By Karl R. Bopp
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Summary

"~~Financial~~ Fiscal Policies and Their Effects on the Local Bank" was the topic discussed by Karl R. Bopp, Vice President, Federal Reserve Bank of Philadelphia, at the concluding session of the Forum series. Mr. Bopp analyzed the effects of alternative fiscal, debt management, and monetary policies. He pointed out that the major agencies in these fields are the Congress, the Treasury, and the Federal Reserve System.

The Congress is responsible for expenditures and receipts and therefore for the cash surplus or deficit of the Federal government. The Treasury takes up where the Congress leaves off. Decisions of earlier Congresses largely determine the management of the debt and decisions of the current Congress largely determine the rate of increase or decrease in the debt. A basic responsibility of the Treasury is the management of the public debt and the cash balance. The Federal Reserve System has primary responsibility for monetary policy. The policy of each of these major fiscal, debt management, and monetary agencies influences and is influenced in turn by those of the others.

Mr. Bopp then reviewed policies in each of these fields during the past eighteen months.

FISCAL POLICIES AND THEIR EFFECT ON THE LOCAL BANK

by Karl R. Bopp
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before the

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American Institute of Banking

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INTRODUCTION:

Economic Policy Commission of American Bankers Association has issued six monetary studies devoted to the topic for this evening.

New York A.I.B. held 6 meetings

Philadelphia A.I.B. held 4 meetings

You have asked me to cover in <u>one</u>.

I. <u>Financial policies directed toward economic stability</u>

A. Fiscal policy - Government receipts and expenditures

1. <u>Level</u> of Government expenditures
even with balanced budget

2. Alternative fiscal policies

a. Annually balanced budget
- impossibility in war

b. Amortize outstanding debt

c. Stagnation thesis and increasing debt

d. Compensatory

(1) General theory

(a) Cash surplus/deficit

(b) Tax structure

(2) Administration

(a) Predictability ?

(b) Legislative process

(c) Technical - the calendar year

(3) Built-in flexibility - automatic
discretionary

3. Best that can be hoped for
- that it will not seriously aggravate

B. Debt management policies

1. Amount of debt, maturities, and changes are <u>given data</u> for the Treasury

2. Alternative principles

    a. Lowest interest cost

        (1) Pressure on monetary authority

        (2) Temptation to shorts

    b. Tailor to investor demand would aggravate the cycle

    c. Compensatory

    d. Balanced debt structure

3. Timing the issuance of long-term bonds

4. Possible stabilizing effects through debt management exaggerated

C. Monetary policy

1. Principles

2. Instruments

    a. Discount rate and discount mechanism

    b. Open-market operations

    c. Changes in reserve requirements

3. Flexibility - but not all-powerful

II. <u>A review of the past 18 months</u>

A. The story in general

1. The economic development

    a. G.N.P. rose to peak of $371 billion in 2nd quarter of 1953

    b. Since then has slid off slowly, without acceleration, to $359 in first quarter of 1954

2. Financial policies

    a. Fiscal policy

        (1) Initial desire to balance budget

            (a) Cut expenditures

            (b) Maintain most taxes

        (2) As weakness developed

            (a) More tax relief including excise cuts

b. Debt management
  (1) Lengthen the debt
    - April 8th announcement of the 3-1/4's
  (2) Now don't want to absorb long-term funds from local Governments or private borrowers

c. Monetary policy
  (1) Requirement to report on actions taken
  (2) Successive directions of F.O.M.C. to Executive Committee: "Transactions for the System open market account should be with a view...
    (a) March 4-5
      "to exercising restraint upon inflationary developments."
    (b) 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)."
    (c) September 24
      "to avoiding deflationary tendencies."
    (d) December 15
      "to promoting growth and stability in the economy by actively maintaining a condition of ease in the money market."

B. It doesn't work out so smoothly in detail - the 3-1/4 story

1. Background

  a. March 1953 - ascertaining the market
    - underwriting ?
  b. April 8 - preliminary announcement
    $1 billion + F + G
  c. April 9 - Treasury announces it will need
    $2 billion through June 30
  d. April 11 - reactions
    Porter
    Goldsmith
  e. April 13 - Circular of terms
    Martin Detroit speech

Illustrative reactions to preliminary announcement:
Goldsmith letter of April 11, 1953: Heading - "New 3-1/4's expected to be heavily oversubscribed and to go to substantial premium."
Porter letter of April 11, 1953: "We believe this first issue of 30-25 year 3-1/4% bonds will move to a substantial premium in the open market."

f. April 14 - issue closed - open one day

"Announcement of allotments will probably be made Friday, April 17"

Subscriptions	$6 billion
Padding	3/4 "
Accepted	$5¼ "

(Private rate up)

Selective vs. across the board allotment

g. April 15 - F.N.M.A. halts buying of VA and FHA mortgages presaging higher rates - national finance companies increase rates offered on their paper.

h. April 22 - 20% allotment

2. How fast can things change and why?

a. April 23

Treasury said receipts had not held up. It would need more than it had expected on April 9 - no estimate of amount.

b. Possible supply: the allotments by classes

(1) Individuals, partnerships, and corporations	254.6
(2) Dealers, brokers, investment houses	158.2
	400
(3) F and G	400

c. Possible demand for - or lack of it

(1) Government investment account fully invested had bought 118

(2) Real investors annoyed with allocations

(3) Fed ? No. Martin Detroit speech

d. Prime rate raised from 3 to 3-1/4% (April)

e. May 6 - Martin Boston speech

f. A. S. conversations

Anticipatory borrowing - fearing still higher rates and perhaps rationing

g. Fed begins buying bills 2nd week in May

h. May 25 - Treasury announces $800 million TAB's - a complete surprise

i. You have seen the worst on June 1

j. Reduction in reserve requirement - July

3. Clausewitz dictum:

   "The results on which we count are never as precise as is imagined by someone who has not carefully observed a money market and become used to it."

III. Effects on local bank

Interest rates will be flexible