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COMMITTEE PRINT

A CONSTANT PURCHASING POWER BOND: A PROPOSAL FOR PROTECTING RETIREMENT INCOME

PREPARED FOR CONSIDERATION BY THE

SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE

AUGUST 31, 1961

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LETTERS OF TRANSMITTAL

AUGUST 28, 1961.

To Members of the Special Committee on Aging:

Submitted herewith for the consideration of the members of the Special Committee on Aging and others is a study paper on a recent proposal for meeting the problems of retirement income of our growing population of retired, elderly Americans.

The 1959–61 Subcommittee on Problems of the Aged and Aging, of the Committee on Labor and Public Welfare, and now the Special Committee on Aging, have been exploring measures that would effectively cope with the fact of longer years of retirement on relatively fixed incomes for increasing numbers of individuals.

One of these new measures could be the issuance by the Treasury of savings bonds, the value of which would be adjusted to keep pace with any increases in the cost of living subsequent to date of purchase. Such a protection feature would be provided only if the bonds are kept for a certain period of time, or only if the owner of the bond is of a certain age, at the time of redemption. Otherwise, the bonds would pay only the given interest rate. The specific details of one such proposal are contained in the anlysis of S. 2181, which I introduced on June 29, 1961, and reprinted in this paper.

The study paper printed herein might well be regarded as an attempt to carry out a major recommendation made 10 years ago by a conference of university economists, called by the National Planning Association, at Princeton, N.J. in October 1961, on "Monetary Policy To Combat Inflation." Recommendation VIII of the conference statement suggested the following:

> Increased saving can make a significant contribution to the restraint of inflationary pressures. Study should be given to the issuance of new types of securities that may encourage saving, such as bonds of constant purchasing power (which might be particularly appropriate for purchase by social security and pension funds), annuities in excess of those provided under the present social security program, and savings bonds offering strong inducements for retention to maturity by the original purchaser.

In complying with my request for further analysis of the idea represented in S. 2181, the staff of the Special Committee on Aging employed an independent economist to survey expert opinion and to explore the desirability and feasibility of a concrete form of it. I have asked that his results be printed and distributed not only for the use of the committee members but also to obtain the review and comment of other experts on the problems of retirement income.

The views of the author are entirely his own, and the committee and the committee staff indicate neither approval nor disapproval by this publication.

PAT MCNAMARA,
Chairman, Special Committee on Aging.

AUGUST 25, 1961.

Hon. PAT McNAMARA,
Chairman, Special Committee on Aging,
U.S. Senate, Washington, D.C.

DEAR SENATOR McNAMARA: Transmitted herewith is a study paper on the proposal for a constant purchasing power bond for purposes of retirement income, written by Dr. Jacob Seidenberg, a consultant economist. Dr. Seidenberg holds degrees from Temple University, the University of Pennsylvania, and Cornell University, and in recent years has served as a private consultant to numerous Federal agencies and commissions including the Atomic Energy Commission, the International Cooperation Administration, the President's Commission on Railroads, and the Department of Labor. He previously taught economics at Haverford College, University of Delaware, and Pennsylvania area colleges.

The paper is presented for consideration and comment by the committee and staff.

HAROLD L. SHEPPARD,
Staff Director, Special Committee on Aging.

THE CONSTANT PURCHASING POWER BOND FOR RETIREMENT PURPOSES

(By Jacob Seidenberg)

I. Introduction

The purpose of this paper is to examine the background, the experience, and to make an appraisal of the economic feasibility of the proposal for the Federal Government to issue a security designed to enable persons to plan and meet the exigencies of income maintenance after they have passed the period of full and gainful employment.

One of the recommendations made by the Subcommittee on Problems of the Aged and Aging, Senate Committee on Labor and Public Welfare, in its report, "The Aged and the Aging in the United States: A National Problem," 86th Congress, 2d session (Rept. No. 1121), in dealing with income maintenance, suggested that the Federal Government issue bonds available for purchase by individuals and certain institutional groups which would, if held to maturity, be a means for achieving or maintaining constant purchasing power. It was this recommendation that initiated the present study for the Senate Special Committee on Aging.

The study is based on a bill introduced in 1960 by Senator McNamara, together with Senators Clark and Randolph (S. 3684) and in 1961 by Senator McNamara (S. 2181) which authorizes the issuance by the Secretary of the Treasury of a constant purchasing power bond which could be accumulated by individuals and eligible institutions subject to certain limitations and conditions.

The limitations which the bill imposes upon purchases of the security by an individual are that they could not exceed $10,000 in amounts in any one year; nor a total of $60,000 for any one individual. The bonds would not be transferable, would have a 20-year maturity period, and would have to be held to maturity in order for the index feature to be applicable unless the holder has reached the age of 60, died, or has become disabled.

The bonds could also be held by corporate trustees to meet their obligations of a trust under an approved pension or profit-sharing plan. Life insurance companies could hold an amount equal to their pension plan reserves allocable to contracts which are purchased or provided under an approved pension or profit-sharing plan. When such eligible institutional investors purchase these bonds, they must offer cost-of-living adjustments under applicable pension and profit sharing plans.

The principal feature of the bond is that if it is held to maturity, or redeemed before maturity under conditions approved by the Secretary of the Treasury, it would pay to the holder, in addition to the face amount of the bond, any increase reflected by the Consumers Price Index between the month the bond was issued and the month preceeding the month in which the bond was surrendered.

The bonds would also be interest bearing and those purchased by individuals might be offered on a discount basis or on a combination, interest-bearing and discount, basis. The proposed bill states that the bonds shall provide an interest rate or yield the same as that of U.S. savings bonds.

II. Foreign Experiences [1]

The concept of a financial instrument providing constant purchasing power is not novel and is in use in many countries of the world. While such instruments have been advocated by a number of distinguished economists years ago,[2] in the period following World War II a number of countries evidenced an interest in utilizing this fiscal device to adjust or compensate for changes in the price level.

The extensive use of the constant purchasing power bond may be gleaned by briefly relating the record of different countries using various types of deferred payment contracts containing a compensating factor for changes in the price level.

FINLAND

(1) In 1945, the Finnish Government, in order to indemnify its citizens who had to evacuate the Province of Karelia as war indemnity to the Soviet Union, issued a 10-year amortization loan for 18 billion marks. The loan contained a provision for repayment of the principal for every 10 percent increase in the domestic wholesale price index without any stipulation as to an upper limit in the rise of the index. In 1955, the bonds were fully repaid. The compensation based on the index clause amounted to 61 billion marks. The bonds were negotiable and quoted on the stock exchange, and at one time commanded considerable premium, and to some extent were used as an investment by life insurance companies.

(2) In 1953, the Government issued a 5¼-percent loan tied to domestic wholesale prices. Here the compensating factor was limited to a 100-percent rise in prices and became effective when the index rose or fell 5 percent.

(3) In 1954, two new index loans were issued. One at 7 percent was tied to the cost-of-living index and offered compensation for any price index increase for both principal and interest, but only for 50 percent of the price increase. The second loan had the same construction as the first except that the interest was nominal and followed the bank deposit rate.

(4) Another loan floated in 1954 was tied to wholesale price indexes, and offered adjustments in principal and interest for each 5-percent price rise, but only up to a maximum increase of 100 percent.

(5) In 1955, four new index loans were issued. Two were tied to the retail-price indexes and offered for each 2-percent increase 50 percent compensation. The third loan, tied to the retail-price index,

[1] Much of the information has been obtained from "Economic Bulletin For Latin America," vol. II, No. 2, October 1957; Bureau of Economic Affairs, United Nations.

[2] Alfred Marshall in 1886 and again in 1911 strongly advocated use of a standard unit of purchasing power in contracts for deferred payments. Jevons thought so much of the proposal that he suggested it might be made compulsory for every money debt of 3 months. Cited by David Finch in "Purchasing Power Guarantees for Deferred Payments." International Monetary Fund, vol. V, pp. 1–22, 1956–57. J. M. Keynes in 1927 advocated the issue of treasury bonds by the United Kingdom by which the capital and interest would be paid not in a fixed amount, but in such amount of sterling as has a fixed commodity value as indicated by an index number. Sumner Slichter was also a persuasive advocate for the concept of a constant purchasing power security.

gives full compensation but it is limited to a 100-percent increase in price level. The fourth loan, tied to a wholesale-price index, gives full compensation for each 5-percent increase.

(6) By 1956, of all the Government debt outstanding, about 33 percent was "indexed."

Nongovernmental

(1) In 1947, insurance companies began to write loans on an index basis. At first, there was resistance to this kind of borrowing, but as money became tighter, it became common and now is the accepted way of borrowing from insurance companies. The rate of interest on these loans is somewhat below the going market rate. Since 1948, the insurance companies have offered new insurance on an index basis. The value of the policy, as well as future premiums, are adjusted to each 10 percent increase in the cost-of-living index.

(2) Commercial banks, as well as savings banks, have introduced a 50-percent guarantee on deposits linked with the cost-of-living index since 1955. The accounts which are guaranteed bear 1½-percent rate of interest below the rate for conventional savings accounts. The deposit must remain blocked at least for a year to get the advantage of the compensating factor and the minimum deposit must be $130. This kind of deposit exists side by side with the conventional form of savings in the same banks.

SWEDEN

In 1952, Kooperative Forbundet, a large cooperative issued a 3-percent bond tied to the cost-of-living index. Full compensation was guaranteed with regard to the principal for any rise in the index.

ICELAND

Landsbonkin Islands issued a 5.5-percent loan in 1955 for financing homebuilding. The payments were regulated according to a retail-price index.

ISRAEL

Several issues have been floated which give the holder the option of being paid in kind. In 1951, the Palestine Land Development Co., issued 5-percent debentures, convertible either into ordinary shares or plots of land. In 1952, Nesher Palestine Portland Cement, Ltd., issued two kinds of debentures. Series A linked the principal and interest to the official price of cement. Series B entitled the holder to purchase cement at a fixed price. In 1955, the Mekadin Co., issued bonds convertible into ordinary shares of citrus orchards in 1958. The Isras (Israel-Rassco) issued debentures in 1955, convertible 2 years later into shares, or in the alternative entitled the holders to apartments at prices fixed in advance.

In 1955, the Palestine Electric Corp. floated a loan guaranteed by the Government, with the value of the security tied either to the official rate of exchange of the dollar or the Consumer Price Index. The preference of the purchasers of this popular issue was greatly in favor of the price index clause.

A number of securities, other than debentures, have been floated since 1954, all containing purchasing power guarantees. The pen-

sions paid and funds lent to the Ministry of Finance by the National Insurance Institute are tied to the Consumer Price Index.

Development loans which the Government has made since 1954 oblige the borrower to redeem the loan in accordance with a specific linking principle. The link is either the dollar exchange rate or the Consumer Price Index.

The Government has also sponsored two major savings projects. In 1955, the "Save to build" campaign was launched wherein the participants made a downpayment on an apartment, the amount depending on the size and, thereafter, monthly payments. If building costs increase, the price of the apartment which has not been paid for is accordingly revised. This protects the invested savings since it is linked to the actual building costs. When the amount owed reaches 25 percent of the value of the apartment at 1955 prices, the participant may engage in an annual lottery drawing for apartments.

Another savings project was the "Citrus growers through savings." Groves of various sizes could be acquired by two downpayments and then monthly payments for 5 years. Thereafter, ownership to the grove is transferred to the participant. The payments made represent approximately half of the cost; the remainder is provided by a Government loan for 14 years which commences after the initial 5-year period. The interest and repayment are tied to changes in the exchange rate.

FRANCE

In France, since 1952, there have been a number of governmental and private bond issues all containing constant purchasing power guarantees.

In 1952, the Government issued its 3½-percent "Pinay" gold loan, the redemption value of the security tied to the price of gold in the market, the index varying according to the average of the last 100 price quotations.

The nationalized industries were the first to make large-scale use of variable return issues. The electric light and power, the railroad, and the coal-mining industries issued bonds in which the interest and capital redemption value varied with a stated index.

In 1952, Electricité de France issued an instrument wherein the payments for principal and interest were tied in to the average price of a kilowatt-hour of electricity.

In 1953, the French railways floated a bond linking the amortization and interest paid to the price of a third-class passenger ticket. The coal-mining industry's index was the man-hour output at the coal face.

The nongovernmental sector of the economy has also issued different kinds of variable return bonds. One kind of bond has made the return vary with the corporation's earnings or dividends; the other kind does not make the return directly related to the profitability of the concern, but rather to such economic variables as the price of the product, the rate of turnover, the volumes of sales, or some measure of productivity.

The following table indicates that the coupon rate of variable return securities was lower than the going rate of interest for conventional issues.

TABLE I.—*Yields on French securities, 1955–58* [1]

	1955	1956	1957	1958
All debt obligations	4.73	4.73	5.72	5.72
All fixed-interest bonds (public and private)	(2)	(2)	6.27	6.30
Variable return bonds (public industrials)	3.94	3.13	3.30	4.07
Fixed-interest bonds (public industrials)	5.92	6.17	7.74	7.95
Equities	2.99	3.38	(2)	(2)

[1] "Variable Return Bonds—The French Experience," Rozental, Alex. A., Journal of Finance, December 1959, p. 523.
[2] Not available.

A noted student of this subject states private corporate users apparently have found the variable return instrument satisfactory in view of the fact that not a single major issue has yet been retired before the stated maturity date in spite of options to do so in a number of issues marketed in the early 1950's.[3]

CHILE

The state bond in 1957 issued adjustable bonds primarily for agricultural development. The value of the bonds were based on the price of wheat.

MEXICO

In 1958, the Government floated a bond issue to aid in the development of native oil resources. The issue carried a rate of interest of 7.6 percent. A wholesale index of prices in Mexico City calculated by the Bank of Mexico is used to determine the increase in the value of the bonds. The monthly average of the index for the preceding 12 months must increase by 2.5 percent, or a multiple thereof, before any adjustment can be made in the price of the bond. Coupon interest payments are calculated on the adjusted value of the bond. Principal and interest will be paid at par even if there should be a decline below the base index.

PEOPLES REPUBLIC OF CHINA

In 1949, "parity deposits" were widely used. These were deposits linked to the price of a "basket" of certain essential commodities in specific quantities. The price of the "basket" was computed daily and used for immediate adjustment of the deposits. Workers with incomes in excess of a certain minimum had to deposit a part thereof. Bank loans were alleged to have been converted to a purchasing power bond and in 1950, bonds were issued with their values being based on the prices of such basic commodities as rice, flour, cotton, cloth, and coal.

UNITED STATES

Prof. Irving Fisher who was a part owner of the Rand-Kardex Co., in 1925, had the company issue bonds tied to the Wholesale Price Index of the BLS. The issue was not successful and after a few years, it was converted to preferential shares and conventional bonds. The Federal Government did execute a contract in 1946 in which the payments were determined by a cost-of-living index, when the United

[3] Ibid., p. 527.

States-Cuba sugar agreement of that year provided that the price paid by the Commodity Credit Corporation for Cuban sugar be governed by the BLS indexes.[4]

III. Need for Constant Purchasing Bond

While the proposed constant purchasing power bond cannot offer succor to those individuals presently or soon reaching the ages of 60 to 65, data on the present income status of the aged indicate these individuals are faced with a very real problem and one which merits the attention of all thinking, sensitive persons. There is nothing in the present economic horizon to indicate that there will be any appreciable change in the economic lot of prospective retirees different from those represented in the present data, unless the Federal, State, and local government agencies, initiate policies and execute affirmative and constructive implementing measures.

The most current and complete review on the income status of the aged is found in the report of the Senate Subcommittee on Problems of the Aged and Aging, Committee on Labor and Public Welfare.[5]

Some of the findings may be briefly stated: taking all aged individuals (including wives and other dependents of income receivers), about 60 percent had less than $1,000 in cash money income in 1958, according to Bureau of Census data released January 15, 1960. Between 20 and 25 percent received between $1,000 and $2,000, while the remaining portion received more than $2,000.[6]

For families with the head aged 65 or over, the median income was $2,666, which was slightly more than one-half of the median for those families with heads 55 to 64 years of age.[7]

The report also notes that, as of June 1959, about one-fourth of all persons age 65 or over were receiving income as a result of being employed or being the nonworking wives of wage earners; about 75 percent received income from social insurance and related program.[8]

In discussing the assets of the aged, the report states:

> It is a generally recognized fact that persons with low incomes typically have few if any assets. The 1957 Federal Reserve Board survey showed that of those aged spending units with assets amounting to less than $1,000, 90 percent had incomes of less than $3,000. Concerning money income from assets, which is perhaps more relevant, three-fifths of the beneficiary couples in the 1957 OASI survey had no money income or less than $75 for that year in the form of interest, dividends, or net rental income. Two-thirds of the widows received no income or less than $75 from the same sources. Asset incomes of $600 or more during the 1957 survey year were received by:
>
> 1. One out of every six couples.
> 2. One in every eight aged widows.
> 3. One in every fourteen single retired workers.[9]

In summarizing the income problem of the aged, the report inter alia, makes this observation:

> The assets of the aged are on the average greater than those of younger persons, but are not sufficient to maintain themselves on an independent basis without additional current income. * * * high levels of income among currently employed men and women are apparently not sufficient to assure that they will be able to set aside adequate amounts for their old age. There is no guarantee that

[4] "Money in the Law—National and International," Nussbaum, Arthur, 2d ed., p. 305, 1950.
[5] 86th Cong., 2d sess., Rept. No. 1121.
[6] Ibid., p. 65.
[7] Ibid., p. 67.
[8] Ibid., p. 69.
[9] Ibid., p. 71.

such savings as are accumulated would not have to be used for other purposes, or that they would not be substantially decreased during the periods of unemployment, or that their purchasing power will remain the same by the time of retirement.[10]

This brief recital of the lack of assets and earning power of aged persons should not militate against initiating the program for a constant purchasing power bond, by inferring that they will not be interested or financially able to engage in this longtime savings scheme. Up to now, middle-income persons, during their peak earning-power years, have had little or no incentive or inducement to invest in fixed-income-extended term securities, because of the gradual erosion since 1940 of the purchasing power of the dollar.

The limited resources of the presently aged persons indicated by the above summary of income data are a persuasive argument for the constant purchasing power bond. It is suggested that the problem of income security might be met in part by offering a security which would be easily marketed, readily obtainable by those unsophisticated in financial matters, and which would offer a real incentive to those who wanted to—by the exercise of foresight and prudence—take measures to provide a modicum of security for the period after their gainfully employed years have passed.

The suggestion has been frequently made that wage earners and salaried persons in the lower and middle income brackets could meet the problem of inflation by investing in common stocks. However, it is a questionable solution for many of these persons. Stockownership may not be a desirable or even feasible course for everyone in this economic bracket. It is questionable whether all wage earners should own equities. They may not be geared to meet the exigencies of the stock market gyrations, and should not be compelled to seek refuge in a plan which is not primarily designed for use by this segment of our society. It would appear to be far sounder to have this group invest in constant purchasing power bonds rather than directly in stocks or indirectly through mutual funds.

IV. Institutional Investment

Regardless of either the interest, ability, or soundness of this security for lower and middle class individual investors, it would also be necessary to have this constant purchasing power bond attractive to institutional investors, especially those who invest the premiums and proceeds of private pension and profit-sharing plans.

The extent of the influence of these groups can be seen by reviewing the scope of operations of this source of capital accumulation and particularly as potential investors in the purchasing power bond.

The first report of the Secretary of Labor, covering the first 18 months of operations of the Welfare and Pension Disclosure Act[11] indicates the extent of welfare and pension plans currently in effect. Table II reveals that at least 127,700 plans have filed reports. Eighty percent of the reports pertained to welfare, 19 percent to pension plans, and the remaining 1 percent to combination plans providing both for welfare and pension benefits.

[10] Ibid., p. 80.
[11] "Report and Recommendations—The Operations of the Welfare and Pension Plans Disclosure Act—Jan. 1, 1959-June 30, 1960," U.S. Department of Labor, Aug. 8, 1960.

TABLE II.—*Characteristics of welfare and pension plans*

A. DISTRIBUTION OF 127,700 SELECTED WELFARE AND PENSION PLANS BY TYPE OF PLAN

Type of plan	Number of plans	Percentage distribution
Total, all plans	127,700	100
Welfare benefit plan	102,400	80
Pension benefit plan	24,600	19
Combination plan (provides both welfare and pension benefits)	700	1

B. DISTRIBUTION OF 127,700 SELECTED WELFARE AND PENSION PLANS BY TYPE OF PLAN AND BY TYPE OF BENEFITS PROVIDED

Type of benefit	Number of plans providing specified benefit				Percent of plans providing specified benefit			
	Total, all plans	Welfare benefit plans	Pension benefit plans	Combination plans	Total, all plans	Welfare benefit plans	Pension benefit plans	Combination plans
Total, all plans	127,700	102,400	24,600	700	100	100	100	100
Life insurance	60,300	59,800	0	500	47	58	0	68
Accidental death and dismemberment	40,400	40,200	0	200	32	39	0	30
Accident and sickness	32,900	32,600	0	300	26	32	0	39
Paid sick leave	3,600	3,500	0	100	3	4	0	8
Hospitalization	66,200	65,800	0	400	52	64	0	63
Surgical benefits	64,400	64,000	0	400	51	63	0	58
Medical benefits	50,500	50,200	0	300	40	49	0	46
Dental benefits	200	200	0	(1)	(2)	(2)	0	2
Unemployment benefits	900	900	0	(1)	1	1	0	3
Retirement for age or service	24,900	0	24,300	600	20	0	99	91
Retirement for disability	17,500	0	17,100	400	14	0	70	54
Death benefits	20,600	0	20,100	500	16	0	82	66

[1] Less than 50. [2] Less than ½ of 1 percent.

NOTE.—Columns are nonadditive because many plans provide multiple benefits. Tabulations based on plan description reports filed as of Aug. 31, 1959.

It is evident that these various plans are expanding and will continue to be a growing source of investment as the funds accumulate under these plans.

A definitive study of private pension plans several years ago stated:

> The growth of private plans is well within the economic capacity of this society. But the growth of these plans depends upon finding ways of controlling inflation and hence the value of the pensions promised. And the growth of these plans is already affecting the investment market and demonstrating the necessity for Government regulation of the handling of the funds through which private funds are financed.[12]

The assets of pension funds of U.S. corporations at the end of 1960 amounted to $27.8 billion, book value, according to a survey made by the U.S. Securities and Exchange Commission.[13] During the year, assets rose $3.3 billion, or 13.5 percent, as compared to $3.2 billion in 1959 and $2.8 billion in 1958.[14]

Investments in U.S. securities had remained at a constant level for several years, but declined slightly in 1960, and at the end of the year totaled $20.035 billion.[15] This is due to the fact that corporate

[12] "Economic Needs of Older People," Corson and McConnell, Twentieth Century Fund, 1956, New York, p. 356.
[13] Release No. 1750, dated May 3, 1961.
[14] Ibid.
[15] Ibid.

bonds and other corporate securities were more attractive during this period. One manager of pension funds investment interviewed said that if it were not for the "magic 5's," the present portfolios would contain even fewer Governments.

Various investment managers interviewed in the course of this study, while restraining their enthusiasm for the concept of the constant purchasing power bond, nevertheless admitted that assets of pension funds do and have to include Governments and that if the Treasury did issue a security with a compensatory feature to cover increases in the cost of living, they would have to seriously consider purchasing it. Some funds, of course, are required by the terms of the indenture to invest all their funds in, while others, a substantial amount in, Government securities. There is little doubt that this kind of security would be marketable to the professional managers of noninsured or trusteed funds, which are those plans not underwritten by insurance companies. Insured plans managed by life insurance companies contain today an even larger amount of Federal issues and it is quite likely that they would add more Federals to their portfolios, especially if an issue contained a compensating feature.

The professional managers of trusteed funds assert that they do not invest very much in Governments because there are better yields to be obtained in corporate bonds. Over the years, the yields respond to the market forces and have been increased by reduction in market price of the security. Therefore, while the funds may obtain higher yields, they are not sure they can always recover the face value of the bond if sold before maturity. The proposed bond would guarantee that the pension fund would at least receive the face value of the bond plus any additional increment due to the increase in the price level. This is not an unpersuasive reason for adding it to portfolios.

In this event, pension funds and profit-sharing plans would be required in the future to make payments, not in fixed amounts, but rather in amounts adjusted to an established index. These proposed bonds would be very desirable instruments. By being able to consider such issues as part of their reserves the funds would have an effective way to meet this contingency.

The proposal would enable the Government to market longer term obligations more easily and restore Governments to their traditional position of being a significant portion of the portfolios of pension funds and profit-sharing plans.

A review of tables III and IV indicates a clear trend for pension funds to buy common stocks in ever-increasing amounts. This is undoubtedly motivated by the anticipation or expectation that long-term inflation is likely to continue, with unfortunate results to portfolios invested solely or substantially in fixed income securities. It has been argued that this growing trend of funds to invest in equities poses a problem for our continued economic freedom and has already been the subject of studies and monographs.[16]

[16] Tilove, Robert, "Pension Funds and Economic Freedom," a report to the Fund for the Republic 1959. Berle, A. A., "Economic Power and a Free Society," Fund for the Republic, 1957. U.S. Senate Committee on Banking and Currency, 84th Cong., 1st sess., staff report, December 1955, "Institutional Investors and the Stock Market."

TABLE III.—*Assets of corporate pension funds*

[In millions]

Class of securities	Book value, end of year					
	1955	1956	1957	1958	1959	1960
Cash and deposits	$343	$332	$368	$383	$407	$419
U.S. Government securities	2,536	2,293	2,032	1,985	2,148	2,035
Corporate bonds	7,225	8,704	10,392	11,731	12,797	14,140
Preferred stock	510	570	611	655	657	652
Common stock	2,524	3,269	4,187	5,396	6,940	8,640
Mortgages	146	230	313	405	576	753
Other assets	511	736	833	892	1,008	1,197
Total assets	13,795	16,134	18,736	21,447	24,533	27,836

TABLE IV.—*Percentage distribution*

Class of securities	1955	1956	1957	1958	1959	1960
Cash and deposits	2.5	2.1	2.0	1.8	1.6	1.5
U.S. Government securities	18.4	14.2	10.8	9.3	8.8	7.3
Corporate bonds	52.4	53.9	55.5	54.7	52.2	50.8
Preferred stock	3.5	3.5	3.3	3.0	2.7	2.4
Common stock	18.3	20.3	22.3	25.1	28.3	31.0
Mortgages	1.0	1.4	1.7	1.9	2.3	2.7
Other assets	3.7	4.6	4.4	4.2	4.1	4.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

Tilove stresses in his study that while the gross purchases are not significant in terms of aggregate activity of the New York Stock Exchange, it is the *net purchases* that merit attention. He states:

> * * * when we come to net purchases of common and preferred stock—the difference between purchases and sales—we find that institutions outweigh individual buyers by far. They buy less for trading than do individuals. Some institutions, particularly pension funds, buy to hold, and their growth means that they buy more than they sell. Without including the personal trust funds, institutional investors are estimated to have accounted, in 1954, for 60 percent of the total *net purchases* of common stock. If personal trust funds are included, the figure was 71 percent. *In 1956, self-insured pension funds made total net purchases of stock equity to one-fourth of the new equity money (and more than one-fourth of the debt financing) required by corporations.* * * * As for 1957, according to SEC estimates, pension fund acquisitions of stocks (common and preferred) increased to 27 percent of the total net purchases of such securities; and net institutional buying without counting personal trusts, accounted to 62 percent of the total.[17] [Italic in original.]

To the extent a new Government security would be issued which would have a significance for pension and profit-sharing funds, and which might divert or prevent, in part, the concentration of equity holdings, it appears to be a move more consonant with preserving the greatest amount of economic freedom. There is every indication to believe that the noninsured pension funds are apt to accumulate, in the period to come, far greater reserves, and the funds, therefore, will be in a position to make increasingly larger purchases of equities and thus add to the potential concentration of economic power vested in these institutions.

[17] Tilove, pp. 43–44.

V. Assessment of the Arguments Against the Constant Purchasing Power Bond

Despite the advocacy by some of the most distinguished persons in the British-American field of economics, such as Alfred Marshall, J. M. Keynes, Sumner Slichter, G. L. Bach, R. A. Musgrave, Richard Goode, Melvin W. Reder and Milton Friedman, the traditional view has been to oppose the issue of a constant purchasing power bond. Despite the fact that for the past decade, the redemption of Government savings bonds (series E) have exceeded the purchases (see table V), all proposals advanced to further this concept have been rejected by the U.S. Treasury, a majority of economists, the banking and investment fraternities and insurance companies. Support for the concept has been found in academic circles, and even here, not too frequently.

In the course of this study, conferences were held with ranking officials of the U.S. Treasury, managers and professional investors of pension and profit-sharing funds, economists of private research groups, academicians interested in debt management, students of welfare and pension funds and investment advisers of labor unions.

While there was no very visible show of enthusiasm for the constant purchasing power bond even when confined to the limited purpose of assisting prospective retirees, many of the experts interviewed agreed that the proposal merited serious attention and consideration. It was acknowledged that this concept has never been considered in the context of a plan to help provide financial security for aged persons. Usually, the proposal has been considered as a general device to combat inflation. Some of the economists interviewed said that their dogmatic statements of opposition, uttered a decade ago, in light of the potential inflation then imminent, would have to be reconsidered in light of the experience with "creeping inflation" of the past decade and more especially in view of the newer and increasing problem of proper care for the expanding number of aged people.

TABLE V.[1]—*Annual sales and redemptions U.S. savings bonds, series E*

[In millions of dollars]

Calendar year	Sales (at cost price)	Redemptions (including earned interest)	Calendar year	Sales (at cost price)	Redemptions (including earned interest)
1951	3,190	4,036	1956	4,142	4,689
1952	3,393	4,098	1957	3,875	5,220
1953	3,906	4,141	1958	3,802	4,658
1954	4,023	4,406	1959	3,598	5,225
1955	4,192	4,572	1960	3,632	4,729

[1] Letter dated June 6, 1961, to writer from Savings Bond Division, U.S. Department of Treasury.

The basic objections to the proposal may be stated as follows:

(1) *A special sector of population being singled out for extraordinary protection*

It has not been the function of the U.S. Government to use the proceeds of the Treasury to afford one group in the economy protection against the ravages of inflation. In the event there is a rise in the index, general taxation will be used to make whole one sector

of the body politic. Protection for one group will be offered at the expense of the general public.

The answer can be made that the Government is here recognizing that there is a special group or portion of the population that needs unusual attention because of its lack of participation in the productive side of economic life. The establishment of a Special Senate Committee on Aging, the creation of a Council on the Aging in the Executive Department, and the holding of a White House Conference on Problems of the Aging, are but a few examples that the Government has recognized that there is a problem concerning the ever-increasing number of senior citizens, who are living for longer periods after retirement from gainful employment, and who are without adequate assets or income for this longer life span. It is not inappropriate, therefore, for the Government to undertake special measures to cope with the problem. The Government may be giving one sector of the population special attention, but only because the needs of this sector demonstratively require it. The special theme of much of the work of the above organizations and conferences has been that new orientations are called for by the emergence of a large retired aged population.

(2) An acceptance by the Government of the inevitability of inflation

The issuance of this kind of a security for general purposes or for the special purpose of aiding workers to prepare for their retirement might be considered an admission by the Government that inflation is inevitable and that it has reservations about its ability to control these inflationary pressures. Any policy which would publicly admit directly or by implication suggest a weakening in the dollar would only increase the strength of the inflationary forces. A stable dollar offers far greater protection for all elements within the society, including the aged, than a single measure which is of doubtful propriety and efficacy.

The answer to this statement is that the Government does have a duty to keep the dollar stable, but this obligation has to be viewed in light of the totality of governmental responsibilities. Consideration must be given to the position that one of the proper functions of Government is to make possible for the small, less informed investor to have a type of investment which protects against the reduction of his financial resources as a result of inflation.

The introduction of a constant purchasing power bond is but a recognition of an almost incontrovertible fact—a gradual increase in the price level, little likelihood of the trend being reversed in the foreseeable future—and the stark reality of basic changes in the numbers of older persons out of the labor force, and hence less able to cope with price changes than those people in the labor force.

The issuance of a security with an index feature could, furthermore, be interpreted as a statement of faith and confidence on the part of the Government that it can and will control inflation, otherwise it would not undertake to assume this great potential liability of having to redeem hundreds of millions of dollars of bonds with increased face value caused by changes in the index.

Another answer is that the issuance of a single security in the limited context in which it is offered could hardly undermine confidence in the soundness and stability of the dollar. It is unrealistic to believe,

in light of present day debt management that the marketing of a single bond on a restricted scale could seriously affect the dollar.

As far as the domestic economy is concerned, it can be seriously questioned whether confidence would be further reduced by the introduction of one index bond. The time has long passed when the evils or presence of inflation can be driven off by being exorcised. The prevailing judgment should be one of sober realism—a recognition that rises in the price level demand some sort of mechanism to assist at least one disadvantaged sector, the retired aged, to meet the exigencies of the situation.

(3) Drive Government savings bonds off the market

The Treasury Department has indicated that its present program of selling Government savings bonds might be seriously and adversely affected if the proposed issue came into being.

However table V indicates that the campaign to promote the sale of savings bonds had not been an overwhelming success. There are no persuasive reasons for wage earners and middle-income salaried persons to purchase these bonds in light of their eroding purchasing power. If these securities have not been accorded a favorable reception—and table V indicates that at no time in the 10 years between 1950–60 have the sales exceeded the redemptions (although it must be recognized that the redemption values include earned interest)—then perhaps other measures should be entertained.

But regardless of the factors influencing the sale of savings bonds, it cannot be said that the introduction of a constant purchasing power bond would be responsible for the failure or demise of the existing savings bond program. This may well have already occurred. Furthermore, there is no valid reason why the Treasury Department should favor one kind of bond issue over another, if it appears that the index bond may achieve all the Treasury's objectives which the savings bond program has not. There is no valid reason for the Treasury to subscribe to a "chosen instrument" theory to combat the ills of inflation. If another instrument may accomplish, in part, this goal, it should be seriously considered.

(4) Would it be marketable?

Some authorities have expressed doubts as to whether this kind of an issue could be marketed.

To the arguments made that since the proposed bond would not be negotiable and the compensating feature would not become operative until maturity, it could not be sold. The answer might be made that the issue could always be redeemed to reflect current value if the bond was issued on a discount basis, and further that the Secretary of the Treasury could be authorized to promulgate appropriate regulations to meet personal emergencies which might grant partial recognition of the indexing feature.

The bond should be marketed easily to individuals if an adequate informational campaign were launched to explain this new instrument and its apparent advantages for persons in the prime labor force—those between the ages of 25 to 40. By letting them know of the merits in planning for retirement and the advantages in maintaining intact asset value as well as a form of income security, there should be no difficulty in getting widespread individual investor acceptance

of constant purchasing power bonds. This paper has already alluded as to why for many individuals this form of savings may be more desirable than investing in the stock market or mutual funds to meet the threat of inflation.

In view of the fairly widespread application of escalation clauses in collective bargaining agreements since 1950, more workers and lower income persons are aware of and subscribe to the index principle and would be willing purchasers of the proposed bond. There is no reason to doubt the marketability of the issue to individuals. Of course, their ability to purchase this or any other kind of security will be a function of their income which is another but related problem.

With regard to institutional investors, Governments always loom large in the investment policies and programs of the professional managers of pension and profit-sharing plans. There is a little reason to doubt that this new issue would receive respectable attention providing the yield on this proposed issue was comparable to those of other Government issues. The professional managers of pension and welfare funds interviewed during this study indicated there had been a gradual diminution in the holdings of Governments in their portfolios. They also stated they always invested a part of their funds in Federal issues and that a constant purchasing power bond would attract interest if the yields were comparable. They also pointed out that certain Federal securities, such as FNMA issues, yielded a return of between 4.25 and 4.44 percent and by compounding this return for 15 years, actually guaranteed the return of the capital intact. Nevertheless, they admitted that, regardless of their own personal views as to the desirability of an index bond, in their professional capacities, they would have to give careful consideration to the possibility of adding it to their portfolios.

(5) This bond would offer severe competition to other fixed money claims

The argument has been stressed that this bond, if issued, would cause people to give up or not to purchase in the future such fixed money claims as mortgages, insurance policies, regular Government bonds, etc. The inability to float these claims would have severely adverse effects on savings banks, insurance companies, and other financial institutions which underwrite or sell these fixed money claims.

The reply to this allegation is that it is unlikely that an individual investor would put all his assets in this one proposed instrument. People who hold fixed money claims would continue to hold and purchase them.

And as a matter of fact such people would continue to have the same interest in seeing the dollar remain stable. It does not follow that merely because a person invested in constant purchasing power bonds, he would lose interest in maintaining the value of regular bonds, savings accounts, and other fixed claim investments. In addition, the proposed legislation limits the amount that could be purchased in a year and in total.

(6) Political pressure would be exercised on index

The issuance of an index bond would increase political pressures to insure that the index reflected or would reflect desired changes. There would be too much at stake to permit the selected index to function purely as a statistical indicator.

It must be noted that the CPI already reports significant economic changes for use in many collective-bargaining agreements and other important economic relationships. While it is true that the CPI and other indexes might be subject to manipulation, the standards of due process and basic integrity in the processes of our National Government are fairly good guarantees that there would be no manipulation. Other governments which have issued index bonds appear to have handled the matter of the integrity of the index without too much difficulty.

In France there is extensive use of index bonds both in the private and public sectors of the economy; the nationalized industries usually select indexes which are external to the enterprise and are usually national or industrial averages. In the private sector, corporate issuers are reluctant to rely on an index computed by a national agency and prefer an index which they themselves compute and which more closely reflects the economic performance of their issues.[18]

But on balance, the problem of indexing should not prove an insuperably difficult task either statistically or politically.

(7) *Bonds will not attract support from low- and middle-income persons*

The argument is frequently advanced by those who are the most sympathetic to this concept of indexing that the record of savings does not support the theory that lower- and middle-class income persons will either be able to purchase, or if they do, hold these index bonds to maturity, and that they will have more appeal to the upper income brackets who already have and can engage in various inflation hedges.

The rejoinder to this criticism is that these index bonds possess the feature or attribute which was lacking in ordinary savings bonds and, therefore, the past record of sales and redemptions of that security should not necessarily be too persuasive. With proper and extensive informational programs to inform the group whom this kind is primarily designed to protect, a different record of sales could be made.

The issuance of a bond which would offer a degree of protection against inflation would be an incentive for an individual to save, and also, as in the case of this particular bond proposed by Senator McNamara, induce savings through a collectively bargained labor-management pension plan. Such collective bargaining plans (as well as other employee pension plans) would encompass large numbers of low-income persons.

Concerning the argument that this would be a refuge for upper income bracketed individuals, the limitation on the amount which may be bought in a year or in total, would be an effective bar to large-scale purchases.

(8) *Extension of pension or profit-sharing plans offering cost-of-living adjustments*

There are two basic objections offered by persons interviewed regarding the provision to make the index bonds available to certain institutional investors who would then be required to offer pension- and profit-sharing plan payments on a cost-of-living basis. Fundamentally it was the psychological fear that the Government was proclaiming publicly that it was abandoning the fight against inflation. Secondly, they believed it was not feasible to seek to provide pension

[18] Rosental, p. 523.

payments on an adjusted basis. The majority view reflected the split in the financial community over the variable annuity issue. Views were expressed that variable payments could not be made even if the investment of premiums were in common stocks rather than fixed income securities. It was further stated that this proposed index bond would demand a drastic change in the present administration of pension funds.

Many pension fund administrators are aware of pressures being exercised by some collectively bargained plans for paying adjusted amounts based on the changes in the cost of living. They stated it was not possible to maintain an actuarially sound pension plan on an adjusted basis.

It might be stated in reply that certainly some variable annuity pension plans would be very interested in the proposed bond. In the case of life insurance companies which do not segregate their assets for the pension plans they administer, they could easily find such a bond an attractive issue, and it also would be well suited for profit-sharing plans which do not have to return a fixed amount at stipulated periods. But even the fixed income pension plans would be interested in participating, for it would enable them to meet a development which is likely to become more pronounced in the future. A proposal of this nature was presented by the UAW in its 1961 collective bargaining negotiations with Ford Motor Co. The issuance of the proposed index bond would do much to quiet the fears of pension fund managers that it is not possible to administer only a few variable payment pension funds on an actuarially sound basis. Having a sound investment source available like a Federal Government security to assist them in meeting their obligations to the beneficiaries of the plans might encourage these managers to consider variable payment pensions in a new light.

On balance, the introduction of this proposed bond would be a salutary influence in the right direction toward meeting one of the more compelling problems in the area of retirement income security that is likely to face our society in the years to come.

SUMMARY

This review of the experience of various countries in utilizing constant purchasing power bonds and assessment of the reasons advanced in this country against its issuance domestically, indicate that this proposal is receiving and merits serious attention. While the plan may appear novel, the growing seriousness of the problem of providing means or plans to enable our constantly expanding population of aged or aging Americans to obtain income security calls for imaginative and resourceful techniques and action.

APPENDIXES

APPENDIX A

Persons Interviewed in Course of This Study

Alexander Bookstaver, financial adviser to AFL–CIO, Washington, D.C.
Dr. Gerhard Colm, chief economist, National Planning Association.
J. Dewey Daane, Assistant to the Secretary, Treasury Department.
Esmond B. Gardner, vice president, Chase Manhattan Bank, New York, N.Y.
Anthony Kersches, Manufacturers Trust Co., New York, N.Y.
Prof. Duncan B. MacIntyre, New York State School of Industrial and Labor Relations, Cornell University, Ithaca, N.Y.
Dr. J. W. McConnell, dean, New York State School of Industrial and Labor Relations, Cornell University, Ithaca, N.Y.
Prof. Robert Raimon, New York State School of Industrial and Labor Relations, Cornell University, Ithaca, N.Y.
Dwight Sargent, director of personnel, Consolidated Edison Co., New York, N.Y.
R. Duane Saunders, Director, Office of Debt Analysis, Department of the Treasury.
Dr. Herbert Stein, Committee for Economic Development, Washington, D.C.
Robert Tilove, senior vice president, Martin E. Segal & Co., Inc., New York, N.Y.
Henry W. Wickenhiser, vice president, U.S. Trust Co., New York, N.Y.

APPENDIX B

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APPENDIX C. ANALYSIS AND TEXT OF S. 2181

Analysis of the McNamara Purchasing Power Bond Bill

Section 1 of the bill adds a new section, section 26, to the Second Liberty Bond Act.

Subsection (a) of the new section authorizes and directs the Secretary of the Treasury to issue purchasing power bonds subject, unless otherwise provided for in the bill, to the provisions of existing law.

Subsection (b) defines the pension and profit-sharing plans, and the institutions which are eligible to purchase the bonds, and requires that, in case of profit-sharing and pension plans, periodical adjustments be made in the paid-out benefits for the purpose of compensating for increases in the cost of living.

Subsection (c) states that the bonds to be issued—

1. May be interest-bearing (coupon) or discount type, or a combination of the two.
2. Shall mature in 20 years.
3. May be redeemed before maturity.
4. Shall bear interest rates identical with the going rate of interest on ordinary savings bonds.
5. Their denominations shall be geared to the needs of the purchasing individuals and institutions.
6. May be retained after maturity.
7. Shall be nontransferable.
8. May be purchased only by or for individuals and eligible institutions.

Subsection (d) limits the amount of purchasing power bonds that may be purchased by individuals to $10,000 annually, and the total holdings of individuals to $60,000 (both figures computed on the basis of purchase price); it also limits the purchase by, and holdings of, eligible institutions to amounts required to back their obligations under the pension and profit-sharing plans under their management.

Subsection (e) provides for the calculation of the cost-of-living adjustments in the face value of the bonds; it also specifies that such adjustments are to be made in case of individual holders only if the holders have either reached the age of 60 or have become permanently disabled, and in case of institutions only if the bonds are held to maturity or, if redeemed before maturity, if such redemption is necessary to enable the institutions to meet their obligations under the plans under their management.

Section 2 of the bill states that, for purposes of calculating the statutory debit limit, the face amount of the bonds—before cost-of-living adjustments—shall be considered the amount outstanding.

[S. 2181, 87th Cong., 1st sess.]

A BILL To assist individuals to obtain retirement benefits protected against increases in the cost of living by providing for the issuance by the Treasury of a new series of bonds containing adjustments, under certain conditions, in maturity and redemption values to compensate for increases in the cost of living which may be purchased by individuals and eligible institutions

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Second Liberty Bond Act, as amended, is amended by adding at the end thereof the following new section:

"SEC. 26. (a) The Secretary of the Treasury is authorized and directed to issue, for purchase only by individuals and eligible institutions (as defined in subsection (b)(2)), United States bonds which shall, in the manner and to the extent provided by this section, compensate the holders of such bonds for increases in the cost of living occurring after the date of purchase of such bonds. The various issues and series of bonds issued under the authority of this section shall be in such forms, shall be offered in such amounts (subject to the limitation imposed by section 21 of this Act), and shall be issued in such manner and subject to such terms and conditions consistent with this section, as the Secretary of the Treasury may from time to time prescribe. Except as otherwise provided in this section, bonds issued under authority of this section for purchase by individuals shall be subject to all provisions of law (including this Act) applicable in the case of bonds issued under authority of section 22 of this Act, and bonds issued for purchase by eligible institutions shall be subject to all provisions of law (including this Act) applicable in the case of bonds issued under authority of the first section of this Act.

"(b) For purposes of this section—

"(1) The term 'approved pension or profit-sharing plan' means a pension plan, or a profit-sharing plan the primary purpose of which is to provide retirement benefits for employees and benefits for their beneficiaries, which—

"(A) meets the requirements of sections 401(a) (3), (4), (5), and (6) of the Internal Revenue Code of 1954, and

"(B) is approved by the Secretary of the Treasury, under regulations prescribed by him, as providing satisfactory periodical adjustments of benefits under such plan to compensate for increases in the cost of living.

The adjustments under subparagraph (B) must be required under the plan to be made at least annually and not more frequently than quarterly.

"(2) The term 'eligible institution' means—

"(A) a trust described in section 401(a) of the Internal Revenue Code of 1954 and exempt from tax under section 501(a) of such Code which is a part of a pension or profit-sharing plan of an employer, and

"(B) a life insurance company (as defined in section 801(a) of the Internal Revenue Code of 1954) which has obligations under contracts described in sections 805(d)(1) (A), (B), (C), and (D) of such Code.

"(c) Bonds issued under authority of subsection (a)—

"(1) may be issued on an interest-bearing basis or, in the case of bonds issued for purchase by individuals, on a discount basis or on a combination interest-bearing and discount basis;

"(2) shall mature twenty years from the date as of which issued;

"(3) shall be sold at such price or prices, and may be redeemed before maturity, upon such terms and conditions as the Secretary of the Treasury may prescribe;

"(4) shall provide an interest rate (or in the case of bonds issued at a discount, an investment yield) which is the same as that provided for savings bonds issued under section 22 of this Act;

"(5) shall be issued in such denominations, expressed in terms of their maturity values, as the Secretary of the Treasury from time to time determines fulfills the needs of individuals and eligible institutions;

"(6) may, under regulations prescribed by the Secretary of the Treasury with the approval of the President, be retained after maturity by their owners and continue to yield interest at rates consistent with the provisions of paragraph (4);

"(7) shall be nontransferable; and

"(8) may be purchased only by or for individuals and eligible institutions.

"(d)(1) The amount of bonds issued under authority of subsection (a) which may be purchased by or for an individual in any one year shall not exceed $10,000 (computed with respect to the issue price). The total amount of such bonds which may be held by or for an individual at any time shall not exceed $60,000 (computed with respect to the issue price).

"(2) The total face amount of bonds issued under authority of subsection (a) hich may be held at any time by an eligible institution shall not exceed—

"(A) in the case of an eligible institution which is a trust described in section 401 (a) of the Internal Revenue Code of 1954, an amount (determined under regulations prescribed by the Secretary of the Treasury) necessary to meet obligations of the trust under an approved pension or profit-sharing plan; and

"(B) in the case of an eligible institution which is a life insurance company, an amount equal to the pension plan reserves which are allocable to contracts described in sections 805(d) (1) (A), (B), (C), and (D) of the Internal Revenue Code of 1954 which are purchased or provided under an approved pension or profit-sharing plan.

"(e)(1) Subject to the conditions prescribed in paragraphs (2) and (3), upon the surrender at or after maturity, or upon redemption before maturity, of a bond issued under authority of subsection (a), of the Consumer Price Index (as published by the Secretary of Labor) for the month preceding the month in which such bond is surrendered or redeemed exceeds the Consumer Price Index for the month in which such bond was issued, there shall be paid to the holder of such bond (in lieu of the amount otherwise payable with respect to such bond without regard to the provisions of this paragraph) an amount determined—

"(A) by multiplying the amount otherwise payable with respect to such bond by the Consumer Price Index for the month preceding the month in which such bond is surrendered or redeemed, and

"(B) by dividing the product obtained under subparagraph (A) by the Consumer Price Index for the month in which such bond was issued.

"(2) Paragraph (1) shall apply with respect to a bond purchased by or for an individual only if such individual—

"(A) before the month in which such bond is surrendered or redeemed, has attained the age of sixty years or has died after attaining the age of sixty years, or

"(B) after the purchase of such bond, has become disabled or has died after becoming disabled.

For purposes of this paragraph, in the case of a bond purchased by or for two individuals as joint owners or as coowners, any condition prescribed in subparagraph (A) or (B) shall be satisfied with respect to such bond if such condition is satisfied by either of such individuals. For purposes of subparagraph (B), an individual shall be considered to be disabled only if he is unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration, and if proof of the existence thereof is furnished in such form and manner as the Secretary of the Treasury may require.

"(3) Paragraph (1) shall apply with respect to a bond purchased by an eligible institution only if—

"(A) such bond is held to maturity, or

"(B) in the case of a bond redeemed before maturity, the eligible institution establishes to the satisfaction of the Secretary of the Treasury that such redemption is necessary to enable the eligible institution to fulfill obligations described in subsection (d)(2)(A) or contracts described in subsection (d)(2)(B)."

SEC. 2. Section 21 of the Second Liberty Bond Act, as amended, is amended by adding at the end thereof the following new sentence: "For purposes of this section, the face amount of obligations issued under authority of section 26 shall be determined without regard to the provisions of subsection (e) of such section."

O