THE GOVERNMENT: DEBT MANAGEMENT AND INTEREST RATES

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before the

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I. Our Common Objective: Stable Economic Growth

A. We have a money economy: spending money is like casting votes for what we want produced -

Role of Government and Central Bank

1. Want enough votes cast to utilize available resources

2. Freedom to choose
   i.e., general, impersonal controls rather than direct or selective

B. Our money - with a fractional reserve system - is largely based on debt - a bank is a dealer in debts

C. So, the volume of money, the volume and character of debts, and the terms and conditions under which they may be exchanged play a large role in economic development

(A few words about fiscal policy before we go into debt management)

II. Fiscal Policy and Size of the Debt

A. Debt is primarily result of wars and depressions

U.S. Public Debt Outstanding

	($ millions)	
June 30, 1916	1,225	
" 1919	24,485	)11 successive
" 1930	16,185	)annual reductions
" 1939	40,440	+ 5,451 Guaranteed
Feb. 28, 1946	279,214	
April 1949	251,530	
Mar. 29, 1955	274,133	

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B. Changes in debt - receipts and expenditures
Result of Congressional action

1. Automatic

(a) Nature of Federal tax system: receipts

	Calendar 1954	
Direct on individuals . . .	32)	3/4
On corporations	20)	
Social insurance	7.6	
	68.6	

(b) Expenditures

Social Security
Support program

(c) Automatic economic stabilizers are automatic debt destabilizers

2. Discretionary

Political aspects

C. Old and newer ideas on fiscal policy

1. Old idea: Government concerned only with its own fiscal problems

Government decided cost of what it wanted to do

Passed taxes to pay

Annual balance - except for extraordinary items

2. Newer idea:

(a) Government has a general economic responsibility

(b) Fiscal policy has important repercussions on the economy

(1) Magnitude 70/350 billion G.N.P.

D. Compensatory fiscal policy

1. The idea

2. Automatic stabilizers (see above)

3. Limits

(a) The budget process

(1) Agencies now working on budget for fiscal 1957
(2) By September 1955 departmental estimates due for 1957
(3) Budget Bureau review
(4) President submits in January 1956
(5) Budget year begins July 1, 1956

(b) Projections - 18-24 months in advance

(c) Applies to calendar year
The more flexible you make it the harder for business to plan

(d) Conclusion: powerful but not very flexible
But big differences should not be vs. stabilization

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E. At any rate debt managers are confronted with <u>results</u> of Congress and its own previous decisions (on maturities)

III. Debt Management

	End Feb. 1955
Total debt about	$278 billion
Non-market (includ. conv.).(11.7) .	120 "
YOUR INTEREST IS IN Marketables . .	$158 "

Alternative principles. No rabbits in the hat!

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 to make <u>all</u> credit cheap and plentiful
   (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
   Of course, need judgment as to available funds and investor groups.
2. "Investor demand" not absolute (Ownership Chart p. 32-33)
   Depends on relative attractiveness of issues
   e.g. corporate purchases of bills
   [margin: on supply of funds]
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
   [margin: on demand for funds]
4. Aggravate the business cycle

C. Counter - cyclical (compensatory)

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
         (i) Risk of failure - other demands are then strong
         (ii) Means when rates are high: successive issues at higher rates. Also late prosperity issues will go to premium.
         (iii) Hard to explain to unsophisticated audience

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(2) In depression? No

(i) 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 - economy would best be served if people bought during inflation - but is individual?

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

(c) Need of the economy for liquidity

E. Debt management can make a modest contribution

F. Has to manage in market as fixed by central bank

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

Orderly market

B. Flexible interest rates

1. Principles

(a) Objective is not to achieve any given rate of interest or any given quantity of money

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(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) availability
Discounting)

Reserve requirements

(d) Basically not structural but general except Reg. T and U

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."

(5) March 3, June 23, Sept. 22, 1954
Repeated

(6) December 7, 1954
Deleted "actively".

V. Government Policy as a Market Factor

A. Based on estimates by policy officials of economic prospects

1. Important to keep informed of what they say e.g., Martin, Sproul

2. Changes are usually moderate: a little more, a little less. Yet don't have precise control. Resolve doubts on side of ease or restraint.

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B. Reflected currently in what is happening: Regular releases

1. Is the Fed. in the market?

   (a) There are times and areas when and where this is important; e.g. the May 1953 purchases after the April speech of Martin

   Watch "other than bills" <u>but</u> note refundings!

   Annual Report for 1954, p. 68, gives holdings by issues.

   (b) Ordinarily, however, mere change in portfolio in and of itself not so important

2. <u>Why</u> is the Fed. in the market?

   (a) Non-controllable factors

   Currency
   Treasury Deposits
   Float

   (b) Reserve balances

   Total - A growing economy needs more unless reserve requirements are reduced

   Margins not totals

   Excess - avail. to expand

   Borrowings - must be repaid

   "Free" - net avail. for expansion

   Question of distribution

   (c) Money rates

   (d) Availability

3. From policy to principles to operations

   (a) Projections of the non-controllable factors

   (b) Inevitable errors in projections

   (c) How correct for errors

   (i) Bring average in line?
   What happens to subsequent days? - and weeks?

   (d) Regular way transactions

   (e) Cash transactions

   (f) Repurchase agreements

   (g) Changes in level over a longer period

C. Conclusions on

Stable growth
Employment
Prices

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