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FINANCING PROGRAM

In view of the enormous amount of financing that the Treasury will have to do in the next few years, it is essential to formulate a general policy in regard to the character of the debt structure that it is proposed to build and the interest rates at which the funds should be obtained.

It will not be in the public interest, or in the long-time interest of the Treasury, to obtain funds at rates so low as to lead to serious consequences in other fields. A rate on open-market offerings that is too low will have the effect of discouraging purchases by individuals, insurance companies, trusts, endowments, and educational and philanthropic institutions. They will suffer from the low rates on their holdings of Government's and will tend to seek outlets in other securities. On the other hand, banks, having a large supply of idle funds, will tend to buy more of the Government securities in order to make up in volume of holdings for the decline in rates and to maintain earnings at a level sufficient to meet expenses.

Allowing rates to go too low, therefore, would tend to defeat the purpose of the Treasury to finance the maximum possible amount of its requirements through sales of securities to others than commercial banks: as the rate goes down others will buy less and banks will buy more Government securities. These purchases will swell the already

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excessove volume of deposits. The deposits, in turn, will add to the buying power pressing on the limited amount of goods available. They will be an inflationary factor.

Except for the fact that securities sold to banks require interest payments and do not add to bank reserves, the process of financing defense or war through the sale of Government obligations to the banks has the same economic effects as financing through the printing press. In either case fiscal needs are met by the creation of new money rather than by the use of money already in existence. In either case the result is inflation.

And ultimately inflation, aside from its other economic, financial and social consequences, results in a rapid rise in interest rates. Every inflation in history has been accompanied by high, sometimes by fantastic rates of interest. When the value of money is shrinking, when the amount of goods a dollar will buy is declining, holders of money are eager to exchange it for land or goods, but are reluctant to lend it, for fear that the buying power of the principal will decline. Others are eager to borrow in order to convert the proceeds into real values. In such circumstances a rise in interest rates is inevitable.

The best policy to pursue at present, pending necessary action to discourage further bank purchases of Government securities, would be to do no long-term open-market financing but to offer non-marketable securities and short-term guaranteed's supplemented if necessary by additional issues of bills. The present situation indicates the need of prompt action to

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limit the possible expansion of bank credit and then to stabilize a reasonable pattern of rates to be supported by the authorities.

The existence of several issues of savings bonds available on tap at 2 1/2 per cent suggests that this may be an appropriate rate around which to form such a pattern. It is a rate that would attract non-bank buyers and would fit into the structure that has become familiar for the past few months. The lower yields now prevailing in the market were brought about largely by bank purchases and could probably not be sustained without continued large-scale bank participation. To capitalize on the present lower level of long-time rates would tend to continue the spiral of lower rates, more bank purchases, more money, still lower rates, and ultimately - inflation.

A saving of interest to the Treasury from a further lowering of the coupon rate on long bonds to be issued now would be only a temporary saving which would in all probability result in greater difficulties and much higher costs for Treasury financing in the not too distant future. It would also increase the risk of subjecting the country to other consequences of inflation.

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