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THE GOVERNMENT - DEBT MANAGEMENT AND INTEREST RATES

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I. Stable Economic Growth

II. Fiscal Policy and Size of Debt

A. Debt primarily result of (Historical Chart Book p. 53)

1. Wars
2. Depression

B. Result of Congressional action

C. Changes

1. Automatic

(a) Receipts (Historical Chart Book
our tax system p. 60 profits
Calendar 1953 p. 73 G.N.P.)

Direct:	on individuals	35
	on corporations	19
	social insur.	7
	Total	70

(b) Expenditures

Social Security
Support programs

2. Discretionary

Too soon and too fast?

D. Compensatory fiscal policy

1. Idea
2. Limits

Legislative process
the calendar year

Powerful but not too flexible

E. At any rate debt managers are confronted with Results of Congress and its own previous decisions (on maturities)

III. Debt Management

Total debt	about	$275 billion
Non-market (includ. conv.)	120	"
YOUR INTEREST IS IN Market-ables	$155	"

Alternative Principles

A. Lowest interest cost

1. Obviously don't make any issue "too sweet"
2. But if this is BASIC objective
   a. Pressure on monetary authority - pre accord
   b. Also tends to rising interest structure
      so issue shorts - end with basket
      of quicksilver
3. Of course, it makes for ease of flotation

B. Tailor issues to investor demand

1. Nice sounding title
2. "Investor demand" not absolute (Ownership Chart pp.32-33)
   depends on relative attractiveness of issues
   e.g. corporate purchases of bills
3. What it comes down to is
   other borrowers would get what they want
   and Treasury would get what is left
   i.e. short-terms in boom and long-terms in depression
4. Aggravate the business cycle

C. Counter - cyclical

1. Intellectual appeal
   Vary liquidity to suit requirements of the economy
2. Some problems - need to predict economic future
   a. When do you issue long terms?
      (1) In prosperity! - But
         (a) Risk of failure - other demands are then strong
         (b) Means when rates are high also late prosperity issues will go to premium
         (c) Hard to explain to unsophisticated audience
      (2) In depression? No
         (a) for fear of aggravating depression but funds are plentiful then

b. What about economic conditions

When bonds mature?

(1) Make callable - but not for nothing

c. Illustrate with problem of savings bonds

3. Some hope if cycles remain moderate in amplitude

D. Balanced debt structure

1. Various meanings

a. Chicago idea of only cash + consols

b. Have funds flowing thru market in orderly way

Regular maturities -
say quarterly

E. Debt management can make ~~only~~ limited contribution

IV. Monetary Policy and Interest Rates

A. Alternative extremes

1. Pegged rates

- lose control over supply and availability of money and reserves

2. A predetermined supply of money

- lose control over cost or rates

3. Pegged market

"Free" market - part of it is market's expectation of what the F.R.S. and Treasury will do!

Flexible market

B. Flexible interest rates

1. Principles

a. Objective is not to achieve any <u>given</u> rate of interest or any <u>given</u> quantity of money

b. Influence supply, availability and cost so that "the supply and flow of credit is neither so large as to induce destructive inflationary forces nor so small as to stifle our great and growing economy."

(W. McC. Martin, April 9, 1954, Pullman, Wash.)

c. Open market operations, Discounting) availability

Reserve Requirements

2. Recent illustrations

a. The year 1953 as a whole

Directives to Executive Committee of F.O.M.C.

"Transactions for the System open market account should be with a view...

(1) March 4-5

"to exercising restraint upon inflationary developments."

(2) June 11

"to avoiding deflationary tendencies without encouraging a renewal of inflationary developments (which in the near future will require aggressive supplying of reserves to the market)"

(3) September 24

"to avoiding deflationary tendencies."

(4) December 15

"to promoting growth and stability in the economy by actively maintaining a condition of ease in the money market."

b. The story of the 3-1/4's

V. Government Policy, as a market factor

Based on economic conditions

Can't predict until we can predict what conditions will be