1	5.6	9.4	8.1
Foreign bonds.....	.9	1.2	.9	1.2	.7
Subtotal, long term.....	38.7	41.6	35.3	46.3	39.8
Bank loans (except real estate loans).....	13.6	19.8	13.0	12.7	16.0
Treasury and agency debt publicly held.....	3.2	.5	2.9	6.3	18.0
Total, satisfied demands.....	55.5	61.9	51.2	65.3	73.8
Net supply of funds:					
Mutual savings bank.....	4.1	3.6	2.5	4.9	3.7
Savings and loan associations.....	10.9	9.3	4.2	9.4	7.5
Life insurance companies.....	6.4	6.7	6.7	6.8	6.8
Fire and casualty insurance companies.....	.8	1.0	1.5	1.0	1.2
Private noninsured pension funds.....	2.1	2.1	1.9	1.4	1.4
State and local retirement funds.....	2.7	2.9	3.2	3.8	4.2
Mutual funds (bonds only).....	.4	.4	1.0	-.6	.5
Total, nonbank institutions.....	27.4	26.0	21.0	26.7	25.3
All commercial bank funds.....	21.5	27.9	17.2	35.2	32.5
Corporations.....	-1.2	-1.4	-.4	-.4	-.7
State and local governments.....	-.3	2.0	1.4	2.0	1.5
Foreigners.....	1.0	0	-1.2	2.1	2.5
Subtotal.....	48.4	54.5	38.0	65.6	61.1
Residual: Individual and miscellaneous investors.....	7.1	7.4	13.2	-.3	12.7
Total supply.....	55.5	61.9	51.2	65.3	73.8

Source: Salomon Bros. & Hutzler, American Banker, Feb. 26, 1968.

STATEMENT OF FRANKLIN HARDING, JR., EXECUTIVE VICE PRESIDENT, CALIFORNIA SAVINGS & LOAN LEAGUE

The California Savings and Loan League is appreciative of this opportunity to make a statement before this committee regarding S. 3133 introduced by the Chairman to extend rate control powers of Federal financial regulatory agencies. The League supports the broad purpose of this bill. However, the League urges that the extension be limited to one year, as was the case last year, and that additional amendments be adopted to correct some problems which have developed which, in our opinion, are defeating or threatening to defeat the objectives of control over rates paid on savings and time deposits.

We commend the Chairman for early introduction and consideration of his bill. Last year, the expiration date was almost upon us before any move was made to extend it. Thus, there was little time to consider any other amendments, suggested by what had been happening since the passage of the initial rate control bill in September, 1966. Now there is almost six months before the next expiration date, September 21, 1968, and we would hope that this committee of the Senate and its counterpart in the House will give consideration to additional amendments.

Our first suggested amendments would make permanent those sections of the bill which clearly should be permanent and leave other sections on a temporary basis, subject to review by the Congress on an annual basis. Regulation Q, controlling rates paid by banks, has been in effect for over 30 years. Statutory changes were necessary in 1966 to permit the Federal Reserve and the FDIC to make differentiations between different types of accounts which were necessary and desirable in 1966. In 1966, the Congress also approved more flexibility for the Federal Reserve to fix reserve requirements of member banks' demand and time deposits. Also by statute, the Congress fixed a responsibility on the Fed and the FDIC to confer with the Treasury and FHLBB before exercising their powers to control rates—consultation which did not take place before the Fed changed Regulation Q in December of 1965. Thus, these sections should be made permanent.

The members of the committee should understandably ask the question why we believe that those sections pertaining to banks should be made permanent

and those dealing with savings and loan associations be kept temporary. And we support continuation of the temporary rate controls on our business because some of the symptoms which were present in late 1965 and 1966 are with us again, and we would hope that controls over rates paid by banks and savings and loan associations can avoid the excessive bidding for savings, which occurred in 1966 and which only raised interest rates and didn't produce more savings.

The dislocations of the mortgage market are still fresh in our memories. These dislocations were caused when the Fed let banks raise the rates on CDs from $4\frac{1}{2}\%$ to $5\frac{1}{2}\%$, while the FHLBB was pressuring savings and loan associations to hold the line. The inability of the Fed to classify deposits and the unwillingness of the Fed to take the mortgage market into consideration caused the outflow of savings from thrift institutions. The 1966 rate control legislation corrected these two causes of dislocation in the savings market. These provisions of the 1966 legislation, therefore, should remain permanent.

Our purpose in continuing the sections dealing with savings and loan rate control on a year to year basis, is to assure that Congress keeps ultimate control of the actions of the Federal rate regulators. Once these provisions become permanent, the Federal agencies are less responsive to the overall objectives of Congress on housing and mortgage credit. The banking interests were served over the interest of the mortgage market in 1965, and only action by the Congress changed the situation.

A proposal has been advanced for rate control of savings and loan associations to be made permanent, but on a stand-by basis. We reject this because we don't know what would trigger the imposition or release of rate control and for what purpose. We would suspect that the decision would be in the hands of the Federal agencies who need not be responsive to the concerns of Congress.

We have an additional reason for wanting Congress to keep control of savings and loan rates. The power to fix ceilings on rates is very substantial and carries with it the responsibility for accurately assessing the financial market. If the judgments rendered result in rate ceilings that are too low, either for all the savings and loan business or a substantial part of it, then "nonintermediation" occurs as well as "disintermediation." "Nonintermediation" is a concern of K. A. Randall who recently posed the problem of the public circumventing the banks and savings institutions which supply the bulk of the mortgage credit of this nation. If the judgments result in one type of savings institution having a practical advantage over the other or intermediaries in one part of the country being at a disadvantage to those in other areas, the mortgage market can suffer. We are convinced that the Congress wants no repetition of 1966. We are convinced that Congress recognizes the need for a differential in rate ceilings as between banks and savings and loan associations as long as there is such a wide difference in the functions of these financial institutions—particularly, their interest in the mortgage market. We point out that in the consultative process specified in the rate control law, there are three bank-oriented agencies and only one identified with savings and loan.

It should be perfectly clear why we want Congress to maintain its interest in the administration of rate control.

Our second amendment comes as a result of studying what the banks have done to attract savings under rate controls established in September, 1966.

In testimony given by Undersecretary Barr and others in 1966, the purposes of the rate control legislation were twofold: one, to curb the unhealthy escalation of interest rates; and two, to carve out of the financial structure a small segment for the thrift institutions which are the backbone of the mortgage market.

Congress was given assurances that the CD was used principally by large corporations and government bodies and that it would not become an important part of the time deposit structure. The 4% ceiling was retained on bank savings accounts and no fear was expressed about CDs as it was indicated that a 5% ceiling would be imposed on so called "consumer" CDs of under \$100,000. The inference was clear that banks which offered consumer CDs would require maturities of 6 to 12 months and in large denominations. Thus, it was clear that there was to be a difference between regular passbooks and CDs as to availability and return.

In the following table the record is clear as to the use of consumer CDs by banks to circumvent the 4% ceiling on passbook savings. Consumer CDs grew \$18½ billion from December of 1965 to October of 1967. From December 31, 1965 to October 31, 1967, savings and loan associations increased their savings by \$12 billion.

TIME AND SAVINGS DEPOSITS OF INDIVIDUALS, PARTNERSHIPS, AND CORPORATIONS HELD BY FEDERAL
RESERVE MEMBER BANKS

[In millions of dollars]

Type of instrument	Amount outstanding		
	Dec. 3, 1965	Jan. 31, 1967	Oct. 31, 1967
Business-type deposits:			
5½ percent:			
Negotiable CD's, \$100,000 and over.....	\$13, 141	\$13, 018	\$14, 119
Nonnegotiable CD's, \$100,000 and over.....	(1) 2, 814	2, 814	3, 582
Time deposits, open accounts, \$100,000 and over.....	1, 767	1, 826	1, 681
Subtotal.....	14, 908	17, 658	19, 382
Consumer-type deposits:			
5 percent:			
Time deposits, open accounts under \$100,000.....	(1) 2, 539	1, 856	3, 246
Negotiable CD's, under \$100,000.....	3, 359	4, 381	4, 746
Other nonnegotiable CD's under \$100,000.....	6, 790	9, 402	11, 866
Savings certificates.....	402	8, 033	9, 866
Savings bonds.....		1, 409	1, 866
Subtotal.....	13, 090	25, 081	31, 590
4 percent:			
Passbook savings deposits.....	74, 089	70, 701	74, 210
Christmas and special accounts.....	3, 285	3, 450	4, 404
Total, time and savings deposits.....	105, 372	116, 890	129, 586

¹ Not available.

Sources: Federal Reserve Bulletin, August 1966, p. 1103; January 1968, p. 42.

Consumer CDs generally are being paid 5%. Savings and loan associations in most of the country can pay no more than 4¼% on savings; in California and several western states 5% is the ceiling on savings. CDs are being offered as "Golden Passbooks" to perform as much like savings accounts as possible—yet circumvent the 4% ceiling. But this is not the full story. Consumer CDs are offered in small denominations and for terms as short as 90 days. The competitive tool for savings and loan associations is a six month certificate with \$1,000 minimum for 5¼% in the East. In California, associations have to go to a 36 month bonus plan to pay 5¼%.

But even this is not the full story. Banks have been guaranteeing the 5% CD rate for five years, some longer than ten years, and banking authorities have permitted advertisements showing the effect of compound interest for these long periods. At the same time, savings and loan associations have been precluded from advertising rates for more than one year.

Thus, our second amendment is to bring parity to savings and loan associations by prohibiting banks from guaranteeing rates beyond one year and permitting associations to fix definite rates up to one year. Considering the wide, sudden swings of interest rates, this amendment would guard against improvident guarantees of high rates for long periods of time. If there was any validity last year to the argument for controlling rates of savings and loan associations to gain control over *all* time deposits, then this amendment must be supported for the same reason. If any portion of the time deposit has rates guaranteed for long periods, the rate control mechanism has lost control over them.

Our third amendment deals with the ultimate liquidity of our financial system. Provision was made in the 1966 rate control legislation for the Federal Reserve to buy and sell debentures of the FHLBB, as well as the obligations of other U.S. government agencies, in the open market. We are proposing that the Fed have, in addition, the power to buy FHLBB debentures direct when necessary.

The credit crunch of 1966 was very real, affecting not only thrift institutions but the banks as well. Governor Robertson of the Federal Reserve Board told this committee on August 4, 1966, that the liquidity of banks was low, and they were "not in a position to meet a sudden withdrawal of from \$18 to \$25 billion." Presumably, the Fed would have had to supply the money if the withdrawals had occurred, and the Fed should have and could have, in my judgment. Our FHLBB went into the money market in 1966 and raised \$1.6 billion in new money and rolled over \$4.6 billion. But our agency was at the mercy of market

conditions, and the cost of the money was prohibitive. We submit that if the Fed had had the power to buy FHLBB debentures direct and in the open market, a more satisfactory result would have been achieved—more in keeping with the objectives of Congress. By way of illustration, we present the following statement which was made by the FHLBB to this committee:

"* * * the Federal home loan banks last year (1966) increased their outstanding loans to savings and loan associations by \$938 million. As a result, the bank system provided the funds for almost one-fifth of last year's increase in association mortgage loan portfolios (net of loans in process), the largest percentage in any period in history. However, net mortgage lending by associations dropped by over \$4 billion last year, when compared with 1965, even including that permitted by Federal home loan bank advances. The bank system was precluded from providing more of an offset to this decline in mortgage lending because existing statutory authority requires it to raise funds by selling securities in money and capital markets; and in periods of monetary restraint the system, like other issuers of securities, is limited in the amount of funds that it can raise in such markets in a short period of time. Moreover, even had it been possible for the bank system to raise additional funds in financial markets, the cost of such funds to the banks, and hence the rate they would have been required to charge associations for advances, would have limited their use by associations, because such rates exceeded the return that some associations could obtain on new mortgage loans" (Federal Home Loan Bank testimony, "A Study of Mortgage Credit," Subcommittee on Housing and Urban Affairs, Committee on Banking and Currency, U.S. Senate, pp. 30 and 31).

Such a change in the powers of the Fed are in order, as it carries out its responsibilities for the total monetary policy of the country. No less an authority than Professor Paul Samuelson said at a recent symposium on "Money, Interest Rates and Economic Activity":

"* * * And hence the central bank, as an important and indispensable arm of the modern state, has a responsibility in conducting overall macroeconomic activities to take into account alternative effects upon sectors. Ours is a pluralistic society and properly so. In a pluralistic society it makes no sense to set up institutions with a monistic function and then have to set up new superagencies to coordinate them. * * *

We doubt that the commitment of the Fed would be great, but the benefits of such commitment would be substantial. This is because the mortgage market would not be starved again as it was in 1966, and thus there would be no repetition of the consequences of the mortgage credit restriction. Such consequences were:

1. Construction, particularly of housing, cut by 500,000 units, causing unemployment.
2. As construction slowed, builders were forced into bankruptcies.
3. Interest rates rose sharply to levels some couldn't pay.
4. Mortgage credit unavailable which "killed" many potential real estate transfers.
5. Caused unemployment in lending institutions, title companies, and real estate broker firms.
6. Caused increased delinquency in real estate tax payments.

We would not contend that it is going to be possible to even out and allocate perfectly the savings of this nation. But we do firmly believe that the reserve systems of the savings and loan business and the banks should do all they can to level out the swings which will occur from time to time—swings in interest rates and swings in availability of credit. Even a modest participation in the marketing of FHLBB debentures by the Federal Reserve should hold down the cost of such money. A side benefit from such back stopping of the FHLBB would be to squelch the careless scare talk about the possible "illiquidity" of the savings and loan business which did occur in 1966 and did cause some withdrawals.

Thus, we urge favorable consideration of our third amendment to permit the Fed to buy FHLBB debentures directly. It could have a most favorable effect on the stability of the mortgage market of the future.

PROPOSED AMENDMENT NO. 1

The Act of September 21, 1966 (80 Stat. 823) is hereby amended as follows:
Section 7 is hereby amended to read as follows:

"Sec. 7. The provisions of [the preceding sections] section 1 and section 4 of this Act shall be effective only during the [two] three year period which begins

on the date of enactment of this Act. Upon the expiration of such period, each provision of law amended by [this Act] said section 4 is further amended to read as it did immediately prior to the enactment of this Act."

PROPOSED AMENDMENT NO. 2

Section 1. Subsection (k) of Section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1823) is amended to read:

"(k) No insured bank shall obligate itself to pay interest on any time or savings deposit for a period longer than one year."

Section 2. Section 5(b) of the Home Owners Loan Act of 1933 (12 U.S.C. 1464 (b)) is amended by adding at the end thereof the following: "Any provision in this section to the contrary notwithstanding, such associations may accept deposits for fixed periods of time, may guarantee a definite return thereon, and may issue certificates of deposit therefor, all as prescribed from time to time by the Board by regulation; provided, however, no such association shall obligate itself to pay any such return for a period longer than one year."

PROPOSED AMENDMENT NO. 3

The Act of September 21, 1966 (80 Stat. 823) is hereby amended as follows:
Section 6 is hereby amended by striking the words "in the open market."

INDEPENDENT BANKERS ASSOCIATION OF AMERICA,
Washington, D.C., March 29, 1968.

HON. WILLIAM H. PROXMIRE,
Chairman, Subcommittee on Financial Institutions,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The Independent Bankers Association submits this statement in support of S. 3133, introduced by Senator John Sparkman on March 11, 1968, to extend for two years "authority for more flexible regulation of maximum rates of interest or dividends, higher reserve requirements, and open market operations in agency issues."

Our Association supported the legislation, then termed as temporary or emergency, in the climate of the 1966 money crisis, to provide flexible controls of rates of interest or dividends, payable by banks or the thrift institutions, on deposits or share accounts, in order to establish such controls for thrift institutions, as well as commercial banks.

Our Association supported the 1966 legislation by statement filed with your Committee on August 8, 1966, relative to S. 3637, then before you, and stated: "We believe most of all that whether your Committee, in its wisdom, decides to fix interest rate ceilings temporarily, or grant new and emergency discretionary authority to supervisory agencies, the provisions established must be applicable both to banks and thrift institutions, and not to either one with omission of the other, in the best interest of the entire financial community and in the public interest."

The following spring, at our annual convention in New Orleans, March 1 to 4, 1967, our Federal Legislative Committee reviewed the financial community's brief experience under the 1966 emergency legislation, passed for one year only, and due to expire last September 21, unless renewed, and voted "that the so-called emergency legislation be made permanent."

As is known, the Congress last fall, with the actual expiration date for the 1966 legislation at hand, accepted an amendment to the proposals as introduced, and first offered in the floor debate in the House, to extend the legislation for one year only.

Subsequently, our Federal Legislative Committee again recorded itself in favor of making the flexible controls permanent, and urged further that the Congress address itself to the legislation to permit thoughtful, rather than belated, hectic and hurried consideration of the matter, well in advance of the fall expiration date.

We are therefore glad that the Senate Banking and Currency Committee is considering S. 3133, to extend the legislation for two years, in the early spring.

We support the proposed extension for two years, but reaffirm our support for making the flexible controls over interest rates and dividends, as applied both to commercial banks and thrift institutions, permanent legislation.

Sincerely and respectfully,

STANLEY R. BARBER,
President.

RALPH L. ZAUN,
Chairman, Federal Legislative Committee.

STATEMENT OF K. A. RANDALL, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. Chairman, I am pleased to have the opportunity to present to the Subcommittee the views of the Federal Deposit Insurance Corporation with respect to S. 3133, 90th Congress, a bill "To extend for two years the authority for more flexible regulation of maximum rates of interest or dividends, higher reserve requirements, and open market operations in agency issues".

Generally, the Act of September 21, 1966 (80 Stat. 823), provides, by statute, a flexible basis for regulating interest and dividend rates payable by insured banks and insured savings and loan associations on time and savings deposits or shares or withdrawable accounts, authorizes the Board of Governors of the Federal Reserve System to increase reserve requirements on time and savings deposits to a maximum of 10 percent, and authorize open-market operations in obligations of agencies of the United States Government.

Specifically, those provisions of the Act relating to the regulation of rates of interest or dividends, with which the Corporation is primarily concerned, change from a mandatory to a standby, flexible basis the authority of the Board of Governors of the Federal Reserve System and the Board of Directors of the Federal Deposit Insurance Corporation to limit the rates of interest or dividends that may be paid by insured banks, including mutual savings banks, on time and savings deposits. The Act gives to the Federal Home Loan Bank Board, for the first time, similar authority with respect to the rates of interest or dividends that may be paid by members of any Federal Home Loan Bank, other than those insured by the Federal Deposit Insurance Corporation, and institutions that are insured by the Federal Savings and Loan Insurance Corporation on deposits, shares, or withdrawable accounts. Under the provisions of the Act, the exercise of such authority by any of the above agencies must be preceded by consultation with all other such agencies.

The Act permits the Board of Governors of the Federal Reserve System, the Board of Directors of the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board to prescribe different interest or dividend rates for deposits, shares, or withdrawable accounts of different amounts or with different maturities or subject to different conditions respecting withdrawal or repayment, according to the nature or location of banks or institutions or their depositors or share account holders or according to such other reasonable bases as those agencies may deem desirable in the public interest.

The provisions of the Act originally were effective only for the one-year period beginning September 21, 1966, the date of enactment of the Act. The authority conferred by the Act was extended for an additional one-year period by the Act of September 21, 1967 (81 Stat. 226). S. 3133 would extend the authority conferred by the Act for an additional two-year period—through September 20, 1970.

Immediately upon the approval by the President of the Act of September 21, 1966, the Board of Governors of the Federal Reserve System and the Board of Directors of the Federal Deposit Insurance Corporation issued regulations designed to limit further escalation of interest rates paid by commercial banks in the competition for consumer savings. The regulations reduced from 5½ percent to 5 percent the maximum permissible rate of interest payable by commercial banks on time deposits in denominations of less than \$100,000. The 5½-percent maximum rate of interest then in effect for single-maturity time deposits of \$100,000 or more was maintained. The 4 percent maximum rate of interest for regular passbook savings deposits held at commercial banks also was left unchanged. Multiple maturity time deposits continued to be subject to interest-rate ceilings of 4 or 5 percent, depending upon maturity.

At the same time, the Corporation issued regulations prescribing a 5 percent ceiling on rates of interest or dividends payable by mutual savings banks insured by the Corporation. A 5¼ percent rate was permitted in Alaska, but that exception has since been revoked. The Federal Home Loan Bank Board simultaneously prescribed—for the first time—ceilings on dividend rates payable by insured savings and loan associations, varying the ceilings in accordance with geographical location and other differential patterns.

By the close of 1966, the disruptive rate competition between financial institutions that reached its peak in the late summer of 1966 had moderated appreciably. While the competition for savings continued active in 1967, it lacked the intensity of the savings competition of 1966.

The gain in time deposits held at commercial banks in 1967 was approximately double the increase in 1966—mostly during the first half of the year. All categories of time and savings deposits showed increases.

During 1967, mutual savings banks and savings and loan associations also experienced sizeable savings gains—about 8 percent in the case of mutual savings banks and about 9 percent in the case of savings and loan associations.

The actions taken by the regulatory agencies pursuant to the authority conferred by the Act of September 21, 1966, contributed significantly to a moderation of excessive competition between various types of financial institutions for savings. If the added authority to regulate rates paid by savings and loan associations as well as by banks and the more flexible authority with respect to bank interest rates are retained, the regulatory agencies will continue to be able to take prompt and appropriate action in this area in the future, whenever necessary. It is essential, in our opinion, that the authority not be permitted to lapse. The Corporation therefore favors the enactment of S. 3133.

The Corporation believes that the advantages of the flexible interest-rate authority have substantially been demonstrated since enactment of the original legislation and believes that consideration should be given to the need for permanent legislation and its appropriate scope or form. We understand that the Department of the Treasury has been requested to work with the other interested agencies, including the Council of Economic Advisers, toward developing a legislative proposal along these lines for possible transmittal to the Congress early next year.

The Bureau of the Budget has advised that it has no objection to the submission of this statement to the Subcommittee and that enactment of S. 3133 would be consistent with the Administration's objectives.

THE AMERICAN BANKERS ASSOCIATION,
New York, N.Y., April 3, 1968.

HON. JOHN J. SPARKMAN,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: We appreciate this opportunity to present the views of The American Bankers Association on S. 3133, to extend for two years the authority for flexible regulation of maximum rates of interest and dividends, higher reserve requirements, and open market operations in agency issues contained in The Interest Rate Control Act of September 21, 1966 (P.L. 89-597), as amended in 1967 (P.L. 90-87).

As you know, the Act in question was intended to prevent destabilizing interest and dividend competition which was retarding the flow of funds to the home mortgage market. The American Bankers Association has been and is in full accord with this objective, and so stated when the original bill was being discussed in 1966 and when it was extended for one year in 1967. We wish to express our support for a two-year extension; in fact, we would like to see the Act made permanent.

We believe the present flexible controls over rates payable by banks on time money and by savings and loan associations on share accounts and on savings certificates have worked reasonably well in the past. During the tight money year of 1966, the enactment of this legislation enabled the Federal agencies to act with celerity in controlling rates and limiting competition for funds that otherwise might have proved injurious in some instances. Experience tested in a difficult time bespeaks the need for extension of the legislation.

If the Act is not extended, the law reverts to the statutory provisions in effect prior to September 21, 1966. Expiration would mean a return to mandatory ceilings on interest rates payable by commercial banks without the authority to prescribe different rate ceilings on different amounts of time deposits, no authority of law to set ceilings on the rates payable on share accounts or on savings certificates of savings and loan associations and, perhaps, no ceilings on rates paid by mutual savings banks. Expiration would also mean the loss of the legislative directive for consultation among the Federal Reserve Board, the FDIC and the FHLBB before setting ceilings on interest rates and dividends.

We think we should make it clear that in supporting the extension of this legislation we do not look with favor on all of its provisions or on all of the actions taken under it. For instance, there is no justifiable reason for granting the Federal Reserve Board power to raise reserve requirements on time deposits to a level as high as ten percent. Legal reserve requirements against savings and time deposits have little function as a source of liquidity or as a device for credit control. Monetary economists generally agree that open market operations, discount policy, and changes in the reserve requirements for demand deposits provide adequate means for influencing the money supply and the cost and availability of bank credit.

In urging extension of the Act itself, the A.B.A. does not wish to be recorded as favoring the differential that exists under current regulations between rates that savings and loan associations may pay and those that commercial banks may pay on passbook savings. We believe the differential is too wide and we expect to work with the agencies in an effort to narrow it.

Notwithstanding our foregoing criticisms, we favor an extension of the Act for a two-year period, or preferably longer. Expiration would be particularly hazardous in view of existing inflationary forces that show no signs of abating. Because of inadequate fiscal restraint and undue reliance on monetary policy to contain inflation, interest rates have reached unusually high levels. Unless the Act is extended, a return to the money market conditions of the first nine months of 1966 is a distinct possibility.

Let me take this opportunity to point out that The American Bankers Association feels that The Interest Rate Control Act is an integral part of a total public policy package for stabilization of our dynamic economy. The Association strongly urges the Congress and the Administration to move with all possible speed to enact the most important of all the public actions for stability—a cutback in non-Vietnam spending and an income tax increase at least as large as the 10 percent surcharge requested by the President. Otherwise, this nation risks serious domestic inflation and further erosion of international monetary mechanisms. The Interest Rate Control Act must be extended but it must be bolstered by courageous fiscal action.

The American Bankers Association appreciates this opportunity to express to the Committee these views on S. 3133 and related matters, and we ask that this letter be made part of the record of this legislation.

Sincerely yours,

J. HOWARD LAERI,
President.

UNITED STATES SAVINGS & LOAN LEAGUE,
Chicago, Ill., March 28, 1968.

HON. WILLIAM W. PROXMIRE,
Chairman, Subcommittee on Financial Institutions, Committee on Banking and Currency, New Senate Office Building, Washington, D.C.

DEAR SENATOR PROXMIRE: The United States Savings and Loan League endorses S. 3133, the proposal introduced by Senator Sparkman, to extend the existing interest and dividend rate control legislation for two years until September 21, 1970. The League represents over 97% of the total savings and loan assets in the nation.

The state of the national economy and the obvious monetary problems which our government is facing requires the extension of this law. The League is ever mindful of the chaotic conditions of 1966 which led to fierce savings competition and extremely high interest rates. This should not be repeated.

We want to emphasize to your Subcommittee that we still consider the present proposed extension a temporary one and we do not endorse the concept of permanent control. Except in unusual circumstances, such as exist today, savings

associations should be free to pay the dividend rate which is consistent with their earning power and the necessity to attract savings.

While the League fully supports the proposed extension of the interest-dividend rate control law, it would like to take this opportunity to bring to the attention of your Subcommittee certain closely related matters. Commercial banks issue savings certificates for periods much longer than one year. Once the CD is issued at a fixed rate, any changes in the rate control percent by the Federal Reserve Board cannot affect those outstanding CD's. This, of course, would mean that rate control would be ineffective on these certificates. We therefore recommend that the bill be amended to prohibit commercial banks from guaranteeing rates on their time deposits for more than one year.

At the same time, we urge that Federally-chartered savings and loan associations be permitted to guarantee rates up to one year in order to channel a fair amount of savings into this type of financial institution. The need for Federal associations to be able to declare rates in advance up to one year is a necessary competitive tool to match the guaranteed rates of banks for a similar period of time.

The rate control law also contains a provision authorizing Federal Reserve Banks to trade in a wider range of agency securities on the open market, including bonds and notes issued or guaranteed by the Federal Home Loan Bank System and the Federal National Mortgage Association. We believe this authority should be expanded to allow Federal Reserve Banks to deal directly with these agencies in the purchase and sale of their obligations. We therefore recommend that you consider amending the bill to give Federal Reserve Banks the authority to buy or sell Federal Home Loan Bank and other agency obligations directly from or to the agencies.

In short, we support an extension of the rate control law for two years, while asking for two amendments to allow thrift institutions to compete more effectively with commercial banks in the issuance of consumer CD's, and a third amendment to give the Federal Reserve the needed authority and flexibility to play an expanded role in supporting the housing industry.

Sincerely,

NORMAN STRUNK,
Executive Vice President.

(Thereupon, at 11:40 a.m., the subcommittee was adjourned.)

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