THE MANAGEMENT OF THE NATIONAL DEBT

31 October 1963

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NOTICE

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ADMIRAL ROSE: As you know, the Treasury Department has a great deal to do with economic policies as well as with the actual monetary policies, and our speaker this morning is the Under Secretary of the Treasury for Monetary Affairs. You have seen his biography and you know that he has a long and distinguished career in the Federal Reserve System and is recognized internationally as one of our foremost authorities in monetary matters.

He will address himself today to the management of the national debt and will highlight also some of the economic problems facing our Nation.

It is a pleasure to introduce the Honorable Robert V. Roosa for his third lecture at the Industrial College.

MR. ROOSA: Thank you very much Admiral. We are in the throes of what used to be an annual exercise. It has now become almost a quarterly one for the Treasury; that of getting an increase in our debt limit. I suppose someday the time will be reached when the major interest in the public debt will not be its size but its management and when it may not even be necessary to have any allowance for an increase during the course of a fiscal year. However, we have not seen any of those years for a long time, and I think it is important to view the analysis of the national debt and its significance to the national economy in terms of both the significance of changes in its size--what lies behind that in the pattern of Federal spending, as well as revenue programs--and in terms of what can and should be done in the management of the outstanding debt, whatever its total, as that passes through the market and provides some opportunity for influencing or reinforcing government public policy in the economic sphere.

Neither one of these approaches, however, can ignore the fact that when you have a debt there are fundamental housekeeping situations which must be taken into consideration. The debt must

be successfully placed--held with willing investors all the time--and it must be placed at an interest cost that will stand up to the critical test of both the Congress and the public who do not want to have any more money devoted to the debt service and interest charge than is absolutely necessary. This means that debt management must always be a reconciliation among a number of objectives.

I would like to start by describing the nature of the present debt a little, and then going on to show you how these three kinds of considerations in the management of the debt work out in practice. While the impact of the deficit and readjustments in the composition of the debt in order to abet the aims of other economic policy are of major concern, we must recognize that the fundamental housekeeping requirements really come first. We, after all, cannot forget in the excitement of Olympian dreams about great influence that we do have a debt on the ground that has to be managed successfully and in such a way that investors will be persuaded to hold it voluntarily in a free economy.

The present size of the debt, as any of you who read the newspapers this morning would know, is crowding close to the existing limit, $309 billion; and we have, through a contrived Rube Goldberg device, got an extension on the way through Congress now that will raise that limit through the rest of this fiscal year, until the day before the end, to $315 billion; closing the year, however, at $309 billion. A debt of that magnitude is divided roughly into two-thirds--one-third between marketable and nonmarketable debt. The nonmarketable, in turn, is divided half and half between savings bonds which are sold, broadly, to all individuals throughout the Nation, and holdings which are a nonmarketable form of government investment. This includes special issues to the social security trust funds and others with which you are familiar, as well as other issues that we make for special purposes; among them, special issues to international holders, to central banks, and to the monetary fund.

So, looking at the debt in the broad sense and rounding it out, it is something like $300 billion; roughly $200 billion or exactly two-thirds of the total is in marketable form, and of the roughly $200 billion of marketable debt there is about an even division between under 1 year maturities--the amount which will pass through the market during the course of the following year, and the longer maturities which are tucked away, a little longer, placed out somewhere beyond 1 year. Actually, the marketable debt which passes through the market by the force of its own maturity is a little less than half;

but, each year for the past several years, in order to try to improve the structure of the debt, we have also refunded in advance, outstanding securities that were somewhere out beyond 1 year--with 2, 3, 4, or more years still to go--and which we could exchange with their holders for issues of longer maturity.

Therefore, in the aggregate it is fair to say that half of the marketable debt--that means roughly $100 billion--passes through the market each year. A part of that, in turn, is Treasury bills which pass through more frequently than once a year, continually rolling over, either in 90 days or 6 months. We also have some 1 year bills that we are putting onto a schedule of monthly maturities. Treasury bills are different from other U. S. Government obligations only because they are auctioned; the price determined at auction not requiring us to set the price and the rate in advance of the subscription.

So much for the broad dimensions of the debt and the categories of it with which we have to deal. Another interesting aside before we get into the way in which the debt must be handled and can be used--the growth in the public debt, although bemoaned always as a sign of national profligacy, is, after all, only a part of the total debt structure of the economy, and almost as if it were natural law, our economy as a whole seems to evolve along a path that gives us a total debt of all forms (Federal, State and local, corporate and individual) which added together amounts to twice the gross national product. As I say, it almost looks like a natural law, although I am not going to say which causes which.

This was true within a billion dollars as a multiple in 1946. It is roughly true today. So that, the overall indebtedness of the country has grown in step with the vast growth of our own output of goods and services, but the interesting thing that I want to stress now is the way in which the Federal Government's proportion of that has vastly shrunk since the end of World War II.

The private sector has reasserted its clearly dominant role in total claims on the capital resources of the country, because when we came out of World War II, close to 60 percent of the total outstanding debt at that time--this means more than the entire amount of the gross national product at that time--was Federal debt. We have gone along through the years with the total of all outstanding debt retaining that same relationship to gross national product, a little up and down--it got down a bit around 1950-1951, and then the Korean war took care of that. Over all that period, as the growth has occurred, the expansion of debt other than Federal Government

debt has been tremendous. State and local government borrowing, which was very small at the end of World War II, has increased very greatly, but the enormous increase has been in the borrowing of private business corporations and of individuals, mainly their home mortgages. As a result, the proportion of Federal debt to total debt, which was 60 percent in 1946, has shrunk to about 25 percent at the present time, and correspondingly is down to half of the total gross national product. Today it would be fair to say that the gross product at this moment is running around $590 billion. It is interesting that the Federal debt at $300 billion, you see, is just a little over half of the gross national product, and the ratio had been over 100 percent in the early postwar years.

Therefore, in terms of its role within the debt structure of the economy, the Federal debt has fallen back into a much smaller place, even though it has continued to grow somewhat in absolute amount. The Federal debt at the end of World War II was around $280 billion, and we now have, as you know, a Federal debt of a little over $307 billion, approaching $309 billion next month.

The important points that I would like to now suggest as an implication of this pattern of debt structure are, first, that within this broad total of capital requirements in the economy, the amount that has to be claimed by the Federal Government as a shrinking portion of the total is nonetheless one of the largest claims in any given year. That is because of the nature of the United States Government debt as it has emerged over the years. Federal obligations are free of credit risk, and in consequence the Government debt has come to occupy the central place here and in many other countries as a money market instrument, a kind of freely marketable, quickly tradeable short-term money market asset that serves as the principal vehicle for the holding of liquid funds by financial institutions.

So, because of that we have $50 billion of our outstanding debt in Treasury bills and roughly $35 billion in other under 1 year obligations. It is this that keeps the Federal debt continually significant as a dominant influence on the pattern of money market rates in the short-term area. In the middle and long-term maturity ranges in the capital markets, the Federal debt is always a factor. Hence it is always possible at any given time to use or abuse the debt management role in such a way that the magnitude of a given Federal operation can, for a period, be a dominant influence on what is passing through any sector of the whole capital market.

So, I do not want to suggest in indicating that the Federal debt has become a smaller part of the total outstanding debt, that its significance has diminished in that same proportion as an influence on current interest rates and current activity in the whole range of the capital markets, from the money market on out to the very long-term. The reason that the Federal debt continues to have a potential dominant influence on the day-to-day behavior of these markets is that a much higher part of the total Federal debt is necessarily or potentially passing through the market in the course of any given year, a much higher part than that of any other component of the debt structure.

Mortgages, as a rule, even though many are repaid or refinanced before maturity, nonetheless have average maturities--actually remaining outstanding--of about 10 years, and of course, their original maturities are usually 20 years or more these days. Home mortgages dominate the long-term debt structure, in terms of of what is newly issued each year. They also account for the largest increases in the total outstanding debt.

Corporate debt in the same way consists very substantially of long-term debenture obligations which are not often called, even though they are callable at intervals, or after an elapsed time of 5 or 10 years; so that in any given week or month, as you look at the financial pages for what is affecting the market or what the market is waiting for or guessing about, you will usually find that although there is some corporate obligation going through each week, the apprehension or tension that is dominating the market at that given time has to do with the terms of a forthcoming Government issue. This is because the market knows that when the Government issue comes out it will be large; its dimensions will be entirely different from that of any corporate obligation.

We just completed a financing operation on Monday, for example, and the total allotment on that which we will be announcing this morning was $8 billion. It turned out that half of the holdings which we were refunding in cash were in the hands of Federal Reserve banks and Government investment accounts, and these were allotted in full, so that the amount passing through the private market was closer to $4 billion. Nonetheless, the largest corporate issues in the market tend to run up to $200 million, and the largest one this week, a GMAC, $150 million, is of course the dominant influence in the markets currently.

So, this gives you a little idea of the way in which the turnover of the Federal debt keeps it an active, prominent influence on the behavior of the capital markets, even though Federal securities represent a shrinking proportion of total debt.

Now before I try to sketch just a little the way in which we try to minimize the harm that we can do, and sometimes even maximize the potential positive contribution we can make toward economic policy, I would like to digress just a minute to the first point that I made in beginning these remarks; that is, how the increases in the debt, as they currently arise, are being placed. This is a separate question, as I mentioned, from the management of a given amount of outstanding debt.

As you have read in all of the comment concerning the proposed tax reduction which we will get sooner or later--and we are still doing everything we can to see that it is sooner--the comment of the critics has centered on whether or not there will be a parallel measure of firm expenditure control. The President and the Director of the Budget have given clear assurances, but looking further--and you are going to hear more of this as the debate goes on in the Senate--is the question: Well, even if there is expenditure control, even if the deficit coming in the year of the tax cut is no larger than the deficit this year, what about the grave risk of a succession of deficits creating new inflationary pressures on the economy before we get to the point of a balanced budget?

Is it not inevitable that the outcome of all this, on top of the deficits we have already had, will be a new inflationary surge in the economy? As to that, our answer is that it depends entirely on how the debt is financed. Now there are a lot of easy shorthand ways of describing this, but they are apt to be misleading. The detailed explanations can get fairly complex, but what the inflationary potential really hinges on is whether, in financing the deficit, there has been a parallel increase in the money supply and in the liquidity of the economy.

This in turn depends on whether or not the increases in the debt have actually been placed with the banking system where money gets created, or whether they have been placed outside. While this is a gross oversimplification, it does get to the center of the problem. Then, as corollary to that, if you have succeeded in placing the debt outside the banking system, have you also placed it outside in a way that will last for awhile? In other words, are the placements on balance more in long-term rather than in short-term issues?

Now the things that have actually happened over the last year or so provide reassurance that there has been no inflationary impact from debt operations in this period, and that there need not be in the transition to a balanced budget, because what has happened is this: The increase in the outstanding debt of approximately $8.5 billion, over the 15 months that ended in September, was just about matched by the increase in Treasury bills, which are all very short-term obligations. I am excluding in the bill comparison some seasonal short-term borrowing which we had outstanding 15 months ago but has since been liquidated.

Someone, then, who wanted to rise up in alarm over the inflationary implications of the deficit, could pick those two figures and say that the whole debt increase had been financed through the issuance of Treasury bills; potentially a very grave danger for the economy. Following from there, we might expect to hear that the Government had lost all sense of fiscal responsibility and that inflation was about to break loose.

However, you have to look just a little further. The first query is: What happened to bank holdings of the debt over this period?

The total Government holdings of the commercial banking system over the 15 month period were reduced by $3 billion; they were not increased. So, while the total outstanding debt was rising, the total holdings by the banking system were actually being cut back. To put this in terms of the point I made at the beginning, the potential for translation of this debt into money creation by the banking system was actually declining, because of the way the debt was issued. In short, we were placing the additional debt with nonbank holders, and in fact even increasing their proportionate share of the total.

Well then, it might be argued that although there was not an increase in the inflation potential because of a lodgment of the debt in the banking system, did not this large rise in short-term debt bring about a clear increase in the potential in terms of the debt structure?

If one had wanted to start out to make a favorable case he could have looked at the debt from the other end and asked what happened to the very long-term debt. Going back over a 15 month period he would have found that the increase in outstanding debt having maturities of 5 years or more was in fact larger than the increase in the total outstanding debt itself over that period. Thus, the entire

increase in the debt could be described as having been placed with long-term savers outside the banking system, where the inflationary potential of Government security holdings is negligible; so one might say, in contrast with the first impression, that the debt increase has been financed in the soundest, most secure manner that the country has ever seen.

Of course, in appropriate audiences we sometimes say that! However, what I especially want to emphasize here is that with the debt as large and complex as ours there are a number of things that have to be taken into account. While it is true that we must be cautious all the time in what we do with the debt as a whole during a period when its size is increasing, we must be continually alert to see that we are not providing a means through which the debt itself can become a vehicle for inflation. Beyond that, there are other elements of public policy which have to be considered. These are elements that are relevant whether the size of the debt is increasing or not. I want to sketch these in, particularly the ones that have become most relevant in recent years, to indicate how this process of compromise that I mentioned earlier has to be effected; because, above all else, the dominant problem of our short-term money market in the past 4 years has been the risk of a substantial and sustained international outflow of short-term money. This occurred because our short-term interest rate structure was consistently below that of all other like countries of the world except the Netherlands and Switzerland.

If, then, you are considering the position of the United States not only internally, but internationally, you try--especially if you realize that the most volatile is the flow of short-term funds--through those portions of the public policy sector that you can influence, to exert a counteracting force against the natural laws of economic gravitation that will be pulling the funds out of the country in substantial amount. I will not trace it all through--I am sure you have had other speakers here who have done it. The net result of this for a leading industrial country, the one country that maintains gold convertibility for the currency, is that when you run a sustained external deficit you also have a problem of financing. I am only talking about the internal debt management part of our job this morning; but the external financing of that deficit, in a way that will minimize the pressures on the country from the outside, must also be a continuing part of the responsibility and concern of public policy.

This is one place where the internal debt management and the concern with the size of the balance-of-payments deficit become inextricably woven together. The reason for the increase in very

short-term Treasury bill debt over these past few years has been that we have deliberately and consciously been taking advantage of the point that I mentioned to you earlier--that the Government debt is the dominant factor in the short-term money market. Treasury financing is the largest component, and by increasing the size of our Treasury bill volume we have been able to edge the short-term interest rates gradually upward to a point where now the rate differential between the United States and other countries has reached an equilibrium position with no gravitational pull either in or out. We reached this point in mid-July and I think we are going to be able to maintain it.

We are not trying to force this particular component of the balance-of-payments to an extreme. We do not want to upset other countries in the world by pulling money of a short-term volatile character back, but we want to stop the flow out from the United States; and that, very broadly speaking, has been done with the influence we have brought to bear on these interest rates. A major part of the influence that has been exerted to bring this about has come from the increase in short-term Treasury bills. Now it is true, as I said a few minutes ago, that this must be recognized to be a potential inflationary risk for the whole economy. It is not now, because we kept all the increase in the short debt out of the banking system, but it could be and it could turn very quickly. So how, then, do you build a line of defense behind this? How do you position yourself so that the risk or the likelihood of this happening on any sustained basis can be minimized?

To do that you dig a hole in the intermediate part of the debt structure anywhere from 1 year on out to 5 or 6, reducing that part of the total outstanding debt. Then in the years ahead the maturities that will be rolling in on the next debt manager to be handled will be small enough so that he will have the flexibility and scope to be able, if it is important then to do so, to keep the short-term debt from increasing; and in fact, successfully to reduce it if the balance-of-payments need is not then dominant.

At any rate, what has been necessary in this period has been to increase the debt, particularly in the 3 to 6 month area, in order to accomplish the money market effects that we were seeking for balance-of-payments purposes. At the same time we have tried to avoid creating a delayed action fuse in the form of an enormous amount of additional debt that would move forward, mature, and pile in on us next year or the year after in a way so that it could not be handled.

You may remember I told you earlier that the very short-term debt in the form of bills had increased by the amount of increase in the deficit in the past 15 months; but when you go back a little further in time--say back to the beginning of calendar 1961--you find that while regular Treasury bills have increased since then by around $16 billion, total under 1 year maturities increased over the same period by only about $8 billion. So there was already a good offset, though not a complete one, through declines in other types of short-term debt; and when you go up from 1 year to 5 years in the maturity structure of the debt, the under 1 year increase is completely offset. Here there has been an actual reduction of $13 billion since the beginning of calendar 1961.

I do not want to confuse you further with a lot of figures. What I have tried to indicate is that in adapting to the limits of what the market will take and what the Treasury can sell, there must be continual thought not only of today but of the future. We have to find the reconciliation between the housekeeping requirements of having a debt firmly placed with satisfied holders in a free economy, and at the same time a debt that will, as it is increasing, not add to any inflationary pressures and will minimize them if possible, and a debt whose latent power can be used in a positive direction to help in the financing of the balance-of-payments.

This is the kind of mixed set of requirements which we are continually fitting together, and which, as I said, we had to take into account in the financing completed on Monday of this week. In addition, just yesterday we issued at auction a 1 year Treasury bill for a billion dollars. The way in which all of these activities continually move through the market does have to fit a pattern. We have to do more than place the debt adequately and in such a way that the overall cost of the interest burden to the taxpayer is minimized--important as that is. Beyond that, we have to adapt debt management to minimizing the inflationary risks of repeated Federal deficits, and somehow or other utilize its potential as well for the balance-of payments.

Now before I conclude and turn to questions I would like to just comment on one other aspect of debt management in which some of you, I think, particularly those in the foreign field, would have an interest. You may in later years be hearing about it. There is another way in which we have dovetailed debt management with the balance-of payments situation, and more broadly, with our unique responsibilities as banker for the world; and this concerns the financing of the external deficit of the United States.

As I said earlier, the aim of the operations in the money market has been to reduce the outflow of funds to other countries. That means to reduce what will end up as a balance-of-payments deficit. However, once you have a deficit in the balance-of-payments, whatever it may be, you have to find some way to finance it that will also avoid upsetting the international financial system, which rests firmly on the dollar as its central pivot.

Our problem externally with our balance-of-payment deficit has been a much graver one for our security and that of the world than anything implied by the internal Federal deficit. The United States has unique responsibilities as banker for the world, and because of that the dollar is a key currency for the world. We have to limit the flow of that currency into the hands and possible reserve holdings of other countries to amounts that will somehow or other fit current requirements. A glut of dollars beyond the amount needed and wanted as reserves might cause people to begin to wonder whether the dollar is really as secure, sound, and permanently useful as they had once thought.

To sum up, there are problems when we do not get our external deficit down to the dimensions of the world's current needs for additional monetary reserves--and we certainly have not done that for the last several years. In this situation we have to find some way of absorbing a part of those dollars before they become a real glut on the international financial market; because at this point they incite the central banks abroad to do a much more rapid gold conversion, draining more from our stocks than they already have.

As you probably know, the net result of the effort we made in this area has been to create some new kinds of Federal debt instruments. The general form of it, without getting into detail, is that if a given country feels that for the moment it is accumulating too many dollars--that its particular part of the by-product of our big balance-of-payments deficit is overflowing from its point of view--and if it does not already owe us a lot of debt so we can just ask them to repay the debt and soak up the dollars in that way, then what we will do is talk with them about taking a bond denominated in their own currency. We assume the obligation to repay at maturity in their own currency rather than in dollars, if they so wish at the time.

Up to now we have, in this calendar year, issued about $700 million of those bonds. It is a small part of our total debt, but with the balance of payments deficit which in the first half of the year was running at an annual gross rate of $4.5 billion, it is a way in which we can absorb the the overhang of extra dollars, and at least give ourselves some time.

We discovered in the old statutory authorizations of 1917 that the Treasury had been given authority to do this sort of thing and we began doing it with the shorter maturities. Longer maturities were only started this year on any substantial scale. We have had a reasonable amount of success so far, to the point where it is interesting to combine these foreign issues with the figure for the gold loss.

Last year the gold loss, as you know, was about $850 million, running a pretty high proportion of the total balance-of-payments deficit, as it did also the year before. This year, to date--I do not ever want to do more than cross my fingers about the future, but at least this year to date--the gold loss has been approximately $400 million. However the takings of these new debt instruments have been, as I said, over $700 million; so that with a larger deficit externally this year, where we might otherwise have expected something like a gold loss going up from last year's $800 million to perhaps a billion or two, this year--at least thus far--we have been able to replace a large part of that potential gold loss with this other kind of debt instrument. This has been just a sort of incidental by-product of our home debt management, but one which I think, in terms of its implications for the external position of the dollar, is of more significance than the comparatively small size might indicate.

I do not want to try to describe that in any detail or go further into our balance-of-payments, unless you have any specific question on it. I would think, though, that because it is something that we have developed a little more in the past year, it would be worth noting, because those of you who go out around the world are going to be hearing about these things and wondering about them; and I did want to take this chance to show you how, in our thinking, they do fit into a place in the overall national economic policy of the country.

Thank you.

QUESTION: I am under the impression that a good many Americans have found comfort in the knowledge that the national debt has been internally held. What is the impact, psychologically or otherwise, in your now purchasing dollars overseas by issuing bonds?

MR. ROOSA: Let us start with recognizing that there is no change in the external holding of the debt. It is just a change in the form in which it is held, because once the dollars have come into the possession

of a foreign owner, those dollars are going to be held in any case in the form of a claim on the U. S. Government. The existing claims on the U. S. Government have, of course, increased with the balance-of-payments deficit year by year, so that our total U. S. Government obligations to foreign holders, private and central banks, are now still not a gigantic figure, but they are in the magnitude of around $16 billion. Those are mainly the holdings by foreign central banks in U. S. Treasury bills or certificates.

What has happened is that some of them have enough of those. You see, they do not just hold them in bank deposits; they hold them in U. S. Government obligations earning interest, and they hold U. S. Government obligations because they are free of credit risk and satisfy their own local banking laws.

When we offer this other kind of obligation, which, by the way, we only offer to governments and central banks--to responsible governmental entities, not to private investors--the transfer is one in the form that preserves them as the owner of a debt claim, and helps persuade them not to buy gold here instead. So, it is not adding; it is other things that are adding. If the American people want to be really worried about having our debt held outside the country, they have to agree that we have to get the balance-of-payments deficit down to zero, and avoid adding to the deficit in that way. This is a way of financing that is already there.

Maybe I should say one more thing. There has been this uncomfortable feeling that since our debt is held internally we owe it to ourselves, et cetera. It is an old wives' tale that, of course, may be of some comfort. However, the basic considerations I meant to imply in my talk are that the debt can be used--given the fact that it is there--it can be used in some ways to help further the interest of public policy, but may become a juggernaut too, if left out of control; and it would be no great comfort, really, that it is all internally held, if the whole debt should become very short-term, the equivalent of money we could generate becoming a distortion of extreme inflations in the home economy--even without having any of the debt held outside the country.

So, you run lots of risks in having a large debt. What it means is, given the risk, it has to be managed according to some understandable and publicly acceptable principles so that it does not become a menace. I have tried to indicate here that we have tailored it in such a way that, given its existence, it has become a

useful part of the whole credit market; and as the markets now exist, if the Federal debt did not exist we would have had to invent it in order to have the markets function in this way. That is not to say that all debt is good, but it is to say that it is one of the ways to minimize the risks.

QUESTION: Sir, there is great command pressure put by the Department of the Army on soldiers to buy savings bonds. Almost under coercion many soldiers buy them and 60 days later routinely cash them in. Does this sort of transaction do more harm than good, and if so, how much does it cost the Government each time?

MR. ROOSA: The individual transaction, I suppose, does clearly involve a net cost to the Government; but we have in the aggregate a continued increase in the outstanding holdings, and the actual redemptions, taking--I do not know about the Army as such--but taking the public as a whole, actual redemptions of savings bonds are running at a much lower rate than last year, and lower than in most recent years. The actual rate of net sales on savings bonds--this is not only true for Government employees, but it is true for the public as a whole--is currently running at a high rate, and it is expected that 1963 will be the best savings bond year since 1956.

Therefore, when you add them all together, even though these particular cases are clearly expensive, you cannot predict which those are going to be; and when the aggregate is put together we have a very viable program which is giving us an increase in the holding of outstanding debt, which is currently running at the annual rate of close to a billion dollars. It really means that debt is being placed in the hands of people who are real savers, and for many it gets them into a savings habit--something that was true for me. When I got out of the Army I kept all my savings bonds, and when I finally had to buy a house I used them. There is nothing wrong with that; there is somebody who is saving all the time.

QUESTION: Mr. Roosa, in regard to the first question that Mr. Levinson asked, referrable to the bond issues to foreign governments, I do not understand how we will accumulate this foreign currency. I can understand the accumulation; that is, the sponging up of the dollars through this bond issue, but how will we accumulate the foreign currency?

MR. ROOSA: Well, on maturity it is always possible that they will be refunded in the same currency and remain outstanding until

some time when it was to the interest of both parties, really, to have them paid off as part of a reduction in the debt outstanding. However, in the event that they are called for payment, the likely condition is going to be one in which the other central bank is in need of dollars; or at any rate, if it wishes to regard these as a sort of frozen internal part of its foreign reserves, it is denominated in its own currency, in effect, to avoid exchange risk.

If it is in a position where it wants payment, it is not likely to want its own currency; that it can always get at home. Its own currency is the assurance it has against a devaluation of the dollar; that's all.

So, the conditions under which it is likely to want payment are those when it will, in fact, say, "I know I have the right to be paid in my own currency, but I would prefer to be paid in dollars. In fact, if you will give me the dollars I will sell you my currency to use for repaying bonds." The exchange will be a two-step one, in which in fact they will be paid in their own currency, and we will acquire the currency from the central bank for the purpose. Their central bank, in so doing, will then receive dollars which it wishes to have.

QUESTION: In other words, then, this really reflects on the stability of the dollar.

MR. ROOSA: It avoids instability of the dollar.

QUESTION: Sir, on this same question, how does the interest come to be handled in this transaction?

MR. ROOSA: Interest is calculated according to the precise maturity on yield curves as of noon on the day before the obligation is issued. We priced this at the noon market yesterday. We take a reading of the rate curve at exactly the maturity of the obligation. This one happened to be in Switzerland. This has not been announced yet, and I will not go into detail, but at any rate, Switzerland has a rate curve below ours.

We went halfway between the noon market reading in their market and ours yesterday, and we gave them a reading halfway between. So, it is less than we would have to pay if we borrowed the same amount on our own market, but it is more than we would pay if we were permitted to borrow from the Swiss market. There we get a somewhat lower rate than we would pay for borrowing the same amount of money in the United States.

Other countries have a higher rate of interest than we, and then we pay the U. S. rate; we never go above. As regards Germany, for example, we just take the reading off the curve as of our own noon market the day before the bond is issued.

QUESTION: Is this going to keep increasing the balance-of-payments in order to pay more interest on these things?

MR. ROOSA: Well, since we are only paying, at the highest, the rate of interest on our own rate curve, and since these other countries already own a U. S. Government obligation when the transaction starts, or at least a bank deposit in this country (including time deposits which bear rates up to around 3.5 percent), there is no increase in the interest rate.

The interest is, of course, payable in the other currency so long as the obligation is outstanding. So far we have found that when the interest comes due they are not all that anxious to have that little addition in their own currency. They just simply sell us their currency dollar for dollar.

QUESTION: You indicated the reasons for the general equilibrium in the inflow and outflow of short-term capital and the reluctance to encourage a further inflow of foreign capital. Why?

MR. ROOSA: This is one of the many aspects which you have in your own area too, of the unfortunate burden of being both the biggest and the leader. Any other country trying to repair a balance-of-payments deficit can think of itself as being small enough not to upset the whole world by taking action that will bring in a little money from here, there, and the other place, and sort of cover up or offset whatever its losses have been. The U. K. has done this several times during the postwar period, and not always without some repercussions on us.

However, on our side, if we were to take action that would be strong enough to actually begin pulling funds back in from others, it would be just the case of the giant rolling over in bed; it would upset these other smaller markets so much, that from the point of view of our role as both leader and sort of overseer of the whole world's monetary system, we have to be careful not to create a crisis in resolving our own problem; it has to be gradual.

Now we are in a situation at the moment where it's just nip and tuck. The Belgians raised their discount rate the day before yesterday. I do not know whether anybody else knew it or not, but the thing is that our pull had reached the stage where we were about right for the U.K., about right against Canada--as near as we will ever get—about right for Germany. We are clearly way ahead of Switzerland. Belgium had to take retaliatory action in a sense--defensive action.

If we did try to raise our short-term rates here at just this moment, let us say just one-fourth of 1 percent, then we might find the others feeling that there is a difference in their situation; not only are they no longer gaining, but it turns out that they are clearly losing. When these things tend to swing they sometimes overswing. There would be a fairly heavy outflow, and then they would take defensive action--each one of them all around the perimeter--which would really minimize in the end our net gain, and would cause confusion in the world money markets.

So, because we are so big we have to take a responsible attitude toward the effect we have on others. This does not mean, by the way, that we are not gaining greatly, because the big items in our balance-of-payments where the losses were increasing this year were short-term outflow and long-term capital outflow. And this increase aggregated at an annual rate between the two of them of over $2-1/2 million--almost $3 million in the second quarter of the year—and that has been cut to nothing. So, we are gaining on it.

CAPTAIN McCUSKEY: Doctor Roosa, we have extended our question period a little longer than normally, and I still see so many of us who would like to get a little more information from you. I know you have got to get back to your job, and we are grateful for a most beneficial morning.

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