

included a substantial expectation on the part of the public of inflation, and that expectation was reflected in the yields on bonds.

In consequence, we took a figure of $4\frac{5}{8}$ percent, which was the average, based on the average of daily bid prices in 1966. This happens to be the period just before the substantial rise in the Federal bond market.

Now, we have not taken any fixed figure of $4\frac{5}{8}$, sir. What we have taken is a figure starting with $4\frac{5}{8}$ which can change up or down not more than one-fourth point per year. Thus, it will reflect, we trust—this is the proposal and comments can be made upon it—it will reflect the trend, the deflated trend, hopefully the deflated discount rate or the yield rate on Government bonds, staying within that limitation.

Chairman PROXMIRE. For the record, why do you put the yield rate instead of the coupon rate?

Mr. CAULFIELD. For the very reason that has been expressed many times before this committee: the coupon rate is the rate that in terms of the present bond issues of the Treasury reflects the 2 percent yields in 1940, and the control on interest rates during the war, and thus, it has not moved up very rapidly.

Ten years ago or so, there was only a 1-percent spread between the coupon rate and the yield rate. Today there is an over 2 percent spread between the coupon rate and the yield rate. The yield rate more accurately reflects—

Chairman PROXMIRE. The current rate of interest is reflected more accurately in the coupon rate at the present time?

Is that right or wrong?

Mr. CAULFIELD. It is wrong. The current cost of money is reflected in the—

Chairman PROXMIRE. You are talking about the yield on current issues rather than the overall yield of the whole Government—

Mr. CAULFIELD. I am talking about the yield on bonds that were issued maybe 15 years ago as indicating the yield that is published in the papers every morning on Government bonds relating to their price.

Chairman PROXMIRE. Then you are talking about the yield for an investor that goes right out and buys a bond. He would expect—

Mr. CAULFIELD. Yes, it reflects the current market value of those bonds.

Chairman PROXMIRE. Then I have to go back to these other questions. The discount rate to be given in any year to be based on the average yield for the preceding fiscal year. Why is the $4\frac{5}{8}$ rate based on 1966 instead of 1967?

Mr. CAULFIELD. Because this is part of our effort to start with a figure that did not reflect, we trust, inflationary expectations on the part of the people in the bond market. Since for the last year or so, there have been, as you know, expectations of inflation in this country, the tax bill is aimed at curbing those expectations of inflation. Right after the tax bill was passed, the yield has gone down almost half a point.

Chairman PROXMIRE. Gentlemen, once again, thank you very much. This has been most entertaining, as well as enlightening for me.

I very much appreciate it. You have done a fine job. I think we are making progress in this area.