Lecture I

MONETARY AND FISCAL POLICY

Outline of Lecture by

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(pencil notes for 1957 revision)

before the

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I. Our common objective: stable economic growth

A. The method of authority versus the method of choice

B. We have a money economy

1. Spending money is like casting votes for use of our resources
2. Freedom to choose
3. Yet want enough votes cast to utilize available resources

C. Relation of fiscal, debt management, and monetary policies on flow of expenditures

D. Obligations under Employment Act of 1946

II. Fiscal policy

A. Older idea

1. Government concerned only with its own fiscal problems
2. Decided what it wanted to do and how much it would cost
3. Passed taxes to pay
4. Annual balance, except for
   a. Extraordinary items
      (1) Wars
      (2) European capital budgets
   b. Tariffs for protection

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B. Newer idea

1. Government has a general economic responsibility
2. Fiscal policy has important repercussions on the economy
   a. Sheer magnitude 1957
      Fed. expend. fiscal ~~1956~~ = $66 billion 69.3 } 105
      State and local = $30 billion 35.7
   b. Tax structure (I) Investment (II) consumption
   c. Expenditure structure

(New Deal Recovery and Reform)

C. Compensatory fiscal policy

1. The idea (effects on business confidence)
2. Automatic - or "built-in" - stabilizers
   a. Nature of Federal tax system - revenues heavily dependent on individual & corp. incomes
      e.g. Fiscal ~~1956~~ 1957

Direct on indiv.	~~33~~	35
Soc. Sec.	~~7~~	7
Corp.	~~20~~	21
	~~60~~/68	63/70

   b. Expenditures
      Social Security
      Support programs

3. Discretionary:
   a. Political aspects

4. Limits
   a. The budget process
      (1) Agencies now working on budget for Fiscal ~~1958~~ 9
      (2) By September ~~1956~~ 7 departmental estimates due for ~~1958~~ 9
      (3) Budget Bureau review
      (4) President submits in Jan. 1957
      (5) Budget year begins July 1, 1957
   b. Projections - 18-24 months in advance

Fiscal Projections and Realizations
Fiscal year July 1, 1955 - June 30, 1956

	Original Est. Jan. 1955	Revised Aug. 1955	Revised Jan. 1956	Revised May 1956	Final as Reported July 19
Receipts	60.0	62.1	64.5	67.7	68.1
Expenditures	62.4	63.8	64.3	65.9	66.4
Deficit or surplus	- 2.4	- 1.7	+ .2	+ 1.8	+ 1.75

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c. Secure flexibility thru administrative control?
   Dangers

d. Tax rates apply to calendar year
   The more flexible you make it, the harder
   for business to plan!

5. Conclusion:

   a. Powerful, but not very flexible

   b. But should not have big <u>deliberate</u>
      unstabilizing effect

III. <u>Debt management policy</u>

A. Size of debt and changes in it a result of past fiscal policy

   1. Responsibility of Congress

   2. Debt ceilings

   3. Debt primarily a result of wars and depressions

<u>U.S. Public Debt Outstanding</u> ($ billions)

Date	$ billions	
June 30, 1916	$ 1.2	
1919	24.5)	11 successive annual
1930	16.2)	reductions
1939	40.4	+ 5.5 guarant.
Feb. 28, 1946	279.2	
April 1949	251.5	
Now	275.0	approx.

   4. Present status

      Total debt about . . . $275 billion
      Non-market . . . . ~~117~~ 115 " (Incl. 11 b. conv.)

      YOUR INTEREST IS IN
      Marketables ~~$158~~ 160 "

B. Alternative principles (no rabbits in the hat!)

   1. Lowest interest cost

      a. Obviously don't make any issue "too sweet"

      b. But if this is BASIC objective

         (1) Pressure on monetary authority - pre-Accord
             to make <u>all</u> credit cheap and plentiful

(Costs ~~of~~ to Gov't of its goods and serv.)

         (2) Also tends to rising interest structure
             so issue shorts - end with basket of quicksilver

      c. Of course, it makes for ease of flotation

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2. Tailor issues to investor demand

   a. Nice sounding title
      Of course, need judgment as to available funds and investor groups

   b. "Investor demand" not absolute (Ownership Chart p. 32-3)

   c. What it comes down to is

      ~~(1) On supply of funds: depends on relative attractiveness of issues e.g. corporate purchases of bills~~

      (1) ~~(2)~~ On demand for funds: 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

   d. Aggravate the business cycle

3. Counter - cyclical (compensatory)

   a. Intellectual appeal
      Vary liquidity to suit requirements of the economy

   b. Some problems - need to predict economic future

      (1) When do you issue long terms?

         (a) 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

         (b) In depression? No

            (i) For fear of aggravating depression but funds are plentiful then

      (2) What about economic conditions when bonds mature?

         (a) Make callable - but not for nothing

      (3) Illustrate with problem of savings bonds - economy would best be served if people bought during inflation - but is individual?

   c. Some hope if cycles remain moderate in amplitude

4. Debt management can make a modest contribution

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

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IV. Monetary policy

A. Basic principle: to influence the flow of expenditure by changing the supply, availability, and cost of money and credit.

1. Central bank given authority to issue money and to determine the conditions under which it will do so

2. Demand deposits, the commercial banking system, and the key role of reserves

B. Objective is not to achieve any given quantity of money or any given rate of interest but, as Chairman Martin phrased it, to influence the 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."

C. The instruments of policy

1. Open-market operations - put money into the market or take it out directly.

2. Discounting
Market takes initiative
effect on availability

3. Reserve requirements

4. Selective credit controls

D. How the System operates

1. Federal Open Market Committee meets every three weeks
   a. Staff review of economic developments
   b. Decision as to whether to
      (1) Continue as is
      (2) Tighten - and how much
      (3) Ease - and how much
   c. Changes are usually moderate
      (1) A little more, a little less
      (2) Resolve doubts on one side or the other

2. Manager of the account and daily telephone calls and wire reports
   a. Projections of non-controllable factors
   b. Inevitable errors in projections
   c. How correct for errors
      (1) Bring average in line?
      (2) What happens on subsequent days?
   d. Regular way transactions
   e. Cash transactions
   f. Repurchase agreements

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6 ~~3~~. What to watch for

a. The critical importance of reserves and interest rates

b. Total - a growing economy needs more - unless requirements are reduced

c. Excess reserves

d. Borrowings

e. Net excess (free) or net borrowing

f. Question of distribution money rates

g. How does this affect new issue market and flow of funds "a little more - a little less"

V. Conclusions

A. Stable economic growth means flexible fiscal, debt management, and monetary policies

B. Restraint is never popular

C. Reason to hope we may achieve but

1. People were sure of this in the new era of the 1920's. Are we, too, deluding ourselves?

2. Is "full-employment" consistent with stable prices - or economic stability?

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