

Although responding moderately, as noted above, to the credit restrictions of 1959-1960 cash flow has been steady and rising during most of the past decade. Month after month policy loans remained in a flat trend, posing no discernible threat to the availability of investment funds.

The companies responded to this apparent growth in cash availability by stepping up their commitments, selling securities or occasionally borrowing from the banks when cash flow ran short, as it did from time to time for some companies. In fact, supplementary sources of funds such as funds generated by the sale of securities began to be drawn upon more heavily in 1962. The rise probably reflected the sale of both bonds and stocks, the profit on the latter offsetting the loss on the former, and the overall transactions enabling the companies to raise their average rate of investment return. New commitments rose sharply from 1960 when cash flow recovered from the 1959-1960 credit restrictions, until the new restrictions in 1966 again reduced cash flow.

Early in 1966 policy loans began to rise as national monetary policy tightened and cash flow came under increasing pressure. Sales of securities were stepped up to provide additional funds, but now neither the stock market nor the bond market were behaving well and it was soon evident that commitments would have to be curtailed. As policy loans continued to increase, a number of companies entered the banks for supplementary funds and commitments were sharply reduced. Life insurance money became extremely tight; investments in residential mortgages, commercial mortgages and securities all were greatly affected as the companies adjusted their operations to their declining cash flows.

To sum up with respect to the response of life insurance companies to the impact of monetary policy, it appears that both the savings they divert from the general economy and the amortization and partial prepayments on mortgages are persistent and largely unaffected by monetary policy. However, the redemption of securities and other repayments on mortgages, which account for a large proportion of the cash flow of the industry, were sharply affected by the 1966 changes in credit conditions. Moreover, as interest rates have risen, policyholders increasingly have used the life insurance companies as banks of last resort.

No doubt many, if not most, of the policy loans in the hands of the banks in 1966 have shifted to the life insurance companies. The potential drain from this source must be less today than it was 2 years ago. Still we must conclude that under the conditions that faced us in 1966 and may be facing us again now, a tight monetary policy very likely will reduce the flow of funds through the life insurance companies and compel them to curtail their commitments.

Now let me turn for a moment to guidelines for monetary action and conclude my testimony with a few comments on the relation of fiscal to monetary policy.

I can dispose of the guidelines quickly because I am very much in agreement with Professor Chandler's views expressed here a week ago. Every time I wrestle with proposals to stabilize the growth in the money supply, I find myself ending up just about where he did—once you allow all the necessary qualifications to the stabilizing rule you find you have pretty much restored freedom of action to the Board.