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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

January 26, 1967

MEMORANDUM FOR THE PRESIDENT

Subject: The 4-1/4% Interest Rate Ceiling

1. Through Joe Califano, you gave us a chance to comment on Joe Fowler's memo of yesterday. Joe proposes to tell Ways and Means now that Treasury will be making specific proposals later this year to relax the 4-1/4% ceiling on interest rates for Treasury bonds of more than 5-year maturity. We would not agree fully with this strategy.

2. We do agree with many of the points Joe makes. We have long felt, in principle, that the 4-1/4% ceiling (like the debt limit and the gold cover requirement) is an arbitrary Congressional restraint in an area where there should be Executive discretion. We wish it weren't on the books.

3. We also have some sympathy for Joe's concern about the shortening average maturity of the debt. As he suggests, a short debt which requires frequent refunding can put us at the mercy of the market in some circumstances. On the other hand, the shortening of the debt is more of a headache for the debt managers than for the country; and they are paid to assume such burdens if that's what the national interest requires. Throughout the last 6 years -- and particularly under Bob Roosa -- Treasury stressed the virtue of lengthening the debt. In our view this was oversold. But it would leave Joe Fowler somewhat embarrassed to have the maturity back down to where it was in late 1960.

4. But we are not convinced that this will be the year to seek a relaxation of the interest ceiling. Even if there were no ceiling, we would be strongly opposed to any significant sale of Treasury long-term bonds in the near future. Long-term Treasuries compete most closely with mortgages and with corporate bond issues. These are the areas that we want to promote and protect in the months ahead. Moreover, direct Treasury borrowing at the long end could hurt our opportunities to sell long-term participation certificates.

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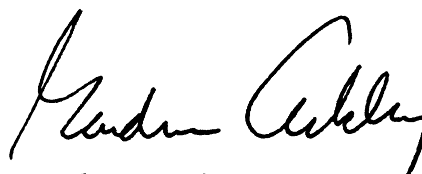
5. As Joe suggests, things may change later this year. But we can't be sure they will. Indeed, to protect our balance of payments, we may not want to see short-term rates fall too far, because short-term funds are the ones that travel most readily across the Atlantic. We may want to "twist" the rate structure to push long-term rates down relative to short-term yields. In that event, the right strategy would be to keep Treasury financing as short as possible. We may also need to keep protecting the mortgage market throughout the year. For these reasons, we would urge Joe not to commit himself now to any proposals later this year for relaxing the interest ceiling. Just asking for it could have an effect on market expectations that would make it harder to get long-term rates down.

6. Actually, we would advise that he should assure the market that no change in this legislation will be requested, at least until mid-year. This would give the long-term bond market an immediate lift. He could hold open the possibility that something might be needed late this year to assure "orderly debt management" without committing himself to any future proposal. Then we could get a better reading of the temperature of the market and the Congress this summer.



Gardner Ackley

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THE SECRETARY OF THE TREASURY
WASHINGTON

JAN 25 1967

MEMORANDUM FOR THE PRESIDENT

Subject: The 4-1/4% Interest Rate Ceiling

One of the questions that will surely come up at debt limit hearings beginning January 30 is our position on the 4-1/4% interest rate ceiling on bonds. This ceiling rate, as you know, keeps us from selling any Treasury issue longer than 5 years to maturity.

As indicated below, I would like to respond to a question on this rate ceiling by saying that our urgent need right now is to get some relief on the debt limit, but that I plan to request some specific Congressional action on the rate ceiling later this year.

At the debt limit hearings last spring, the Treasury's position was that we would welcome some additional flexibility to sell longer debt, but we stopped short of making an outright request for removal or modification of the ceiling. We did suggest some formulas that would give us reasonable flexibility -- such as exempting from the ceiling the issuance of up to $5 billion per year -- but we left the initiative to the Congress and nothing was done.

Probably, an outright request would have gotten nowhere last year, against a background of steadily rising rates, and it may not get too far this year -- but I believe we should make the effort. From the standpoint of market trends, this may be the best time to try for some relief -- when rates are declining but not yet low enough to sell bonds at 4-1/4%.

When rates <u>are</u> low enough to sell bonds, no one will take the trouble to push for modification of the ceiling. When rates are high and rising, we would risk aggravating an unfavorable market trend if we pushed for modification. If rates are high and falling sharply, the obvious wise course is to wait and let them fall. But when the long

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rates are steady or in mild decline, as they are now, we can make our best case.

The main argument for modification of the ceiling is to promote orderly debt management, which is a part of good economic management. During 1966 we took every reasonable occasion to float some debt in the 5-year area, but the average maturity of the debt declined 5 months during the year -- to 4 years 7 months. A repeat performance this year could bring the average maturity down to the same low point as September 1960, before we got the benefit of a succession of advance refundings.

The danger in this trend is that with too much of the debt bunched up in the short-term area we could face massive refunding needs at times when the economy needs restraint, and when rising rate levels put us at the mercy of the market in seeking to refinance or borrow new funds.

Of course, the current debt limit problem commands top priority, and this issue should not be burdened with any other matter. But we will be back before Ways and Means later this year and if you agree I would propose to respond to current questions on the 4-1/4% ceiling by saying that we recognize a need here, and that Treasury will advance some specific proposals later this year, in the interest of sound financial management. The appropriate time for this might be during or just after the hearings with respect to the debt limit for FY 1968.

My specific proposal, as I conceive it now, would be along the lines I suggested earlier -- to exempt the sale of up to $5 billion of bonds per year from the 4-1/4% ceiling.

Henry H. Fowler
Henry H. Fowler

Recommendation: That you approve my responding to a question on the 4-1/4% ceiling as outlined above.

Approve:____________

Disapprove:____________

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