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"Problems of High Interest Rates"

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Problems of High Interest Rates
(select subject from controlled vocabulary, if your office has one)
Ralph Waldo Emerson said it 180 years ago: "Money often costs too much."

Money costs too much today. Way too much.

That is not our only problem. Wall Street is obviously not confident that the President's economic recovery program is on the right track.

As one wit once said, "Anyone who thinks there is safety in numbers hasn't looked at the Stock Market pages."

The underlying cause of so many of our problems is the rate of inflation. The symptom, and part of the disease, is high interest rates.

The problem that people in Washington face on these issues is evident: when inflation is high, the heat is enormous to lower it.

When interest rates are high, the heat is enormous to lower them.

Unfortunately, it is difficult to do both at the same time. Options are limited.
Congress has been studying various proposals regarding inflation, inflationary expectations, and the demand for money and credit relative to the supply. These issues have dominated the 97th Session.

In recent years, there has been interest in controlling the money supply to control inflation. Borrowing and spending are curtailed. Keep in mind that only two things can control inflation: Limiting the supply of money and balancing the budget.

By curtailing inflation, credit will become more available. Interest rates will moderate over the long run. Paul Volcker, Chairman of the Board of Governors of the Federal Reserve System, made it clear that this was his view during recent testimony.

He said many of the accumulated distortions and pressures on the economy could be traced to our high and stubborn inflation. Dealing with inflation was essential for our future well-being as a nation.

However, excessive reliance on monetary policy alone cannot solve the problem. It must be accompanied by other measures, a view supported by the Federal Reserve Board.

For example, balancing the budget is an essential part of any inflation control program.

In other words, we must balance the budget and control the supply of money. We must put a cap on our national debt.
THE OBJECT OF SUCH A TANDEM OF POLICIES IS TO MAKE US MORE OF A SAVER NATION THAN A DEBTOR NATION. MORE MONEY WOULD BECOME AVAILABLE FOR INVESTMENT AND GROWTH.

MONEY HAS BEEN TOO EASY FOR TOO LONG FOR BOTH INDIVIDUALS AND GOVERNMENT. TOO EASY CREDIT LEADS TO INFLATION AND A DETERIORATING ECONOMIC SITUATION.

THE ADMINISTRATION'S PROGRAM IS BASED ON THAT THESIS.

IT HAS DESIGNED A HUGE PERSONAL INCOME TAX CUT AND BUSINESS INCENTIVE TAX CUTS TO STIMULATE SAVINGS AND INVESTMENT. AT THE SAME TIME, IT HAS MASSIVELY REDUCED SPENDING IN EVERY AREA EXCEPT DEFENSE.

THE GOAL IS EVENTUALLY TO BALANCE THE BUDGET, AN OBJECTIVE IT SEES AS ESSENTIAL TO BRING INFLATION AND INTEREST RATES UNDER CONTROL.

UNFORTUNATELY, IN MY VIEW, THERE ARE MANY WEAK POINTS TO THE ADMINISTRATION'S PROGRAM, AND MANY CONTRADICTIONS IN ITS PROPOSALS, GOOD AS THE GOAL MAY BE.

FIRST OF ALL, THE ADMINISTRATION RECOGNIZES THAT IT WILL BE VERY HARD TO BRING DEFICITS UNDER CONTROL. IT DOES NOT MIND THOSE DEFICITS SINCE IT CAN USE THEM AS AN EXCUSE FOR MASSIVE CUTS IN GOVERNMENT SPENDING.
David Stockman and many of his colleagues seem determined to get the government out of our lives so totally that the benefits we have learned to appreciate can be reduced or done away with.

Social Security, loan guarantee programs and other assistance programs for business as well as the general populace are being threatened.

As long as there is a deficit, the Administration can argue that it has to slash away. It wants a deficit so it can continue to reduce or do away with government programs, good or bad.

Second, while it cuts these programs, its tax program is sacrosanct. It insists that a massive personal income tax will create huge funds of new investment money. Wall Street and many economists disagree with that.

The prevailing view is that the personal tax cut will tend to be spent rather than saved.

Third, there is a growing awareness that tight money, high interest rates and unrestricted cuts in government programs are a road map to recession.

Indicators such as industrial output are dropping. Slight declines in interest rates are discounted by such economists as Henry Kaufman, of Wall Street’s Solomon Brothers. Respite “are not likely to endure,” he states, given expected heavy borrowing by the Treasury and corporations later this year.
So the Administration gives us a massive tax cut to stimulate the economy and continues to cut spending in an effort to balance the budget. It insists on not cutting the defense budget very much.

There is a flurry of proposals to seek artificial answers to our problems.

Most of these focus on the Federal Reserve System itself, which has become the whipping boy for our problems.

Let me analyze the Federal Reserve for a moment.

First of all, the Federal Reserve does not have the power to set interest rates in general. But it does control the Federal Reserve discount rate. Changes in the discount rate can influence other markets.

Second, the Federal Reserve can change reserve requirements. When banks are required to keep more reserves, less money is available to lend out.

Third, the Federal Reserve can influence the market and interest rates through its open market operations, which is one reason there are efforts to make the open market committee more susceptible to economic influences.

That is the extent of the Federal Reserve’s powers in this area, large as they are. Interest rates are primarily determined by the market and by actions of either borrowers or lenders. There are economic and psychological factors involved as one can see by the reaction of Wall Street to the Administration’s program.
But nonetheless, many proposals affecting the reserve have merit, and we should pursue them with vigor.

There are a number of Congressional resolutions which encourage the Federal Reserve to lower interest rates while maintaining firm control over the growth of money and credit.

Another resolution protects small business institutions, farms and the housing industry by having these sectors better represented on the Federal Reserve Board open market committee.

Still other measures before the Senate are designed to make the Federal Reserve back down on its interest rate policies and to make it more responsive to different sectors of our economy that are particularly affected by its policies.

It would serve all interests well if the Fed let up on credit stringency by altering its way of guaging the money supply. It also could provide some informal credit guidance to the banking community so that the latter pumps more money into small business, for example, and less into corporate take-overs. In other words, jawboning.

But it is also incorrect to blame the Fed entirely for all our problems, and therefore penalize it excessively. We can do some fine tuning, but we would be dreaming if we think fine tuning is going to make money readily available. And remember, if there is any silver lining to our current situation it is that inflationary rates have diminished over the past year.
A dubious economic policy which will produce enormous future deficits as a result of excessive cuts in taxes and a destruction of our government program is more to blame for our problems. Wall Street has made that clear.

Many government programs have functioned well to keep our economy, and our individual economic lives, prosperous.

Suddenly yanking such things as loan guarantee programs away from business does not help the economy.

The business community is not so sure that the economy will expand, and therefore, is holding back on investment dollars. It sees enormous future deficits. Anything that limits the supply of money and credit available for lending is likely to cause market interest rates to climb.

So where does all this put us?

Unfortunately, as you all know too well, there are a number of dangers associated with high interest rates.

One is recession.

Second is that certain groups or sectors within an economy may share a disproportionate share of the impact of high interest rates and credit shortages.
SMALL BUSINESSES, PUBLIC UTILITIES, STATE AND LOCAL GOVERNMENTS, AND CONSUMERS ARE ALL AFFECTED. MORTGAGE MARKETS AND THE CONSTRUCTION INDUSTRY, AS YOU ALL KNOW, ARE IN DIRE STRAITS AT THE MOMENT.

indeed, many suspect that such developments are expected and accepted by the administration. given the choice between a return to inflation and a return to bread lines, david stockman has testified his preference is for the bread lines.

if you are hard-hearted enough, he is right. recession, unemployment and bread lines will bring down interest rates because there will not be any work to be done anyway.

if our economy nose-dives, you can be sure jobs, work -- and interest rates -- will diminish.

i wish there was some simple solution to the problems of inflation and interest rates. there is not.

but i do believe that there are things that could be done.

many suggest that we postpone part of the tax break until we see more clearly when the budget will be balanced. let me ask for a show of hands on this: how many would support a roll-back or temporary delay on taxes if this helped interest rates come down?
The Administration thinks that the only way to balance the budget is to cut out government spending.

Yes, government spending has to be reduced.

But we cannot put the entire burden on slashing the government out of existence.

I believe that when the President was elected, the American people made clear they were prepared to bite the bullet and do what it takes to bring our economy back to prosperity.

The Administration has undertaken a great experiment that seems to be having trouble getting off the ground. For the good of all of us, it must get off the ground.

There will be a loss of revenue as a result of the tax cuts. The Administration will not be able to balance the budget as it hopes to do.

The U.S. government budget is too big and too committed to entitlements to be able to cut the amount necessary to balance the budget.
Is there not some other alternative that is not going to destroy our economic recovery? That will allow us to balance the budget, and will not end so many valid activities in which the government is involved?

I know it is politically unpopular and difficult to favor a tax cut roll back.

That is why the subject is dealt with gingerly.

But many do feel that we can cut no more out of our spending side of the budget, and that defense spending is something the American people want to see increased, as indicated by their vote a year ago. But must the tax cut also be untouchable? Can't we shift with the wind? Would we rather see Social Security gutted, or agree to hold off on the personal tax cut, perhaps only a few months?

Both personal and business tax cuts can stand review.

On the business side, new depreciation schedules could become subsidies to business. That is, more money is given out to business through tax policy than is taken in. There are also some leasing provisions which are excessive under the circumstances. There are other items, too, which should be re-scrutinized, including tax expenditures. After all -- 22 years ago, corporations paid 19.5 percent tax relative to personal taxes. Today the figure is 7.7 percent.
On the personal side, everybody's paycheck increases by a few dollars each month as a result of the cut. And even that is tilted to favor the higher income people.

Sure, some of that will go into savings. But will enough go into savings to make such a huge cut worth it?

A lot of people are asking that question.

A lot of people think that much of the money will go into consumption which will drive up inflation again.

I remain committed to the idea that we should bring spending under control first before cutting our sources of revenue. I believe we should give businesses incentives. I believe that a personal income tax is needed to provide relief. But we can afford some flexibility.

I believe we need a strong defense, but I do not think that any sector of our budget can be immune from financial constraint.

We need to look over the tax cut package that we approved. We need to close up loopholes and some day possibly alter our basic structure to make it fairer.
This is what we must do. We should do it in a bi-partisan way.

And I shall continue to work in Congress to try to ease interest rates by adjusting our programs in a way that will achieve our economic recovery objectives more sensibly. Modifying the tax cut is one viable and real way to do that.

I shall continue to explore that avenue and all avenues in an effort to help you.

Thank you.

(In closing, you might want to make a reference to the show of hands. If they supported you, fine. If they opposed a roll-back, you can cite the difficulties in implementing programs which hurt the individual.)