Chapter V

Public Debt - A New Factor in Monetary Management.

Peculiar way of War-finance.

During the Second World War, in several countries large portions of war finance were supplied by commercial banks by purchasing government securities of different maturities. The banks were attracted towards this type of investment due to certain reasons. Firstly, banks could not get opportunities for commercial loans in an atmosphere of war-time controls. Secondly, business corporations could build good reserves out of high war-time profits and hence, they were not obliged to approach banks for their working capital needs. Above these reasons, was the policy of the central banks in co-operation with their governments to maintain the prices on government securities . This gave a strong incentive to banks to purchase government securities in large amounts for, they were protected against capital losses arising out of fluctuations in the prices of securities in future. In addition to this, in order that the banks may be able to purchase government bonds in large volume, the central banks undertook measures to increase bank reserves by open market operations and reducing reserve requirements especially in the U.S. In U.S.A., the Board of Governors of the Federal Reserve System declared that they would make available ample supply of funds for financing the war efforts by maintaining such conditions in government security market as were favourable for government requirements. Throughout the war, this declared policy was maintained and the Treasury had absolutely no difficulty in obtaining funds required in excess of the proceeds of taxation and borrowings from non-bank lenders to the government.

In order that the cost of government borrowing may be as

low as possible, yields on government securities were maintained at a low level . This was achieved by a complex of monetary measures in addition to the help of direct controls. The discount rates of the Federal Reserve Banks were kept very low at ~~x~~ 1%. The Reserve Banks readily made advances to both the member and non-member banks against the collateral of government securitiesm and the preferntial rate of ½ of 1 % was given on advances to member banks secured by government securities maturing or callable within one year, e.g., Treasury Certificates of Indebtedness. The low discount rate of 1% was not so much important as the concessional ½% , for, the banks were in ample possession of short-term governments. They could pledge these to the Reserve Banks and could obtain funds at the concessional rate of ½%, ~~of 1%~~. The yields on government securities were prevented from rising above a particular level which was initially fixed. The Federal Reserve stood ready to purchase all those government securities that others were not ready to buy and hold at given rates. On April 30,1942, the Federal Open Market Committee ordered the Reserve Banks to buy all Treasury bills offered to them at ⅜ of 1% yield. The commercial banks were also given the option of repurchasing the bills at the same rate. The yield on Treasury bills was held constant upto 1946. The Treasury bills could be sold to Federal Reserve in any amount. The banks holding the bills were, for all practical purposes, holding a kind of money that enjoyed a yield.

In U.K., though the absorption of public debt during the time of war was not so large as in the U.S.A. and Japan. Nevertheless, the investments of banks in government securities (Treasury bills apart) increased substantially from £706.9 million ~~dollars~~ in 1939 to £ 1380.3 millions in 1943.[1] Out of the total increase in government debt

1. League of Nations, 'Money & Banking' 1942-1944, p.193.

upto March, 1944, the banks absorbed 24.7% in U.K., 41.8% in U.S.A. and 97.6% in Japan.[1]

In the post-war period, the policy of maintaining the prices of government securities was continued in order that the cost of debt service may not rise. Government securities, therefore, formed highly liquid assets in the assets structures of banks. This created a great difficulty of managing the quantity of money in the post-war period. This difficulty was enhanced because of the widespread ownership of public debt outside the banking system. For, the non-bank holders are not generally amenable to the control of monetary authorities as the banks are. The policy of stabilizing the yields on government debt effaced the dividing line between money and other assets, as the latter too were rendered as liquid as money for all practical purposes. The result was that the monetary authorities lost control over the volume of money. For, the large volume of public debt held in and outside the banking system constituted a vast potential supply of money. Public debt in the post-war period thus, constituted a new factor in the management of the quantity of money.

The Post-War Problem.

How serious was the problem created by a huge volume of national debt for managing the quantity of money can be well illustrated from the situation that prevailed in the U.S. in the post-war period. In the post-war period in the U.S., the banks emerged with enormous liquid resources in the form of government securities. Ordinarily they were holding one or other kind of assets other than money but so long as the monetary authorities continued their wartime policy of supporting the prices of governments, at least the long term securities, the liquidity of the banks was much enhanced. So long as the banks are ready

1. League of Nations. World Economic Survey 1942-44.1945,p.179.

to keep their funds engaged in governments their power for further credit expansion is restricted. Government securities occupy a peculiar place in the investment portfolio of banks. They are the safest of all bank investments and, in a period of depression when other outlets for more profitable investments of bank funds are absent, they supply a good prop to the declining earnings of banks. But in the post-war period characterised by a high pressure of private demand for bank loans, banks could not be induced to hold government securities in excess of the amount just necessary for safety. When the volume of government securities was far in excess of what was required to satisfy their safety considerations, it is natural that they were attracted to purchase other more profitable assets by liquidating their holdings of government securities.

Prospects for purchasing better-yielding assets than government securities arose in the post-war period. The pent-up war-time demand for consumers' goods flared up in the post war period . As the supply of such goods could not be increased immediately, prices for these goods began to rise rapidly. This rise in prices provided a strong incentive for making investments for producing consumers' goods. Such investments received an added impetus due to the relaxation of war-time controls in the post-war period. Despite this, the war-time policy of maintaining interest rates at a lower level was continued. The result was competitive bidding for bank loans. The banks therefore, were induced to liquidate their government securities and invest the proceeds in commercial loans. Such an attitude was displayed not only by banks but by all individuals and institutional investors who could get opportunity to effect necessary changes in their assets. Liquidation of government securities would take place not only for purchasing other interest-bearing assets. Business men might utilize the proceeds for building inventories and individuals might utilize the proceeds for purchasing durable

consumers' goods. The monetary authorities in such a situation were faced with two rival objectives viz., maintaining the prices of government bonds and controlling inflation. It may be true that the rise in prices was responsible not to any increase in the quantity of money but to relaxation of controls leading to an extraordinary rise in the demand for both consumers' and producers' goods. But so far as the money payments required for meeting the transactions at a higher price level were supplied from the proceeds of the sale of governments and increased bank loans, the melody was essentially monetary. From a low level of about 19 billion dollars, in the middle of 1943, bank loans rose continuously to almost 40 billion dollars in the early months of 1948. There was a corresponding fall in the government security holdings of the banks.

The policy to be adopted by the monetary authorities was quite clear. So far as the banks were able to obtain reserves by monetising the public debt the expansion of bank loans could be checked by stopping such monetization. This could be done only when governments become relatively attractive in yields in comparison with loans. But the policy to make the governments attractive enough for the banks to hold them would involve an open abandonment of the objective of supporting the prices of government securities so as to maintain a low yield on them. Tightening of credit control was impossible without raising the whole structure of interest rates, but this ran counter to the policy of Federal Reserve (in association with Treasury).

This exigency was, however, realised by the monetary authorities and some measures towards raising interest rates on governments (especially short-term) were taken. In July, 1947, for the first time, after the war, the policy of maintaining the yields on governments was relaxed. The Federal Open Market Committee

eliminated the 3/8 of 1% rate on Treasury bills and declared that the yield on bills would be allowed to find its proper place in the market. The rate on certificates was continued to be supported at 7/8 of 1%. This support was also discontinued in August, 1947 and the support level of yield was raised to 1.1/8% which was the rate on newly issued certificates. In the case of longer-term governments the support prices were brought down somewhat in December, 1947. The long term governments were selling at a premium. The Treasury sold 1.8 billion of bonds out of its own investment accounts and in October, offered for sale a new issue of non marketable 2½% bonds. The post-war policy now aimed at a higher level of support rather than to give up wholesale the support of governments. This was a good gesture. The authorities threw a stone in the central pool of money market but the influence only stopped there. It did not spread through the multifold channels of the banking system. It is true that no direct effects of even some magnitude on the propensity to save and the cost of investment can be expected from this small raising of the levels of interest rates but the indirect effects could have been comprehensive and all-pervasive had the expectations of both bankers and businessmen been dominated by the thought of some unfavourable circumstances following the footsteps of this symbolic rise in rates. In that case, the lenders would have been cautious and would have hardened the standards of credit-worthiness of their customers. The producers would have anticipated further rise in the rates of interest and the resultant fall in the marginal propensity to consume and a rise in the marginal propensity to save. The holders of governments would have become highly sensitive to the fall in the capital values of bonds and this would desist them from unloading the securities. Such indirect effects of course depend upon largely the degree of sensitivity of lenders and borrowers to react to an

initial change in the policy and the confidence in the ability of monetary authority to pursue a restrictive credit policy in the prevailing circumstances. But the monetary authorities in the U.S. could not inspire such confidence and, therefore, even the indirect psychological effects of the rise in interest-rates were lost.

However, some sensitivity could be traced in the case of the U.S. when the support of Treasury bills was withdrawn in 1947. Dr.Burgess in his evidence before Douglas Committee told that the increase in Treasury bill rate showed the process of new financing i.e. made people to go a little slower.[1] It is true that when the short-term rate of interest on governments increases, market rates have to rise higher in comparison, in order to compensate for the element of risk involved in private debts. But in the atmosphere of high pressure of demand for loans, a small rise in the rate of interest was incapable of bringing about a fall in the demand for bank loans. Moreover, the liquidity of banks was so high that they were ready to bid for private loans even for a smaller margin of interest on private loans over that on government paper. The rise in the short-term rates had, therefore, practically no effect on the demand for bank loans. Even in U.K., when the new monetary policy was introduced in 1951 by raising the Bank rate from 2% to 2½% and by abandoning the preferntial 1½% market rate for Treasury bills, the effects of the new monetary policy were, in the beginning, not expected to bring about the expected results. This was because the banking system had an ample supply of floating assets - Treasury bills and loans to the discount market - which could be called in or allowed to run off, especially if they were Treasury bills. There was sufficiency of liquid assets along with cash and therefore the banks were in a position to expand credit even without selling off their investments.[2] So long as this cushion

1. Quoted by David A.Alhadeff.'Monetary Policy and Treasury Bill Market' A.E.R.June 1952,p.340.
2. Economist .Nov.10, 1951 p.1125.

of liquid assets was there, the banks could not be given any shock by the new policy. But in U.K. the banks co-operated wholeheartedly with the monetary authority and did not allow their liquidity ratio to fall below 40% and, therefore, the problem of supporting the prices of government securities was rendered easier in that country.[1] In the U.S., however, small rise in interest rates had practically no effect on the liquidation of government debt by banks. This was because, whatever effects the rise in interest rates could be expected to exert were swamped by inconsistent government policy in other fields. In U.S.A., in 1946-47, the banks held over 20 billion of governments maturing within a year and carrying a maximum yield of 1½% . So long as the banks could not be made debtors to the Reserve Banks, it was not possible for the new restrictive policy to have any effect on further credit expansion. And so long as the banks could monetize at their option the public debt of varying maturities, it was not possible to make them indebted to the Reserve Banks. In such a situation, even the symbolic effects of the mildly restrictive policy were lost and the changes looked only artificial. But how is it that even these psychological effects did not come to prevail in the U.S. ? In U,K., the decision to make the market rate flexible was interpreted as being suggestive of the authorities' resolve to go further if necessary.[2] But in U.S.A., the prevelant atmosphere was so adverse for the authorities that the inability and helplessness of the monetary authorities could be easily ascertained. In the first place, Congressional policy itself was inflationary. From July, 1946, price control was removed along with other physical controls. Secondly, from November 1, 1947, the regulation of consumer credit was discontinued.[3] Consumer credit, which had declined

1. A.H.Ensor 'Government's Monetary Policy', E.J.Dec.1952, p.719.
2. Economist Nov.10, 1951, p.1125.
3. Fed.Res.Bull. Nov., 1947, p.1356.

sharply during the war, rose rapidly and by the spring of 1947 was in the largest volume on record. Thirdly, a substantial amount (about more than 5 billion dollars) was left in the hands of the people by way of tax reduction and as a result, the spendable income of the community increased, Fourthly, from the middle of 1948 there was an increase in military expenditure. And dominating all these factors, there was a large volume of public debt.

By June 1948, the amount of public debt held by commercial banks amounted to 65.4 billion dollars out of 197.4 billion dollars held outside the Federal Reserve and U.S.Government Agencies.[1] Immediately after the war the total holdings of governments by banks amounted to 90 billion dollars. To meet the demand of rapidly ~~expanding~~ expanding private economy in the post-war period, the banks reduced their holdings of ~~their~~ government securities. Their total holdings declined to about 65 billion dollars by June,1948. This could be possible because the Federal Reserve continued the war-time policy of supporting government securities. The result of all this was that the total money supply increased considerably under the multiple credit system. It should be noted that when, in 1947, the Federal Reserve gave up supporting the various rates at their old war-time level, it was not an attempt at total denunciation of the objective of maintaining the prices of government securities. It was only an attempt at slightly raising the rate structure above its war-time pattern. Men-official and non official - holding influence in financial circles were iterating and reiterating with considerable emphasis the necessity of keeping the yields on governments pegged at some level. Mr.M.Eccles, the Chairman of the Board of Governors declared, in 1946, that, with the public debt as large as it was in the U.S., a free market was out of the

1. Fed.Res.Bull., June,1948 p.700.

question. The real question was not whether the yields should be pegged or freed but at what levels the yields should be pegged.[1] The same authority further, after one year, speaks : "Under present conditions large scale and continuous Federal Reserve Open Market Operations are essential for the maintenance of an orderly and relatively stable market for government securities. It is a necessary adjunct of the Treasury program for managing the economy's huge public debt of 260 billion dollars."[2] Further, the Patman Sub-Committee on General Credit Control and Debt Management observes: 'Neither the problem of the monetary policies nor that of debt management can be solved in isolation from each other'.[3] When these and other innumerable voices were pointing out a definite direction of monetary policy, the bankers and the holders of governments had absolutely no cause to be alarmed at the attempt to bring about a moderate rise in the yields. In the context of the prevailing policies in monetary and fiscal fields, it is not difficult to understand the reason why even the symbolic effects of the attempt to raise the rates of interest were lost. When,with such a policy objective, the liquidity of banks was assured and when the short-term rate on governments was amounting only about to 1.17% to 1.47%, the bankers, it was natural, could not resist the temptation for loans at 2.70% .

The two rival objectives:
Support of government securities Vs. the control of inflation.

Control of inflation by monetary measures was impossible unless the government debt was immobilised. In this respect, the recent restrictionist policy of the Reserve Bank of India deserves

1. Fed.Res.Bull.,November 1946,pp.1231-32.
2. Fed.Res.Bull.,January, 1948,p.15.
3. "Monetary Policy and the Public Debt in the U.S.A." A summary of Patman Sub Committee Report - Reserve Bank of India Bull.Sept. 1952,p.731.

appreciation. In India, so long as the banks were able to get reserves by monetisation of public debt, the new Bank rate of 3½% could not have any effect without being accompanied by a further change in open market policy. With the raising of the Bank rate in November, 1951, the Reserve Bank declared that during the ensuing busy season it would not normally buy government securities but would give advances against such securities under sec.17(4)(a) of the Reserve Bank of India Act. The measure had salutary effects so far -- as the bank holdings of government securities were concerned. Banks were obliged to approach the Reserve Bank for funds. The Reserve Bank credit (excluding that for Central & State Governments), no duubt, increased by 55 crores of rupees by March, 1952, but on this amount 3½% rate was effective. Despite stringent busy season of 1951-52, the investments of scheduled banks in government securities declined only by Rs.9.84 crores during the period of 3 months from January to March, 1952 as against Rs.41.53 crores during the corresponding period of 1951. [1] Of course, in a period of continuous need for government borrowing, fall in the price of governments cannot be put up with any longer. But this fall is largely a paper fall. So long as the banks are retaining government paper, they have not to suffer any loss due to the fall in its capital value. The trouble is created when the government debt becomes mobile . This mobility far increases the liquidity of the system by controlling which alone can the central bank have power to control inflation. The measures adopted by the Reserve Bank of India definitely show the way how central bank can come into a closer contact with the money market and how banks can be made dependent upon central bank credit by immobilising government securities held by them.

In the case of the U.S. the vastness of the public debt

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1. Report on Currency and Finance 1951-52, pp.165, 171.

and the wide variety of the holders presented great difficulties. The Federal Reserve System was often required to purchase and sell securities worth hundreds of millions of dollars in a week. In October and November of 1947 the System's purchases amounted to 3.2 billion dollars and sales amounted to 1.2 billion dollars. Out of the maturing issues, 2.5 Billions worth were redeemed and exchange of maturing issues for new ones amounted to 8.2 billion dollars.[1] Thus, the problem of refinancing a very large volume of public debt maturing every year was not an ordinary one. The confidance of the institutional investors was to be preserved for this purpose at any cost. Again, the rise in the rate of interest would involve huge interest cost to the Treasury.

These could not be connived at. But rival objective of the control of inflation had still greater importance from an overall economic point of view. It is true that the objectives of the support policy was not to save the holders of governments from capital losses. But it was certain that it contributed to the loss of real income to a very large number of citizens including the holders of public debt. This is a monetary illusion easy to understand. If at the time of repatriation of the debt the price level were to be 200% on the basis of what it was at the time of the purchase of the government paper, the real value of the proceeds would be only half of what it was before. If this monetary illusion is realised, the holders themselves would have nothing to grumble against the policy of removing the support. Viewed in this perspective, the importance of maintaining the purchasing power of the dollar was greater than the one for supporting the prices of governments. This whole argument is explicitly stated by one of the most outstanding monetary Economists of the U.S. - Dr.Goldenweiser:

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1. Fed.Res.Bull, January 1948,p.15.

"If the dollars paid out at maturity to holders of saving bonds or other bonds will buy only half of the money would have bought at the time the investment was made, the government bears a heavy load of responsibility for having urged to purchase the securities as the best protection for the old age or emergencies or the best way to prepare for the purchase of homes and other durable goods when the war was over. Is the holder more concerned about being able to save his bond at par at any time or to buy approximately as much for his money when he does sell the bond?"[1]

How to meet the situation?

A number of measures were suggested by various authorities on the subject - economists, official and non-official experts. It was not a question whether the monetary measures could be successful but whether they should be utilized, looking to the problems created by public debt. A substantial rise in the rate of interest would have gone a long way in controlling the situation. But it was not easy to ascertain what rise would have been exactly necessary for this purpose with its possible serious consequences for the public debt. Under the powers already with the Federal Reserve, a substantial rise in the rate of interest was the only possible rememdy to mend the situation, irrespective of the effects of such a policy on public debt . To serve both the objectives i.e. to control inflation and, at the same time, to safeguard the ~~xxxxx~~ security market, a number of non-traditional methods were suggested among which (1) the 'Security Reserve' Plan and (2) imposition of special reserve requirements against bank assets, instead of or in addition to present requirements against deposits, were the most important.[2] The Security Reserve Plan was given by the Federal Reserve Authorities themselves to cope up with the extraordinary situation.[3]

1. E.A.Goldenweiser - Monetary Management - Mc Graw Hill Book Co. New York 1949m,p.82.
2. "Monetary Policy to combat inflation" A statement sponsered by the National Planning Association 12-10-51.Am.Eco.Rev.June 1952 p.387. Also see A.H.Hansen, Rev.of Eco.Stat. August, 1951,p.193.
3. Proposal for a special reserve requirement against demand and time deposits of banks filed by ChairmanEccles. Fed.Res.Bull.Jan.,1948 p.14.

This scheme received a mixed reception especially due to the complicated nature of its working.[1]

Apart from the complicated nature of working, all plans wh-ich try to put restrictions on banks are discriminatory against banks in two ways. Firstly, if a flat rate of reserves is prescribed, banks with limited resources will be penalised and it is likely that some of them may not be able to meet even the operating expenses. To prescribe differntial reserves is to make confusion worst confounded. Secondly, as stated before, banks were one of the groups of the holders of government securities among several other groups of holders. The following extract from the Federal Reserve Bulletin June,1948 gives the main holders of public debt outside the Federal Reserve, and U.S. Government Agencies and Trust Funds.

TYPE OF HOLDER.	HOLDING ON MARCH 31st 1948(In Billion of Dollars).
1. Commercial Banks.	65.4
2. Mutual Savings Banks.	12.1
3. Insurance Companies.	23.8
4. Other Corporations and Associations.	21.8.
5. State and Local Governments.	7.5
6. Individuals.	66.8
Total	197.4

It can be understood clearly from this that any attempt at exercising restrictions on commercial banks alone would have very little effect on the credit situation. Prescribing secondary reserves in the form of government securities or to prescribe special reserv-es against loans or to fix loan quota for each individual bank-all would curtail no doubt the capacity of banks for further credit expansion. But when there was a very large number of holders outside

1. Golderweiser Monetary Management. p.91 and E.C.Simmons 'Secondary Reserve Requirements for Commercial Banks. Am.Eco.Rev.March, 1951 p.123.

the banking system, there was no guarantee that these holders will not step in where the banks would be stopped to tread. The widespread ownership of government securities made the funds considerably mobile from the government securities to the other fields of investments and vice versa. Any measure of restriction in this situation aiming at immobilising bank-held debt is discriminatory against one particular class of bond-holders. Even a self-imposed restriction such as the voluntary proramme of the American Bankers' Association can be of little avail. If for the sake of general interest a bank refuses to lend even to a good customer the bank would permanently lose a good customer who would be obliged to seek, say, a non-bank lender. The non-bank lender may secure funds by liquidating government debt and the loan advanced out of the proceeds would be as inflationary as a bank-loan would be.[1] To induce the non-bank holders to prefer governments to other assets, there was no striking monetary weapon except the rise in the yields on governments. To make the policy at once phenomenal and striking a substantial increase in the long-term rate was necessary and the increase was to be effected at a stretch. Slow and gradual rise loses even the psychological effects of the measure. First measure should have come as a shock which would have exercised a successful brake on the process of unloading governments. This measure would have become all pervasive as it would have affected all classes of bond-holders. Those who purchase government securities for income would not try to exchange governments for other assets even if the latter would be baaring slightly higher yields. With wide margin between the yields on governments and those on non-government assets and with no fear for capital loss on government securities sold off, the consequence can be easily imagined. Here, the quantitative measures would have achieved success, for, the problem was not to direct

1. Thomas B.Macabe, Chairman, Board of Governors- Statement before the House Banking & Currency Committee Fed.Res.Bull,Aug.1948,p.909.

bank credit into particular channels. Nearly all loans including the so called productive loans led to inflation. The American economy was functioning to capacity and a loan, the proceeds of which were to be utilized for even productive purposes, would create unnecessary excess demand for resources under the conditions of full employment, leading ultimately to a rise in prices.

It might be that, despite this, the pressure of demand for loans might continue. Here, as a supplementary measure, direct control of bank loans was necessary. Higher reserve requirements against loans could have been prescribed. Such a policy would have given a good prop to the initial increase in the yields on governments.

What about the cost to the Treasury?

The rise in the rates of interest would have definitely brought some increase in the cost of debt service to the Treasury. This problem could have been solved better by fiscal policy. A tax on interest income above a certain fixed level from any source would be a strong deterrent against changing governments for other assets. The device of using the expedient of taxation on interest income was already in use before 1941 in the U.S. Till 1941, interest on Treasury bills was exempt from Federal, State and Local Taxation, excepting the Estate and Inheritance Taxes. The result was that the Treasury bills were some times tendered at par or even at a premium, giving negative interest.[1] The proceeds from higher tax on interest would have gone some way to meet the increased burden of interest cost. Again, checking inflation itself would curtail government expenditure due to higher prices. Looking from this point of view, the advantage in the form of less outlay expenditure at lower prices might out-balance the disadvantage from

1. Reserve Bank of India Bull. June 1952 p.453.

increased interest cost due to the raising of yields. Initially, the increase in interest cost would not be on the whole of the public debt. It would be restricted to the part that would fall due for repayment and, therefore, which required refinancing at the new higher levels of interest.

It is very difficult to ascertain the cumulative effects of these measures taken simultaneously. But it would have become evident that the argument of increased interest cost to the Treasury was exaggerated. In addition to this, a timely reimposition or continuation of the regulation of consumer credit (this was discontinued from November 1,1947 and reimposed in Sept., 1948) would have definitely brought the situation under control.

Public Debt : Its impact on Monetary Management.

The huge burden of public debt with which the financial structures of almost all the countries in the post-war period are burdened will continue for a very long and indefinite period and, as such, it forms a secular factor in monetary management. Even if eventually the budgetary positions of various nations might improve and a steady retirement of public debt might be possible, the problems raised by the management of public debt have a fruitful bearing on the management of money. In principle, the management of money should aim at increased production and employment. All other objectives should be subordinated to this supreme objective. Monetary management as such should not be geared to the needs of the Treasury. The need for supporting government securities may be imperative but it should not be at the sacrifice of real income and happiness of millions of citizens who have not to benefit from such a policy. This problem can be tackled by fiscal and even direct control measures

and such measures should be adopted unscrupulously. It appears from the situation prevailing in the U.S. in the post-war period,, that the authorities did not show any resolution on their part to bring inflation under effective control. As reviewed, the measures were half-hearted and were not properly timed. The Federal Reserve Authorities under the pressure from the Treasury were over scrupulous in exercising their weapons.

The very existence of a large volume of public debt makes for greater inequality in distribution of income. For, it is self-evident that the relatively rich save more than the relatively poor and, therefore, their share in the total interest disbursement of the Treasury would be larger relatively. If, over and above this, inflationary is allowed to flourish under the pretext of heavy burden on the Treasury, the poor would be burning their candles at both ends. It is said that in the inter-war period in Germany public debt was consumed in the fires of inflation. In the present post-war situation, heavy burden of public debt introduces an inflationary bias in monetary management. The trend of policy in the U.S. points out clearly to the same direction.

The efficacy of monetary measures in this context was out of the question. During war, to facilitate war financing as cheaply as possible, cheap money policy was followed. Fiscal policy also could not be used as a control measure against inflation, for, deficit financing was indispensable . The Government, therefore, applied the third alternative, viz., direct controls. In the post-war period, when the controls were relaxed and fiscal policy was not adapted to the exigencies of the situation, the authorities should have used decisively the monetary weapons. To the extent that it was not desirable to use monetary measures due to certain fiscal considerations, authorities should have

resorted to the other two alternatives. Reimposition of direct controls in peace time would be anomalous in the American economy where the introduction of non-traditional methods even in the field of monetary management is taken to be an interference in the free working of the economy. But a proper combination of monetary and fiscal devices as described above would have gone a long way to control inflation.
