Dr. StrangeLoan: or How I Learned to Stop Worrying and Love the Financial Collapse

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The world almost changed Wednesday, September 17, 2008.

For years, the U.S. government debt soared. For years, the U.S. Treasury borrowed more and more funds. For years the government paid obscene sums in interest to service the debt. All that almost came to an end on Wednesday, September 17, 2008. That day, a light shown at the end of the tunnel and the government almost found a way out of this "business" of borrowing money and entered the business of guarding money, an honorable and profitable business that Brink's security company and vault makers like Diebold have enjoyed for years.

On September 17, the interest rate on 90 day Treasuries fell to three basis points. That is 75 cents of interest on $10,000 of borrowing. Government borrowing was essentially free. And the interest rate, falling fast, seemed sure to go negative. Surely Treasury rates would have gone negative had the Bush administration not come out Thursday with its new plan to buy up toxic financial paper.

Think how close we were to finding a solution to the problems of debt and taxes. The government could earn money simply by offering to guard funds!

COMING TO GRIPS WITH NEGATIVE INTEREST RATES

What would negative interest on Treasuries mean? No more costs from servicing the debt. People would be paying the Treasury for the privilege of using their money. Sound strange?

Well, in real terms, after deducting inflation, the Treasury has been paying substantially negative interest for a while, at least on shorter term borrowing. But the Treasury was still paying positive nominal interest so a T-bill was substantially better than holding cash or keeping funds in a non-interest bearing account.

Why you ask would anyone pay another in nominal terms to use their cash instead of the reverse? Wouldn't it be better to just keep the cash at home stuffed in a mattress?

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The simple fact is that you could easily lose all the money in your mattress from theft or in a fire. People have been paying Brinks or vault makers for years to secure cash against thieves. So, now we were simply on the verge of paying the U.S. Treasury to do the same thing—safeguard our cash.

You just have to change your mindset from paying someone to use your money, to paying someone to guard your money. Guarding your money is a service for which it is eminently sensible to pay.

THE TREASURY'S VALUE PROPOSITION

Every business must have a value proposition: the more unique the better.

For years, the U.S. Treasury has issued bonds borrowing money in competition with America's leading firms or other government borrowers. Typically, the U.S. treasury offered investors lower returns but promised more safety—safety (or "quality") was always the Treasury's niche.

On Wednesday, September 17, 2008, no longer did money market funds, banks or anyone else offer the U.S. Treasury any serious competition. So safe did Treasuries look by comparison that the Treasury could pay nothing for your money and people gladly handed it over. And it seemed likely that by Thursday, the Treasury would enter a whole new world in which interest rates were negative and we paid the Treasury for safeguarding our funds.

How would the Treasury compete with other purveyors of security services? Bepress, like all firms, must meet payroll and other costs, so I wondered where to store the money needed to do so. The money currently sat perilously in a money market deposit account at a bank. Treasuries were at zero and possibly heading negative. Could keeping our notional accounting "cash" in the form of real cash be the best option? A few calls to security companies made it clear that guarding a big pile of greenbacks for ninety days would be very expensive. Interest rates on Treasuries would need to go very negative before the U.S. Treasury found any serious competition from security companies.

What a value proposition the Treasury stumbled on!

COULD THE TREASURY SOLVE THE GOVERNMENT'S DEBT PROBLEM?

It seemed that the Bush Administration had found a perfect solution to the government's financial problems. Instead of paying tons of money to service the massive debt the government had accumulated, now that all of Wall Street seemed on the verge of collapse, now that Paul Volker and Laurence Lindsey were warning us that the payment system (i.e., banks) could be next, the U.S. Treasury was in an incomparable competitive position. On one side of the market, it had other borrowers who had no credibility of repayment and could not compete, and on the other it had security companies who require significant sums to guard your cash behind guns, steel, and cement, and could not compete. With this kind of market power, the Treasury could have profited enormously by charging negative interest rates, eliminated our government debt problem before too long, and then begun cutting taxes to the quick.

Sadly, the Bush administration did not realize how close they were to solving the governments troubles, and instead, I fear they stepped into some more. On Thursday, the Bush administration came up with a plan to bail out the private financial system, destroying the Treasury's competitive advantage by shoring up the Treasury's competitive rivals in borrowing. Not only does the government now bear the costs of our borrowers failing to repay, but it must now again pay significant sums for its own borrowing. In the best of all worlds, if this works out very well, then at substantial cost to the taxpayer, we will be back where we started. The government will be paying huge sums to service its even larger debt. And the Wall Street bankers will be back in business raking it in.

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REFERENCES AND FURTHER READING

U.S. Treasury (2008) "Daily Treasury Yield Curve Rates." Available at: http://www.ustreas.gov/offices/domestic-finance/debt-management/interest-rate/yield.shtml.