NEWS RELEASE

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FOR RELEASE TO A.M. PAPERS, WEDNESDAY, APRIL 1, 1964: PR-26-64 (3-30-64)

"The business expansion now 38 months old and on its way to becoming one of the longest on record, is due in large part to the new and bold program of managing the national debt adopted in January, 1961, when traditional remedies for meeting the recession were faltering," Joseph W. Barr, Chairman of the Federal Deposit Insurance Corp., said in a speech on "Debt Management -- The Record and Outlook" Tuesday at the annual dinner of the Chicago District, Illinois Bankers Association.

"Remarkable success of the program has dissipated most of the misgivings in the financial community which greeted its adoption," Mr. Barr said. The FDIC Chairman at that time was Assistant to the Secretary of the Treasury. As signposts of the progress of business expansion generated by the program, Mr. Barr listed:

(1) GNP - up 16 percent in constant dollars;
(2) Wholesale price index - unchanged;
(3) Industrial production - up 23 percent;
(4) Personal income - up 17 percent;
(5) Corporate profits - up 44 percent;
(6) Average length of the public debt - increased 15 percent;
(7) Ownership distribution of the public debt - improved with relative proportion of the total held by banks decreased by 11 percent;
(8) Gold outflow - from $1,669 million in 1960 to only $391 million in 1963; only $15 million in the last quarter of the year.

Debt management, Mr. Barr emphasized, is "no 'dry-as-dust' affair. If it is bungled, the economic strength of the country--at home and abroad --can be seriously damaged."

Reviewing what the new Administration faced in 1961, Mr. Barr said:

"Three problem areas clamored for attention. First, the debt structure was sorely out of balance with a huge volume of short-term maturities ever in need of refunding. Secondly, there was a persistent deficit in the balance of payments. Finally, the economic climate of the nation was such that the traditional remedies for the first two problems led to contradictions and inconsistencies.

"A few figures reflect the magnitudes involved in the management of a debt which was largely the heritage of World War II. In 1961 more than $85 billion of the marketable debt was due to mature in one year and behind this was another $58 billion moving down toward this category. Long-term debt--maturities beyond 20 years--accounted for only $11 billion, or 4 percent of the total. Moreover, the average maturity of the marketable public debt had declined rather persistently from 9 years and 5 months in June 1947 to as little as 4 years and 2 months at the postwar low in 1960, or by more than 50 percent.

"The first task was to cut down the size of the near-term maturities and to restore balance in the entire debt structure. The second major problem was our posture in the international balance of payments. The payments deficit in 1960 was $3.8 billion. In the previous 3 years, the nation had run a total deficit of $10 billion in its basic international accounts. Gold was leaving the country at a rate of more than $300 million a month. The third problem area was the economic climate of the nation in January 1961. Our economy was in the grip of recession. We found ourselves, in short, with new problems calling for new methods and policies.

"To meet this complex of difficulties there emerged a policy framework which took account of both the domestic and the international situation. Efforts were concentrated on encouraging and raising the level of private investment as an essential stimulant to recovery and basic economic growth.

"Close cooperation between the Federal Reserve System and the Treasury maintained general monetary ease to assure an ample supply of credit and attractive rates in the long-term capital market. This was designed to promote business and mortgage borrowing. At the same time, the short-term interest rate structure was shored up to levels which would discourage the outflow of funds by removing the attractiveness of competitive investment opportunities abroad--and yet not put undue upward pressure on our own long-term interest rates.

"Meanwhile, reduction of the FHA ceiling rates on insured mortgages, supported by FNMA mortgage purchases, eased mortgage credit and stimulated home-building. The Small Business Administration made its credit more widely available at lower cost. Advance refunding techniques has been an effective brake on inflation. It has made it possible to extend the maturity of the debt in sizable amounts and to offset the increased volume of Treasury bills that had to be sold for balance of payments reasons. Furthermore, so far as ownership of the debt goes, the policy of noninflationary finance has been pursued vigorously. Commercial banks have not been called upon to monetize the Federal debt."

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WEDNESDAY A.M., APRIL 1, 1964

DEBT MANAGEMENT - THE RECORD AND THE OUTLOOK

Address of

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at the

ANNUAL DINNER

of the

CHICAGO DISTRICT, ILLINOIS BANKERS ASSOCIATION

at the

Pick-Congress Hotel

Chicago, Illinois

Tuesday, March 31, 1964

DEBT MANAGEMENT - THE RECORD AND THE OUTLOOK

On January 31, 1961, the day I was sworn in as Assistant to the Secretary of the Treasury, problems of debt management facing the country and facing those charged with the responsibilities of Government were formidable indeed.

Three problem areas clamored for attention. In the first place, the debt structure was sorely out of balance with a huge volume of short-term maturities ever in need of refunding. Secondly, there was a persistent deficit in the balance of payments. Finally, the economic climate of the nation was such that the traditional remedies for the first two problems led to contradictions and inconsistencies.

A few figures will give you some idea of the magnitudes involved in the management of a debt which was largely the heritage of World War II.

In 1961 more than $85 billion of the marketable debt was due to mature in one year and behind this was another $58 billion moving down toward this category. Long-term debt--maturities beyond 20 years--accounted for only $11 billion, or 4 percent of the total. Moreover, the average maturity of the marketable public debt had declined rather persistently from 9 years and 5 months in June 1947 to as little as 4 years and 2 months at the postwar low in 1960, or by more than 50 percent.

The first task, of course, was to cut down the size of the near-term maturities and to restore balance in the entire debt structure. Too much short-term debt means a constant stream of sizable refundings. Thus, the Treasury lacks the option to avoid financing when market conditions are unfavorable. Moreover, this refunding pressure can inhibit the execution of monetary policies. Only for short intervals would the Federal Reserve be able to work out gradations of change, or shifts, in monetary policy freely and independently without risking undue disruption of the markets and of the Treasury financing operations as well.

Of course, for very short periods it is possible to defer debt extension, should this conflict with economic policy considerations. But this is like deferred maintenance on a railroad or on an industrial plant. If the deferral is continued too long, the deterioration may virtually preclude return to a sound debt structure. This is one reason why the debt managers have to seize every appropriate opportunity to extend maturities. And, I might add, this takes courage. Sizable and vocal elements in the community can always be depended upon to insist that any time is the wrong time to lengthen the debt.

Quite apart from the structure of the public debt, the second major problem facing the debt manager in 1961 was our posture in the international balance of payments. The payments deficit in 1960 was $3.8 billion. In the previous 3 years, the nation had run a total deficit of $10 billion in its basic international accounts. Gold was leaving the country at a rate of more than $300 million a month.

Confidence was shaken abroad in our willingness and our ability to maintain and defend the stability of the dollar.

Whatever debt management could do to remedy our balance of payments deficit clearly needed to be done. According to the classical prescription, the therapy for such a balance of payments deficit was simple enough: tighten money across the board with the objective of shrinking domestic business activity. But remember, this prescription assumes business excesses as chiefly responsible for the payments deficit.

Owing to the peculiar shape of our payments deficit problem in early 1961, and at present, it has not been amenable to the classical remedies, except at a cost to economic well being that is wholly unwarranted. This brings us to the third problem area--the economic climate of the nation in January 1961. Our economy was in the grip of recession. Almost 7 percent of the labor force was unemployed. Productive output was running $50 billion short of the economy's potential. Nearly one-fifth of manufacturing capacity lay in idleness. These conditions reflected not only the 1960 setback, but also some carry-over from the incomplete recovery from the recession of 1957-58. In other words, the problem was not only how to recover from one recession but how to recover from two. Moreover, acceleration of the economic growth rate would help to alleviate both our domestic and foreign problems.

Application of classical remedies for the balance of payments deficit in 1961, as today, would injure our domestic economy and would be of very dubious value on the international front. We found ourselves, in short, with new problems calling for new methods and policies. I think we can justly take a great deal of satisfaction in the ingenious techniques which have been devised and applied so successfully to redress the balance of payments without harming domestic business.

Now what was done and how have we fared? In the circumstances, the debt manager had to weigh goals one at a time against each of the others with due regard for possible conflicts. The need to restore balance in the structure of the public debt argued for issuing long-term securities. But such a policy carried the risk of raising long-term interest rates. This, in turn, could discourage businessmen from borrowing for investment in productive facilities, an essential for combating a recession. Furthermore, higher interest rates in the United States were indicated as a corrective for the balance of payments problem. Yet, the depressed condition of business domestically called for decided credit ease. Reduced cost and increased availability of credit were needed to stimulate confidence and encourage businesses to replenish their inventories and to pour new resources into plant and equipment. Then the familiar multiplier and acceleration effects could be expected to inject new life throughout the economy and reverse the prevailing downward trend.

To meet this complex of difficulties there emerged a policy framework which took account of both the domestic and the international situation. Efforts were concentrated on encouraging and raising the level of private investment as an essential stimulant to recovery and basic economic growth. Such investment in the longer run would increase the productivity of American industry and its competitive position in world markets.

Close cooperation between the Federal Reserve System and the Treasury maintained general monetary ease to assure an ample supply of credit and attractive rates in the long-term capital market. This was designed to promote business and mortgage borrowing. At the same time, the short-term interest rate structure was shored up to levels which would discourage the outflow of funds by removing the attractiveness of competitive investment opportunities abroad--and yet not put undue upward pressure on our own long-term interest rates.

Meanwhile, reduction of the FHA ceiling rates on insured mortgages, supported by FNMA mortgage purchases, eased mortgage credit and stimulated home-building. The Small Business Administration made its credit more widely available at lower cost.

In the financial community, there were many who doubted the efficacy of these multipurpose remedies. As they saw it, any efforts to compartmentalize the money market were doomed to failure. Fortunately, the remarkable success of the program has dissipated most of these misgivings. The business expansion which got underway in February 1961 is now 38 months old and on its way to becoming one of the longest on record. Our progress since 1960 speaks for itself.

GNP - up 16 percent in constant dollars.

Wholesale price index - unchanged.

Industrial production - up 23 percent.

Personal income - up 17 percent.

Corporate profits - up 44 percent.

Average length of the public debt - increased 15 percent.

Ownership distribution of the public debt - improved with the relative proportion of the total held by banks decreased by 11 percent.

Gold outflow - from $1,669 million in 1960 to only $391 million in 1963; only $15 million in the last quarter of the year.

The policy of maintaining stability in long-term interest rates while at the same time permitting short-term rates to rise--the so-called twist mechanism--has been much more successful than appeared likely at the outset. While short-term rates (Treasury bills) have risen approximately 50 percent since 1961, long-term rates and corporate bond rates are today actually lower than they were in February 1961. This is particularly significant. A builder, an industrialist, anyone in the economy who wanted to borrow money finally began to realize that he did not have to hedge or speculate on a merciless money market. Industrialists, municipalities, builders, and just plain people did not need to play the market to get the best rate, because an environment had been created which enabled a person in need of money to borrow on fair and reasonable terms.

And how about the impact of management policies on our debt structure and our goal of noninflationary finance? Skillful use of the advance refunding techniques has made it possible to extend the maturity of the debt in sizable amounts and to offset the increased volume of Treasury bills that had to be sold for balance of payments reasons. Furthermore, so far as ownership of the debt goes, the policy of noninflationary finance has been pursued vigorously. Commercial banks have not been called upon to monetize the Federal debt. From the year-end 1960 to 1963 the debt has risen about $20 billion, reflecting budget deficits in a period of inadequate economic growth. During the same period, commercial bank holdings have risen only $2 billion. This, it can be argued, is evidence of excessive conservatism. After all, savings deposits in commercial banks have grown at the rate of about $10 billion annually.

This leads to just one more thought that I should like to leave with you. It concerns investment in obligations of the United States. Sound and sensible Federal debt management needs the support and cooperation of the lending and investing institutions. I am appalled that many corporate treasurers and financial officers of other institutions do not invest a reasonable portion of their funds in United States bonds. Ordinary prudence dictates the wisdom of such commitments.

There is no safer investment than the obligations of the United States Government. These securities should not be forgotten in an era which has seen a fair number of sophisticated lenders absorb sizable losses because they paid too little attention to credit quality.

U. S. Government securities also have the virtue of being easily marketable. There is no question but that, even for the long-dated obligations, Federal bonds in multimillion dollar blocks can be sold on very short notice. The superior marketability will be appreciated by anyone who has ever tried to sell a comparable amount of corporate bonds.

Generally, the owner of Federal bonds has protection for a longer period against a call for payment prior to maturity than do corporate bondholders. The corporate bond investor is fortunate if he has five years of protection against a call for payment. Yet there are U. S. Government securities outstanding that cannot be called for twenty-three years. To be sure corporates offer a higher coupon but in recent months the spread between corporate and Treasury bond yields, 4-3/8 percent or even 4-1/2 percent against 4-1/4 percent, has been much too narrow to compensate for the greater vulnerability owing to the call date feature.

Commercial banks, of course, have investment problems that make it difficult for them to take full advantage of good buying opportunities in the bond market. They are always balancing the alternatives for the employment of funds--loans versus investments. Their investment record does not appear to be outstanding. But banks are primarily lending institutions and when loan demands are high, bond prices go down as yields go up. At such times, liquidation of bonds often is the chief source of funds needed to accommodate borrowing customers. Banks thus face a general dilemma. I do suggest however, that many banks could manage their bond portfolios more advantageously for themselves and for their stockholders by studying the choices with greater care than heretofore.

President Johnson has directed me to keep in mind the history of the Great Depression, and especially the years 1932-34. I understand this era only from what I have read. But I do remember distinctly the evening of May 28, 1962, the day of the largest stock market break in recent history. I sat in the office of the Secretary of the Treasury that night while we pondered what we could or should do and what should we say. We decided that we could not do anything, that we should not do anything, and that silence was the best statement. In retrospect

I am convinced that we were right. We did not and could not move to protect investors in a disorderly stock market. But the investors in the obligations of the United States are in a different position. They know that in this one sector of our financial system their Government can and should act to correct or prevent a disorderly market. Only holders of U. S. Governments are safeguarded by an assurance of this nature: no comparable securities are available in the world today.

To conclude, I would like to share with you a few personal observations on my three years in the U. S. Treasury. First of all, debt management to me is no "dry as dust" affair. If it is bungled, the economic strength of the country--at home and abroad--can be seriously damaged. Secondly, the credit of the United States is no petty partisan affair. Douglas Dillon, a Republican, has served Lyndon B. Johnson and John F. Kennedy faithfully and well for the past three years and has established the record which I have attempted to describe. But Douglas Dillon and Bob Roosa built on a sturdy framework of development and change that was bequeathed to us by Mr. Robert Anderson and Mr. Julian Baird. Thirdly, I am convinced that the pace of change in the nation and in the world today forces all of us in Government and all of you in the financial community to a constant appraisal of ways and means to meet new situations. And, finally, I am convinced that the U. S. Treasury is no place for a lazy or a complacent man. However, the credit of the United States is surely worth all the effort.