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ON DEBT POLICY

HENRY C. SIMONS

I HAVE never seen any sense in an elaborate structure of federal debt. The national government must, of course, provide and regulate the currency—a task it has never faced. It may perhaps, on some occasions, properly borrow money; i.e., open-market operations are a convenient, traditional, and perhaps desirable temporizing means of currency regulation.

On the other hand, it is essentially improper and undemocratic (Schachtian) to confuse issues by proposing and using a miscellany of debt forms. In wartime and in peacetime we should issue currency and (or) bonds. We should never disguise currency as bonds or conversely. Moreover, every issue of bonds should be primarily an announcement of prospective tax increases. (The converse here is not valid, since debt retirement may and should proceed secularly, at least if bonds are outstanding in excess of the amounts necessary to facilitate open-market measures.) Bond issues are properly a means for checking incipient inflation and are, like currency issue, a means especially well suited for prompt action by administrative rather than by legislative action.

Bonds, as the antithesis of money, here denote consols or perpetuities, i.e., obligations without *either* maturities or “call” features. In the good financial society bondholders could liquidate only by open-market sales; the Treasury could sell only one interest-bearing debt form and only by open-market sale; and it could retire such debt only by paying the current, free-market price. (There would, of course, be no bonds save those of the Treasury or, at least, no trading of private debts on organized exchanges; but sane government finance obviously need not wait for sane reform in private corporate finance.)

There is little hope for sound monetary-fiscal policy under representative government if our representatives persist in con-

fusing everybody, including especially themselves, by issuing moneys, practically moneys, and near-moneys under other names. Trying to steer a path between phobias about paper money and terror of high interest costs, they create only fiscal bedlam and intolerable monetary uncertainty.

The community is now almost persuaded, on Treasury authority, that it can, with the same dollars, buy ammunition to make things hot now for Germans and refrigerators to keep things cool later on at home. Economists may be less credulous; but their relevant persuasions cannot be said to have escaped the confusion which bad fiscal practice invites. It is indeed difficult for anyone to think quite straight about equipment-trust certificates issued to pay either for war materials or for food distributed to the unemployed.

The issues here come to focus upon the problem of interest rates. Should the Treasury offer better interest terms to its lenders now? What interest rates should be offered after the war, when and if we clean up an awful mess of debt by consolidations and refundings. If wartime borrowing, like wartime (non)taxation, is beyond repair for the duration, postwar financial measures cannot yet be dismissed as unalterably determined wrongly by momentum or political habit. Neither may one concede the impotence of academic opinion or the certainty that its influence will again be predominantly wrong at the crucial time.

One merit of these strictures about debt form is that, if sound or if provisionally accepted, they largely answer our interest problem by indirection. Borrowing or refunding via consols must mean higher interest rates; we must pay people something to give up the liquidity features of their near-moneys. If we won't pay taxes to stop inflation, we must at least pay interest!

It should not be inferred, however, that the devices proposed will necessarily increase the interest burden, real or nominal. Confining bond issues to consols, we must pay higher rates, to be sure; but we need not pay higher rates on so large a debt. Retiring short-term and redeemable issues, we may then safely have more debt in a noninterest-bearing form; indeed, we should certainly need more money to prevent deflation if we dispensed with moneys disguised as bonds. Indeed, there is even less sense in the Treasury's paying interest on demand or time deposits than in permitting banks to do so (whether in cash or in kind).

Come at in this way, the postwar problem (if not war finance!) becomes readily intelligible and discussible. Our federal debt should be refunded promptly and totally into currency and consols. In other words, we should remedy as rapidly as possible our wartime mistakes as to debt forms. (Our sins of omission taxation-wise cannot, unfortunately, be corrected so easily, if at all. Inflation will prove largely irreversible—although much may be said for stabilizing the indexes rather than the realities, i.e., for deflating back to where the indexes tell the truth instead of revising the indexes so that they promptly cease lying when peace comes.) Some people evidently think that, having done everything wrong during the war, we should or must go on doing it all wrong afterward. I find little use for the hypothesis that error becomes truth merely by long or consistent practice.

This leaves the question of how much near-money should be converted into real, honest money and how much into consols. The answer is simple in principle and amenable to determination by experiment. It is only a matter of implementing monetary stabilization, i.e., of doing what is necessary to stabilize some sensitive and reliable price index. The major variable, namely, private investment, is largely an independent variable for fiscal or monetary policy—assuming that thrift is not undermined by extreme inflation and internal disorder. Investment is largely a matter of the fundamental security of property, including security against

monopolies, labor and other. Another major variable is postwar banking policy, especially as to reserve requirements or permitted devices of corporation finance. (It would certainly clear the air, however, if banks as owners of federal debt were offered simply a two-way choice between “unsupported” consols and fully supported currency.) Finally, there is the relation between federal tax revenues and expenditures.

The rule for policy as to consols and currency, i.e., for *composition* of the debt including money, is simply stabilization of the value of money. Converting money into consols is an anti-inflation measure; converting consols into money is a reflationary or anti-deflation measure; and that is that. The problem becomes difficult or complicated only on the assumption that measures taken in other areas of policy will simply prevent stabilization, regardless of debt policy. Considering the amount of debt available to be monetized, the real problem here is uncontrolled inflation. Until this whole game is hopelessly lost, however, it is the business of debt policy to assume that it will *not* be lost and to *stick to its* appropriate anti-inflation measures *whatever the interest cost*. Above all, it should both assume and imply that the Treasury intends to *stay* in business, not just for ninety days or ten years but indefinitely, and issue its obligations accordingly.

Simple debt management would almost certainly improve policy and action in other areas. If Congress and the executive could finance expenditures only by taxation, by currency issue, or by borrowing, each in its most straightforward form,¹ we might ex-

¹ The proper tax form, as I shall argue elsewhere, is a holeproof personal income tax, with a high and stable basic rate, with a variable exemption level, and, of course, with extensive source collection.

It is interesting to speculate, in this connection, on how the democratic process would work if currency, instead of debt, were the residual element in fiscal policy or practice. Normally, of course, Congress makes appropriations and levies taxes, leaving the Treasury to cover deficits by borrowing, under generous, elastic, and routine authorizations, or to utilize any surplus for debt reduction. Suppose this practice were reversed, i.e., that all legislation regarding sale or purchase of debt (consols) were

pect really responsible behavior not only in these matters but in expenditure as well. Currency issue, as I have argued elsewhere, is both a more effective and politically a safer means of reflation or inflation than is (that compounding of opposites) inflationary borrowing, if only because the process and its possible abuses are generally understood. It would be hard politically to pursue obviously inflationary finance in the midst of actually inflationary conditions. Moreover, it would be politically more difficult to hold taxes down or expenditures up if the obvious cost was borrowing at open-market consol rates—with “danger” of having to pay through the nose later on to retire the current consol issues. On the other hand, it would be conveniently difficult to advocate or to pursue a scheme of combatting deflation by selling *consols* to private issuing agencies (banks). The case for currency issue instead of indirect deposit creation would be very clear.

mandatory, like tax legislation, and that all deficits or surpluses were handled automatically, under broad, permissive, continuing authorizations, by issuing or retiring currency. It is arguable that, if issue powers were really confined to the government (i.e., with 100 per cent or ceiling reserves), this scheme would produce more responsible fiscal policy than the prevailing one.

What we are really proposing, of course, lies in between. There would be no borrowing authorizations save for consols; i.e., the Treasury would have no freedom or discretionary power with respect to maturities, and possibly none as to nominal interest rates. Subject to that limitation, however, and a mandate to stabilize a price index, the Treasury would have generous or unconfining authorizations for both currency issue and borrowing. Revenue surpluses or deficits would then determine the decrease or increase in the aggregate of currency and consols; while the necessities of price-level stabilization would determine changes in the relative amounts of currency and consols. Excessive expenditure relative to taxes would then reflect itself in the increase of consols or, with an inordinate amount outstanding, in failure of a proper debt-reduction program. A mass electorate may be expected to understand the virtues of price-level stabilization and the need for conserving borrowing powers against the contingency of war or, during wars, against the contingency of very long war. It might, with a simple debt structure, recognize practices which jeopardized or sacrificed these objectives and effectively threaten the political future of leaders who indulged or espoused such practices.

Many readers will have recorded their categorical dissent from our proposals because these all imply a price-index rule or guide for policy. I persist in the notions that stabilization of the value of money, however unrealized, is the only rule or principle of monetary-fiscal policy we have ever had, that it is the only rule really available to a democratic society, and that only by recognizing and by accepting this rule explicitly can legislatures be made responsible financially or business be spared intolerable monetary uncertainty. Be that as it may. One may, I presume, reject price-level stabilization without embracing its opposite. Opponents, in the main, do not advocate maximum instability or total monetary uncertainty. Rather they recommend crossing bridges when we come to them, i.e., trusting to the authorities of the moment, if not crossing, bridge or no bridge, and finding the bridge afterward if you did not drown. Consequently, it may be of interest to see what kinds of measures are consistent with stabilization and what kinds are not, since no one is proposing to go squarely in the opposite direction. The important fact is that so many people are actually proposing measures or stressing considerations which lead where no one wants to go.

Let us first belabor those numerous folk who, while applauding, condoning or just not discussing the size of our debt, insist on keeping down its interest burden. The company is numerous, distinguished, and highly placed, both in government circles and in academic esteem. There is, to be sure, a grain of wisdom in their solicitude. First, the Treasury should never offer its issues on such terms that radical rationing measures are required; bonds should not be distributed like postmasterships. Second, the government should never raise interest rates by promoting, by encouraging, or by tolerating expectations of price inflation. These propositions about exhaust the truth in a mountain of foolishness. The truth assay is really very low.

Subject to these obvious reservations, the Treasury should seek always to pay as much interest as possible. (There may be impuri-

ties here, but I have not found them.) This merely amounts to saying that it should pay enough interest to prevent inflation. On the other hand, as a corollary, it should also always issue as much money as can be issued without raising the price level. Thus, it should simultaneously maximize the rate of interest payment and maximize the amount of noninterest-bearing issue, subject to the same condition, namely, a stable price level or index.²

Since it is difficult to argue about axioms, I shall attempt only some elenctic remarks. First, if one *wants* to minimize the nominal interest cost, one may best resort to paper money. It is admittedly improper to issue additional currency when inflation is under way. By the same token, it is wrong to issue short maturities or, indeed, any debt form save that furthest removed from the pure-money category. In such circumstances issue-yields will normally vary directly with maturities. Consequently, when we want to stop inflation, we should maximize interest rates; we should mop up money not with other moneys slightly disabled but with money contracts as much unlike money as possible. Conversely, stopping deflation, we should issue not near-moneys but the real thing without disabilities; and, issuing it, we should displace not near-moneys but as-far-from-money-as-possible moneys.³

During actual or imminent deflation, on the other hand, it may be better to borrow at short term than at long term; but it is best not to borrow at all, i.e., to issue merely currency, not only for the desired immediate effect but also for long-term safety and mini-

² These references to "maximizing," and others which follow, are perhaps polemic extravagances, for the "conditions" alone imply determinate amounts.

³ For merely monetary purposes, of course, open-market operations should be conducted with equities, not with money contracts at all. Only a collectivist, however, may intelligently offer this counsel of monetary perfection. With ultimate control lying in revenues and expenditures, the strong case for any open-market measures lies where there is an interest-bearing debt requiring some management in any case. There is little reason, in an economy where government is already surfeited with (misused) monetary powers, for admiring the collectivist state for its still larger powers.

mal national misunderstanding. Borrowing is an anti-inflation measure, not a proper means for financing reflationary spending. Borrowing is properly a means for curtailing purchasing power, private and governmental. To use it for injecting purchasing power is (to repeat a figure I have used elsewhere) like burning the fire engines for heating purposes when there is an abundance of good fuel to be had free.⁴

To repeat, the right way to lower interest costs is to issue paper money—which sometimes is and sometimes is not a proper thing to do.

Let us now argue obliquely from another direction, namely, from the standpoint of the Treasury as central bank (which it alone should be). Here is the one aspect of the traditional monetary-fiscal pattern which has been mainly correct—indeed, the only one where perverseness has not prevailed. It is naturally also the phase of action with respect to which orthodoxy is most nearly sound. It is generally agreed that the Treasury, at least in disguise, should sell bonds to banks in boom times and buy them during severe deflation. This obviously means, in general, seeking to maximize capital losses over time, concentrating purchases at bond-

⁴ It does not follow that debt should never be retired during prosperous years, though it certainly should be retired more slowly at such times, and not at all unless inflation is otherwise fully under control. If tax rates are properly sustained and increased during prosperous years, open-market operations may properly show a balance of purchases even at such times. In depression or deflation, debt retirement should reach its maximal rate, as part of a deliberate program of monetizing bonds. For the good future, retirement of our huge war and pre-war debt will be a continuous process at varying rates, not a matter of alternate forward and backward steps. There will be no more sense in sustaining the aggregate amount than there was in acquiring it in the first place. If our democracy again becomes responsible financially, our bonded debt will fall at least as rapidly after this war as it did during the twenties. Borrowing power must be carefully conserved if only against the inflation contingencies of our next (first) total war. Unused borrowing power and a record of fiscal good faith (which it is still our opportunity to initiate) are now grossly undervalued relative to an army and navy; but I'll lay my bets for the future on an America which protects internal unity and morale by real fiscal prudence.

price peaks and concentrating sales at the lows.⁵ (Why such inherently lossful responsibilities were ever delegated to private corporations, I have never understood.)

Surely it is logically or heuristically permissible to treat such capital losses as part of the cost of servicing the debt. Indeed, in an institutionally well-ordered democracy, based on systematic dispersion of power, it would probably seem silly to regard them otherwise. One of the costs of living with near-moneys, even though they be no nearer than consols, lies in the necessity of forever buying them dear and selling them cheap, as monetary stabilization necessitates. Even if we evade the responsibility of rapid secular amortization, we must always be prepared to give money freely for bonds when they are most valuable and to take money for bonds when they are least valuable.

Thus, we may charge that proponents of minimal "controlled" rates on our federal bonds are inconsistent unless they also propose to reverse traditional rules about open-market operations. Surely the formal interest burden could be diminished or offset budgetwise if "perverse" rules of Federal Reserve practice were "put straight," if Reserve Bank capital-gain profits were recaptured, and if the revenues thus smartly obtained were used instead of taxes to pay bond interest! There should be no trouble in selling the scheme, for it only involves asking the Reserve banks to make more money and to follow accepted Treasury practice instead of attempting to stabilize prices—which, behavior notwithstanding, they have always denied trying to do and certainly have not the power to do. Indeed, even for intelligent people, it may seem wise to do everything wrong consistently, since the shortest political route to thesis may involve going all the way to antithesis first.

It is now fitting to pass comment on some minor variants of the antithesis. Some people, while commending and condemning mildly a little bit of everything in practice,

⁵ The losses, of course, may properly be minimized by avoiding instability, i.e., by making stabilization measures really effective.

have steeled themselves to accept postwar refunding into longer if not indefinite maturities but still lack the fortitude to accept possible high costs of debt retirement. Thus, they veer toward a consol form for the bondholder but leap back toward money for the Treasury via wide or indefinite "call" options. Here the inconsistency noted above is just reversed. The advocate of call features, while accepting higher interest rates, seeks to avoid the illusory misfortune of contingently high bond prices. Escaping one horn of a spurious dilemma, he impales himself on the other; or, in a better figure, he avoids Scylla by smashing upon Charybdis.

The proper way to avoid high prices for retired debt is to avoid deflations, i.e., to maintain private investment and reasonably attractive alternative investment outlets for private funds. Labor and patent monopolies, among others, may make this difficult to achieve by monetary measures; but debt policy should do its best willy-nilly and stick to its price-level guns. If we must have deflations and high consol prices, the more the government has to pay for its debt the better. Surely it does not aggravate the task of monetizing debt to have opportunely high bond prices! With effective monetary stabilization and the sustained prosperity which it would assure in a free-market economy, there would be no wide sweeps in bond prices. But it will do no good, and some harm, to control this monetary thermometer when the task is one of stabilizing the monetary temperature. Even penny-pinchers should not complain if the community asks high prices to exchange its bonds for noninterest-bearing obligations and makes this conversion harmless by its increased demand for socially costless liquidity.

We are asking people now to buy war bonds which it is here traditional to default on substantially, via inflation—and with only optimists expecting a small default this time. Against this near certainty and the enduring risk of further wild inflation, there is the relatively small chance of nominal gain through eventual decline of interest rates. This remote favorable contingency the call feature is designed to remove! Save

for indefinite forced lending (and do not suppose there will ever be none of it), call features can only raise the interest rate⁶ and, besides, create an implied obligation to support the market, i.e., to convert bonds into money at the worst times, if not, indeed, to make them really money all the time.

We have proposed, to repeat, that our debt be wholly and promptly converted into currency and consols, in whatever proportion is requisite for price-level stabilization. Such action, as already intimated, would place banks in a quandary. They would be loath to take consols, because of the loss of liquidity. They would be loath to take currency because of the loss of interest revenue, unless permitted to compound the currency by their own expansion of investments and deposits. The proper answer here is as simple as it is remote from our thinking or from our likely actions. Those institutions which choose cash should find their reserve requirements radically increased thereby (to or toward 100 per cent)—and should find their revenues in service charges. Those which choose consols should find their equity requirements increased (also ultimately and ideally to 100 per cent)—and should thereafter become largely or exclusively investment trusts. Thus, we only repeat proposals for the 100 per cent reserve scheme—for which I still have no great enthusiasm save as part of a gradualist program whose objective is recognized (and consistently pursued) as gradual reduction and ultimate denial of borrowing and lending powers to all corporations, especially as regards obligations of short term.

Misguided fiscal practice and unguided institutional evolution have placed us in a foolish quandary. Seemingly, we cannot afford prosperity or full peacetime employment because they would render our banks insolvent and increase interest costs of our federal debt! Conversely, one way to keep our banks solvent and our interest costs at a low level is to render private investment so unattractive, and property so insecure, that

⁶ The captious critic will note here an exception to my general rule about maximizing interest rates!

people will be glad to hold money and deposits in preference to real assets and delighted to buy money in an interest-bearing form. The dilemma again is wholly spurious, save for those who deplore increase in reserve requirements of banks (or our reluctance to accept collectivism). The government, instead of worrying about interest costs, should covet the large revenues which high prosperity and high interest rates bring along—while always eschewing, of course, the too easy route of deliberate or permitted price inflation, which must sometime produce astronomical interest rates if not eschewed. Let us pray for the highest interest rates consistent with monetary stability—for the highest possible “real” marginal efficiency of capital. Prosperity need not prove insufferable or disastrous.

There is urgent need for reducing discussion of monetary and fiscal problems to simple, common-sense terms. Our financial system is becoming simply too elaborate and too complex for the political system within which it operates. Both private financial institutions and fiscal practice are too complicated for government by law; i.e., they are not sufficiently amenable to effective control though the democratic process of action out of discussion and deliberation. Needless complexity in the private financial structure is heritage of bad policies in the past and should gradually be corrected and removed. Needless complexity in government finance can and should be dealt with by prompt, thoroughgoing measures.

Taxation, expenditure, pure debt, and pure money are, along with price level, quite intelligible conceptions. If institutional borrowing and, especially, institutional issue were exclusive governmental prerogatives, and if these governmental prerogatives were exercised only in the most straightforward way, both economists and the public might quickly and wisely distinguish between proper uses and abuses and, thus, democratic government might adhere to sound fiscal-monetary policies. The proper first step is simplification of our federal debt.

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