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QUESTIONS ON MONETARY POLICY AND DEBT MANAGEMENT

PREPARED FOR THE

STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS

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STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS

(Pursuant to S. Con. Res. 13, 86th Cong., 1st sess.)

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FOREWORD

In connection with its responsibilities under the Employment Act of 1946, the Joint Economic Committee has had a continuing interest in the formulation and application of monetary policy and in the problems of debt management. Intensive studies were conducted in 1949 by the Subcommittee on Monetary, Credit, and Fiscal Policies, under my chairmanship, and in 1951 by the Subcommittee on General Credit Control and Debt Management under the chairmanship of Representative Patman, who is the present vice chairman of the Joint Economic Committee. Since these studies, the committee has, in conjunction with its annual reports on the President's report or on special occasions, attempted to keep abreast of current problems in this area.

The Joint Economic Committee is now conducting a large-scale study of employment, growth, and price levels. As part of this study the committee held public hearings at which the Secretary of the Treasury, the Chairman of the Federal Reserve Board and other officials of the System, and five dealers in Government securities testified on current monetary and debt management policies.

As a supplement to these hearings the Joint Economic Committee has submitted a series of questions to the individuals and organizations appearing at the hearings, and to the other 12 firms dealing in Government securities. The questions have been designed to present the general setting for current monetary policy, a comprehensive view of the nature of the market for Federal Government securities, and the role of this market in monetary policy and debt management.

The questions were submitted to the respondents during the week of August 16. Because of widespread interest in the Congress, and the press in the questions themselves, they are reproduced herewith prior to receiving the answers. The answers are to be submitted by the end of September and are expected to be published by the committee during the month of October, as part of the materials upon which the committee will be basing its report which is to be submitted to Congress by January 30, 1960.

PAUL H. DOUGLAS, *Chairman.*

AUGUST 31, 1959.

QUESTIONS ON MONETARY POLICY AND DEBT MANAGEMENT

QUESTIONS FOR THE SECRETARY OF THE TREASURY

I. MONETARY POLICY AND ITS RELATION TO DEBT MANAGEMENT

A. Has too much reliance been placed on monetary restrictions and not enough on budgetary surpluses in recent years to achieve the goals of economic stabilization and sound debt management?

B. Does the Treasury participate in the formulation of monetary policy? If so, in what ways? Is any such participation sufficient to insure coordination of monetary, budgetary, and debt management policies for achieving public economic policy objectives?

II. THEORY AND PRACTICE OF DEBT MANAGEMENT

A. Should the Treasury follow the policy of issuing long-term obligations during periods of economic expansion and short-term obligations during periods of economic contraction? Alternatively, should the Treasury manage the debt with the objective of minimizing interest costs?

B. In view of the postwar history, can the average maturity of the debt be lengthened appreciably during periods of economic expansion? during periods of economic contraction?

C. Is the issuance of short-term debt during periods of economic expansion inflationary? If so, why?

D. Why has the Treasury somewhat lengthened the average maturity of the debt during periods of recession?

E. What are the arguments for and against assigning the entire task of debt management to the Federal Reserve System, completely separating budgetary policy and debt management policy?

F. Would the Treasury favor limiting the number of types of Treasury securities currently being issued? For example, the Treasury might issue only bonds; or only bills; or consols only.

III. MARKETING THE PUBLIC DEBT

A. To what extent does the Treasury use moral suasion in marketing its debt? What type(s) of moral suasion is (are) used?

B. On balance, would debt management costs be reduced by the Treasury's maintaining a larger cash balance than at present so as to minimize the need for having to come to the market at inopportune times?

C. Could the Treasury undertake its financings more frequently and in smaller volume in order to make it easier for the market to absorb its issues? Could "tap" issues be used for this purpose?

D. Would it be desirable for the Federal Reserve to use its direct purchase authority of section 14(b) of the Federal Reserve Act, as amended, to finance an increase in the Treasury's cash balance in order to facilitate Treasury management of the debt?

E. (1) Would it be possible to reduce the Treasury's debt management problems by making greater use of the auction technique in connection with the issuance of intermediate- and long-term securities?

(2) If the auction technique were feasible and if all Treasury debt financing employed this technique, would there be less constraint on the Federal Reserve in discharging its monetary policy responsibilities?

(3) Does the Treasury under present marketing arrangements pay a premium interest rate so as to compensate those who buy on the primary distribution (dealers and commercial banks) for resale on a secondary distribution basis?

(4) Might there on occasion be an overpricing of an issue? If so, how does this arise? Is it possible that the risk of such a development could ever be entirely eliminated? In particular, would the auction technique eliminate this risk?

F. How has the Federal Reserve's "bills only" policy influenced the Treasury's marketing problem? Has this policy made the marketing problem easier by strengthening the market for Treasury securities, and thereby making it easier for the market to absorb large issues? Or has the "bills only" policy made the marketing problem more difficult; for example, by denying to the Treasury the possibility of obtaining temporary underwriting support?

Is it possible for the Treasury to use its own trust accounts to this end, or in some other way provide itself with temporary underwriting support?

G. Are present arrangements for the secondary distribution of Treasury securities adequate? Do dealers and commercial banks provide an adequate network for placing securities with final holders?

If not, is there some better arrangement? For example, would making use of the Federal Reserve as a distribution system be of help?

H. How does the Treasury conduct its advisory consultations concerning debt operations with the various representatives of the financial community? For example, what kinds of institutions and individuals are called upon for advice? And how stable is the composition of these various advisory groups? Are specific recommendations of any sort made by these groups, and, if so, is a record kept? To what extent does the Treasury get conflicting advice from its various advisers? When there are differences, how, if at all, are they reconciled?

To what extent has the Treasury been guided in its debt operations by the advice of these advisory groups? To the extent that the advice provided is adhered to, does it (1) tend to result in operations which minimize the interest cost to the Treasury, or (2) tend to result in operations which contribute directly to maintaining economic stability, or (3) both? In any case, why?

I. To what extent can the Treasury, without disrupting the bond market and without support from the Federal Reserve, obtain additional funds by borrowing at short term by raising short-term interest rates?

J. Is the market for Treasury issues largely limited to current cash flows, or do Treasury offering terms sometimes induce a readjustment of existing portfolios to accommodate the new issues?

If the market for new Treasury issues is largely limited to current cash flows, to what extent are these flows earmarked for particular maturity lengths and for particular degrees of risk? How is such earmarking to be accounted for?

IV. THE COMPETITIVE POSITION OF TREASURY SECURITIES

A. Has the competitive position of Treasury securities worsened in recent years? If so, which factors account for this development? Has the competitive position of Treasury securities been affected by recent price behavior of Treasury intermediate- and long-term issues? By growth in amount outstanding of federally guaranteed and agency issues?

B. There are several possibilities, listed here, for correcting the alleged decline in the competitive position of Treasury issues. Which of the following alternatives would be most desirable and acceptable in improving the competitive position of Treasury securities:

(1) Remove the present ceiling on interest rates payable on issues with maturities over 5 years?

(2) Institute secondary reserve requirements, of a variable nature, which can then be used to put Treasury securities permanently into commercial banks?

(3) Raise reserve requirements of member banks and offset this potential reduction in the money supply by Federal Reserve purchases of Treasury securities?

(4) Offer a type of security which would compete directly with savings institutions (savings and loan associations, mutual savings banks, etc.) for the current savings of the household sector?

(5) Abandon the several types of guarantee programs—guaranteed and insured mortgages, guaranteed non-Treasury securities issues, guaranteed deposits of commercial and savings banks, and shares of savings and loan associations—or else require affected lending institutions to take stipulated amounts of Government securities?

V. PERFORMANCE OF THE MARKET FOR TREASURY SECURITIES

A. What are the criteria according to which the performance of the market for Treasury securities should be judged? What is satisfactory market behavior?

B. If market performance has been unsatisfactory, what factors account for it? Are there any specific remedial steps which could be taken to improve market performance?

QUESTIONS FOR THE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I. GENERAL MONETARY POLICY

A. The proper degree of monetary restraint

(1) Has monetary policy had to assume too much of the burden of economic stabilization in recent years? at the present time? Would greater reliance on fiscal policy, and less on monetary policy, better serve to achieve public economic policy objectives?

(2) Is the present level of interest rates sufficiently high to limit expansion of total spending to noninflationary proportions? Is the present level of interest rates serving to check spending for consumer durable goods and for plant and equipment?

B. The impact of monetary policy

(1) Does a restrictive monetary policy, as reflected by high interest rates and tight bank reserve positions, equally affect all sectors of the economy?

Does a restrictive monetary policy have a greater impact on any of the following sectors than on others:

(*a*) State and local governments;

(*b*) Small business;

(*c*) Business in competitive (as opposed to oligopolistic) industries;

(*d*) The residential construction industry;

(*e*) Industries, such as public utilities, with long planning horizons?

(2) Have any empirical studies been undertaken in the Federal Reserve System in recent years to determine whether restrictive monetary policies affect some types of activity more than others? If so, what are the results of these studies? If not, are any such studies now planned? Can the flow-of-funds analysis which has been developed at the Board of Governors be used in this connection?

C. The mix of weapons of monetary control

(1) Reserve requirements:

(*a*) Has Federal Reserve policy aimed at a secular decrease in reserve requirements in the postwar period? In the last few years? If so, what objectives are sought? Is a change in the level of bank profits one of these objectives? Would lower reserve requirements make it possible for the monetary authority more readily and effectively to control the member bank reserve base?

(*b*) Does the Federal Reserve System, in carrying out its responsibilities for monetary policy, affect member bank earnings? If so, has the discharge of this responsibility permitted an adequate level of bank earnings over the postwar period as a whole? At the present time?

(*c*) Is the logical limit of the policy of minimum intervention and the associated "bills only" policy that all changes in member bank reserves should be carried out by changes in reserve requirements? If so, why hasn't the "bills only" policy been carried to this limit?

(2) Open market operations, with special reference to "bills only":

(*a*) The explanation provided in the report of the Ad Hoc Subcommittee on the Government Securities Market is quite generally cited as the "official" explanation for the "bills only" policy. Has this position changed?

(*b*) With the benefit of hindsight, should there have been more frequent deviations from the "bills only" policy than in fact occurred since 1953?

(3) Selective credit controls: Are standby consumer credit controls necessary at the present time? Would any of the following standby credit controls be desirable at the present time?

(*a*) Direct control of bank lending?

(*b*) Secondary reserve requirements?

(*c*) Direct control over the terms of mortgage lending?

(*d*) Direct control of corporate and State and local securities issues?

(4) Control of financial intermediaries: Would it be desirable to give the Federal Reserve System or some other Federal agency authority to control the lending activities of institutional lenders, e.g., life insurance companies, mutual savings banks, savings and loan associations? If so, should such authority be on a standby basis? What specific controls would be desirable?

II. DEBT MANAGEMENT

A. Do the Treasury's debt management operations hamper the execution of monetary policy? If so, is this hindrance of major significance? If so, are there ways of conducting debt operations so as to minimize this interference?

B. To what extent can the Treasury, without seriously affecting the bond market and without support from the Federal Reserve, obtain additional funds by borrowing at short term by paying short-term interest rates?

C. Is the market for Treasury issues largely limited to current cash flows, or do Treasury offering terms sometime induce a readjustment of existing portfolios to accommodate the new issues? Why?

If the market for new Treasury issues is largely limited to current cash flows, to what extent are these flows earmarked for particular maturity lengths and for particular degrees of risk? How is such earmarking to be accounted for?

D. *Marketing the public debt*

(1) Private underwriters provide their own underwriting support for issues they market. In view of the fact that its issues typically are larger than private issues, doesn't the Treasury need such underwriting support? If such support is sometimes necessary, should the Treasury provide this support or should the Federal Reserve provide it?

(2) What are the arguments for and against assigning the entire task of debt management to the Federal Reserve, completely separating budgetary policy from debt management policy?

E. *Theory of debt management*

(1) Should the Treasury follow a policy of issuing long-term obligations during periods of economic expansion and short-term obligations during periods of economic contraction?

Alternatively, should the Treasury manage the debt with the objective of minimizing interest costs?

What other considerations determine the choice of maturity when new securities are to be issued?

(2) Is the issuance of short-term debt during periods of economic expansion inflationary? If so, why?

III. THE PERFORMANCE OF THE MARKET FOR TREASURY SECURITIES

A. From the viewpoint of aiding the conduct of an effective monetary policy, should the market for Treasury securities be so organized as to make it possible for transactions of relatively large volume to take place with only small price changes? Or would it be better if the market were so organized as to require relatively large price movements, even for transactions of small volume? Or does the best arrangement lie somewhere in between these two extremes? If so, where?

B. Does the discharge by the Federal Reserve System of its responsibility for controlling the money supply seriously affect the normal functioning of the market for Treasury securities? Does it hamper debt management operations? Are the characteristics of the market for Treasury securities such as to limit the Federal Reserve System in the discharging of its responsibility?

C. Has the performance of the market for Treasury securities, as measured by price volatility, been satisfactory in the period since mid-1953? Has this performance been better than in the period prior to mid-1953?

D. What criteria other than price volatility should be used in evaluating market performance? According to these other criteria, has the market for Treasury securities performed satisfactorily in the period since mid-1953? In particular, has it performed better than in the period prior to mid-1953?

E. What is the outside limit on the amount of securities the Federal Reserve System can sell (or buy) per period of time without "disorganizing" the market for Treasury securities? On what factors does this outside limit depend? Has this outside limit increased, decreased, or remained constant over the last few years?

F. Has the "bills only" policy of the Federal Reserve System strengthened the market for Treasury securities in any way? If so, how? In particular, has this policy had the effect of reducing or of increasing the amount of speculative activity in this market? Why?

G. Would it be desirable to extend the Federal Reserve System's control over margin requirements to cover borrowing for the purpose of buying Treasury securities? Would this significantly reduce speculative activity in Treasury securities?

Would a reduction in speculative activity in Treasury securities be helpful from the point of view of conducting monetary policy and debt management in the interest of economic stability? For example, has such speculation actually hindered monetary policy, or countercyclical debt management policy, in the period since the accord?

QUESTIONS FOR DEALERS IN TREASURY SECURITIES

I. DEALER FUNCTIONS AND PRACTICES

A. What functions do dealers in Treasury securities serve?

B. Do dealers in Government securities have an obligation to stabilize securities prices in the very short run?

C. How do your inventories of Government securities (long-, intermediate-, and short-term) change when interest rates change? For example, when interest rates increase, do you increase your holdings of long-term securities, or decrease them, or perhaps even take a short position? Under what circumstances might one or the other of these reactions occur?

D. What factors other than interest rates influence the level of and changes in your inventories of Government securities?

E. Have your inventories (as measured by, say, monthly or quarterly averages) increased perceptibly in the period since mid-1953? On the average, are they larger now than they were in 1953–54? or than they were before 1953? or before the accord?

F. In financing your operations, to what extent do you rely on—

(1) Your own capital?
(2) Borrowing from New York City banks?
(3) Borrowing from banks outside New York City?
(4) Borrowing from State and local governments?
(5) Borrowing from nonbank financial intermediaries?
(6) Borrowing from nonfinancial corporations?
(7) Borrowing from the Federal Reserve System?
(8) Borrowing from other sources?

Has the relative importance of these sources changed in recent years? If so, how? Does the relative importance of these sources change in a systematic way as credit conditions change?

Do you experience difficulties in raising sufficient funds to finance your positions? If so, what changes in financing arrangements might improve the situation?

Do the present arrangements give a competitive advantage to bank dealers?

G. Have your operations in Government securities changed as a result of the introduction of the "bills only" policy? If so, how? In particular, has this policy strengthened the dealer function of your firm relative to the broker function?

H. In what way would your operations be affected if the Federal Reserve System were to deal in long-term Government securities? Would such operations create a more serious problem for dealers than Treasury debt operations in the long-term market?

II. TREASURY DEBT MANAGEMENT

A. Can the Treasury, without disrupting the bond market and without the support from the Federal Reserve, continue to obtain additional funds by borrowing at short term through raising short-term interest rates?

B. Is the market for Treasury issues largely limited to current cash flows, or do Treasury offering terms sometimes induce a readjustment of existing portfolios to accommodate the new issues? Why?

If the market for new Treasury issues is largely limited to current cash flows, to what extent are these flows earmarked for particular maturity lengths and for particular degrees of risk? How is such earmarking to be accounted for?

C. Would it be possible to reduce the Treasury's debt management problem in some measure by making greater use of the auction technique in connection with the issuance of intermediate- and long-term securities, and/or by issuing such securities more frequently, more regularly, and in smaller amounts?

D. Might the auction technique, assuming it is feasible, make it possible for the Treasury to increase the average maturity of the public debt during periods of inflationary pressure without impeding the Federal Reserve's ability to apply a restrictive monetary policy?

E. Would greater use of the auction technique in the marketing of intermediate- and long-term Treasury issues affect the stability of the market for Treasury securities in any appreciable way? Would it have any impact, in the longer run, on the behavior of interest rates?

F. Are there any other possible innovations in the area of debt management which might make it easier for the Treasury to issue securities appropriate to economic conditions (e.g., long-term issues during periods of inflationary pressure), in connection with either refundings or new money operations?

III. THE CHARACTER AND PERFORMANCE OF THE GOVERNMENT SECURITIES MARKET

A. Has the performance of the market for Treasury securities, as measured by price volatility, been satisfactory in the period since mid–1953? Has this performance been better than in the period prior to mid-1953?

What criteria other than price volatility should be used in evaluating market performance? According to these other criteria, has the market for Treasury securities performed satisfactorily in the period since mid-1953? In particular, has it performed better than in the period prior to mid-1953?

B. What meaning do you attach to the phrase "depth, breadth, and resiliency" as applied to the Government securities market?

C. What meaning do you attach to the adjective "disorderly" when it is used to describe the market for Treasury securities?

D. Assuming a specific market price quotation to start with, what magnitude of price change is necessary to effect a transaction in Treasury securities of a given volume? Does the magnitude of the required price change depend in any significant way upon—

(1) The type of security (e.g., long- or short-term) traded;

(2) The market conditions (e.g., credit ease or credit restraint) prevailing;

(3) The initial or current price of the traded security; or

(4) The state of expectations in the market?

E. What is the outside limit on the amount of securities the Federal Reserve System can sell (or buy) per period of time without "disorganizing" the market for Treasury securities? Upon what factors does this limit depend? Has this limit increased, decreased, or remained constant over the last few years?

F. Has the "bills only" policy of the Federal Reserve System strengthened the market for Treasury securities in any way? Has it increased the depth, breadth, and resiliency of the market as the 1952 report of the Ad Hoc Subcommittee on the Government Securities Market said it would? If so, how?

Has this policy had the effect of reducing or of increasing the amount of speculative activity in this market? Why?

Would it be desirable to extend the Federal Reserve System's control over margin requirements to cover borrowing for the purpose of buying Treasury securities? Would this significantly reduce speculative activity in Treasury securities?

Would a reduction in speculative activity in Treasury securities be helpful from the point of view of conducting monetary policy and debt management in the interest of economic stability? For example, has such speculation actually hindered monetary policy, or the issuance of long-term debt during boom periods, in the years since the accord?

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