

# EXTENDING THE TREASURY-FEDERAL RESERVE DRAW AUTHORITY

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HEARING  
BEFORE THE  
SUBCOMMITTEE ON  
DOMESTIC MONETARY POLICY  
OF THE  
COMMITTEE ON  
BANKING, FINANCE AND URBAN AFFAIRS  
HOUSE OF REPRESENTATIVES  
NINETY-FIFTH CONGRESS  
SECOND SESSION

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# CONTENTS

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## STATEMENT OF

Taylor, Paul H., Deputy Fiscal Assistant Secretary of the Department of the Treasury.....	Page 3
---	-----------

## ADDITIONAL INFORMATION SUBMITTED FOR THE RECORD

Miller, Hon. G. William, Chairman, Board of Governors of the Federal Reserve System, letter dated April 4, 1978, supporting extension of the authority of the Board to purchase U.S. obligations from the Treasury on a direct basis up to a limit of \$5 billion.....	2
Taylor, Paul H., table submitted entitled "Direct Borrowing From Federal Reserve Banks, 1942 to Date".....	4

(III)

# EXTENDING THE TREASURY-FEDERAL RESERVE DRAW AUTHORITY

WEDNESDAY, APRIL 5, 1978

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON DOMESTIC  
MONETARY POLICY OF THE COMMITTEE ON BANKING,  
FINANCE AND URBAN AFFAIRS,

*Washington, D.C.*

The subcommittee met, pursuant to notice, at 8:15 a.m. in room 2220, Rayburn House Office Building, Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

Present: Representatives Mitchell, Barnard, and Hansen.

Chairman MITCHELL. The hearing will come to order. First, a brief explanatory note. There is a Democratic caucus this morning at 9 a.m., which will deal with a rather controversial matter, rollback of the social security taxes; therefore, we wanted to complete our hearing so we could get to the Democratic caucus.

In addition, eight other members were confirmed to be here. I am certain they will get here sooner or later.

I know how precious everyone's time is; therefore, I would like to start the hearings on time this morning.

The Subcommittee on Domestic Monetary Policy is holding this hearing and planning to markup legislation to extend until April 30, 1979, the authority of the Federal Reserve to purchase U.S. obligations, up to a limit of \$5 billion, from the Treasury on a direct basis.

Extensions of this authority have been granted on 21 occasions so far since it was first granted by Congress in 1942. The authority provides a backstop for Treasury cash and debt operations. It assures that the Treasury will be able to raise cash almost instantaneously in emergencies.

It has been described by former Treasury Assistant Secretary David Mosso as "a key element in all of the Treasury's financial planning for a national emergency." Currently, the authority is scheduled to expire on April 30, 1978. Prompt action to extend it would appear to be in the public interest.

At the same time, we must not forget that the authority makes it possible for the Treasury to use the Federal Reserve as its "hand-maiden," and thus to avoid the discipline of the marketplace. If abused, this could cause excessive money creation and inflation. Because of the potential for mischief inherent in the authority, the legislation only extends the authority for 1 year.

Our witness today is Paul H. Taylor, the Deputy Fiscal Assistant Secretary of the Department of the Treasury. We also have received a letter on the resolution from Hon. G. William Miller, Chairman of the Federal Reserve Board, which, if there is no objection, I will place in the hearing record at this point.

[The letter referred to from Chairman Miller follows:]



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

G. WILLIAM MILLER  
CHAIRMAN

April 4, 1978

The Honorable Parren J. Mitchell  
Chairman  
Subcommittee on Domestic Monetary Policy  
Committee on Banking, Finance and Urban Affairs  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Chairman:

I am writing in response to your letter of March 30 requesting our views on the joint resolution you are introducing to extend the authority of the Federal Reserve to purchase U. S. obligations from the Treasury on a direct basis up to a limit of \$5 billion. That authority expires on April 30.

The Board strongly supports extension of the authority. This authority has been used sparingly, principally at times when the Treasury has been faced with a temporary depletion of its cash balances, such as just prior to receipt of quarterly tax payments. Nonetheless, it has proven to be of great value and serves, generally, as a needed safety-valve for Treasury debt and cash management operations. It provides protection for the Treasury in face of the inevitable uncertainties in estimating the amount and timing of receipts and expenditures. It also helps provide the Treasury with flexibility in managing its cash position and in the timing of its debt management operations.

Because extension of the authority would not seem to raise controversial issues, the Board would endorse a longer extension than the one year suggested in your letter. An extension until October 31, 1981, as recommended by the Treasury, seems to us entirely reasonable.

Sincerely,

Chairman MITCHELL. I am always delighted that my colleague shows up on time, full of vim and vigor, every morning that we have an early morning hearing. Do you wish to make an opening statement, Mr. Barnard?

Mr. BARNARD. No, thank you, Mr. Chairman.

Chairman MITCHELL. If there are no other opening statements, we will now hear from you, Mr. Taylor. We welcome you, and you may proceed as you wish. We have a copy of your testimony in front of us. Thank you very much for getting here at this awful hour of the morning, but I am afraid that it is the only hour at which we can get business done in an expeditious manner.

**STATEMENT OF PAUL H. TAYLOR, DEPUTY FISCAL ASSISTANT  
SECRETARY OF THE DEPARTMENT OF THE TREASURY**

Mr. TAYLOR. Thank you, Mr. Chairman and members of the subcommittee.

I am pleased to appear in support of proposed legislation to extend until April 30, 1979, the authority of Federal Reserve Banks to purchase directly from the Treasury up to \$5 billion of public debt obligations. Under current legislation, Public Law 95-154, approved November 7, 1977, the authority will expire at the end of this month.

The authority has existed since 1942, and has usually been extended for 2-year periods, although there have been some lapses in recent years. In January 1977, the Department submitted proposed legislation to the Congress to extend the direct-purchase option to October 31, 1981. I understand, however, that, prior to taking up that measure, the subcommittee desires to hold oversight hearings on Treasury debt management policies, and that the 1-year extension you are now considering would merely provide interim authority.

The primary purpose of the authority is as a backstop for Treasury cash and debt operations, permitting more economical management of our cash reserves and allowing us to carry lower than normal balances in our checking accounts at the Federal Reserve Banks when the need arises.

The purchase option has been used sparingly. However, its value does not rest on its frequency or the extensiveness of its use, but its availability as a backstop for Treasury cash operations, permitting more economical management of our cash position and assuring our ability to provide needed funds almost instantaneously in the event of any kind of emergency.

During normal conditions, the Treasury has wholly adequate recourse to short-term funds through our weekly Treasury bill auctions or the short-term cash management bills which can provide funds to the Treasury in as few as 3 days. From the close of calendar year 1975 to the present, we have made only a single use of the option, and that use was limited to a \$2.5 billion draw to maintain a maximum cash balance just prior to expiration of the legislation establishing the temporary ceiling on the public debt in the fall of 1977.

In the more distant past, the authority was used during periods when disruptions occurred in the financial markets at the same time the Government needed to raise cash to maintain Government functions. Usually, the authority is not used for long periods, the average length being from 2 to 7 days; only twice in the past 35 years has the Treasury had to draw funds in this manner for 20 days or more at any one time.

The accompanying table shows the instances of actual use.

[The table referred to follows:]

DIRECT BORROWING FROM FEDERAL RESERVE BANKS  
1942 TO DATE

<u>Calendar Year</u>	<u>Days Used</u>	<u>Maximum Amount At Any Time (Millions)</u>	<u>Number of Separate Times Used</u>	<u>Maximum Number Of Days Used At Any One Time</u>
1942	19	\$ 422	4	6
1943	48	1,302	4	28
1944	none	--	-	-
1945	9	484	2	7
1946	none	--	-	-
1947	none	--	-	-
1948	none	--	-	-
1949	2	220	1	2
1950	2	180	2	1
1951	4	320	2	2
1952	30	811	4	9
1953	29	1,172	2	20
1954	15	424	2	13
1955	none	--	-	-
1956	none	--	-	-
1957	none	--	-	-
1958	2	207	1	2
1959	none	--	-	-
1960	none	--	-	-
1961	none	--	-	-
1962	none	--	-	-
1963	none	--	-	-
1964	none	--	-	-
1965	none	--	-	-
1966	3	169	1	3
1967	7	153	3	3
1968	8	596	3	6
1969	21	1,102	2	12
1970	none	--	-	-
1971	9	610	1	7
1972	1	38	1	1
1973	10	485	3	6
1974	1	131	1	1
1975	16	1,042	4	7
1976	none	--	-	-
1977	4	2,500	1	4

Note: Federal Reserve direct purchase authority expired October 1, 1977, and was reinstated November 7, 1977, until April 30, 1978.

Office of the  
Fiscal Assistant Secretary

March 9, 1978

The authority is subject to the public debt limit, and its use is reported in the daily Treasury statement, the weekly Federal Reserve statement, and in the Federal Reserve Board's Annual Report to the Congress.

Thus, the Department views the authority as a temporary accommodation to be used only under unusual circumstances. In that connection, it is important to emphasize that any direct recourse by

the Treasury to Federal Reserve credit under this authority is subject to the discretion and control of the Federal Reserve itself.

The authority is an invaluable cash-management tool, however; and the Department urges prompt consideration of the proposed legislation to ensure that it does not expire on April 30, 1978.

That concludes my prepared statement, Mr. Chairman. I will be glad to respond to any questions.

Chairman MITCHELL. Thank you very much. This is a rather routine matter, and I don't have a large number of questions. I would just observe, as you have noted, that we do intend to have oversight hearings on Treasury debt management. I think, pending the holding of those hearings, that the 1-year extension is the best and most effective way to handle this issue. The House Joint Resolution 816, was placed in the hopper on Monday, and we hope it will move quickly. If enough members show up between now and 9, I will try for a quick markup on the bill and move it right through.

Congressman Barnard?

Mr. BARNARD. Thank you, Mr. Chairman.

Mr. Taylor, how do you determine the rate of interest on these transactions?

Mr. TAYLOR. That is by agreement with the Fed. This current agreement has been in effect for a number of years. It is one-quarter of 1 percent below the bank discount rate at the Federal Reserve Bank in New York. That would currently be if we borrow today, for instance, 6¼ percent. The discount rate is 6½ percent currently.

Mr. BARNARD. That seems fair enough.

That is the only question I have, Mr. Chairman.

Chairman MITCHELL. The distinguished ranking minority member has joined us, Mr. Hansen.

I might indicate, while we are waiting for Mr. Hansen, that, in his correspondence, Chairman Miller did suggest we vote for more than a 1-year extension. Unfortunately, it is the opinion of the Chair that we cannot honor that request, primarily because of the scheduled hearings by the subcommittee, and we will so advise Chairman Miller.

Mr. Hansen?

Mr. HANSEN. Yes, thank you.

I arrived during the last part of your statement, and have now read the first part, and appreciate your being here this morning. I only have a couple of questions.

One, in your mind, do you feel it is possible that the tax and loan account legislation just passed might alleviate the need for this request?

Mr. TAYLOR. No, sir, I personally don't think so. This is still, as I mentioned in my testimony, primarily an emergency tool insurance if you will, and enables us to target minimum cash balances at a particular time. And I would still foresee times, even with the tax and loan investment authority, that we would still have to draw all of our money from the tax and loan account and still have a total shortage of cash at a given time, particularly in an emergency. And so I would not see that that would negate the need for this.

Mr. HANSEN. Are we talking polarization here, in terms of yes or no? How about somewhere in the middle? Does it reduce the need?

Mr. TAYLOR. No, sir. I don't think so, not for this type of emergency borrowing.



I might make a point that the amount that is being asked to be renewed, the \$5 billion, has stayed the same since 1942. However, if you relate it to Government outlays in 1942, when this authority was established, Government outlays were in the vicinity of \$35 billion. They are projected for 1979 at somewhere around \$499 billion. So, relatively speaking, the amount has definitely been reduced in relation to the outlays. In fact, I guess our cash flows now are approaching, if not already there, \$1 trillion a year. So, from that standpoint, you could say that the amount has gone down, relatively, to the size of the outlays, but it is still a very helpful device for us to have.

Mr. HANSEN. I always get a kick out of these analogies—based on gross national product or cash outlays or whatever, because some people try to relate the national debt to this and say, "Well, it really isn't growing, if you look at it in proportion." But, if we ever have a bust in our economy and our GNP, for instance, went down, even though you would be producing the same amount of goods, you would not get the same amount for them, and then you would not find that the proportion rises rather fast. So, there is always cause to worry about the proportionalizing that goes on.

I also am amused by this business regarding insurance. You are not the only ones, so don't take it personally. But people always say they want insurance. I think, really, what they want is a signed blank check.

Mr. TAYLOR. Well, the answer, I would give is that we have used this authority sparingly, and we recognize the responsibility to use it discretely and only when we absolutely need it. So, we have used it, very judiciously, in my opinion. We have used it once, since 1975. That has been the span since I have been directly connected with this authority.

Mr. HANSEN. I don't quarrel with that. I was teasing you a little bit. I hope the chairman can successfully stall for a quorum. But I am about through, except to say that I appreciate the fact that we are going to have oversight hearings, and I think that is the time to get into some of the nuts and bolts of these things.

Mr. Chairman, I have no further questions. Thank you.

Chairman MITCHELL. Thank you very much. I am not stalling. I really want to learn something. I have been here not 7½ years, and I am one of the Members of the Congress who feels that for as long as he has been here, he is still in the process of learning.

You did use the authority last fall?

Mr. TAYLOR. Last September. Yes, sir.

Chairman MITCHELL. Now, in terms of that use, just for my own enlightenment, would you track through the mechanics of how that authority was used; how the decision to use it is arrived at? What kind of timespan does it take for the Fed to provide you the funds when the Treasury needs them?

Mr. TAYLOR. Well, I think the decision was made, when it looked like the temporary ceiling—which, at that time, I think, was \$700 billion—was not going to be extended before it expired on September 30. So, at that time, we wanted to maximize our cash balances to carry us over to pay our bills as long as we could, in case the debt limit bill was not passed in time.

Well, it so happened that it didn't. I think it was 4 days before the debt ceiling passed, and we were able to borrow again.

So, what we did, we worked as we always do, very closely with the staff of the Open Market Committee in New York and, based on the remaining ceiling that we had available to us on September 30—\$2½ billion—we borrowed within that amount to get as much cash as we needed to carry us as long as we could.

Mr. BARNARD. Mr. Chairman, would you yield at this point?

Mr. MITCHELL. Yes.

Mr. BARNARD. That is what confuses me. Wouldn't that \$2½ billion have also been included in the debt ceiling?

Mr. TAYLOR. That's correct. We had, prior to the ceiling reverting from \$700 billion to \$400 billion, we had within that \$700 billion ceiling, \$2½ billion approximately that we could use. And so we used that prior to expiring on September 30.

Mr. BARNARD. But that is part of the total?

Mr. TAYLOR. Yes, it is part of the debt ceiling.

Chairman MITCHELL. Besides the staff of the Open Market Committee and the Treasury, are any other agencies getting involved in preparing this recommendation?

Mr. TAYLOR. No.

Chairman MITCHELL. Then final approval, of course, is with whom?

Mr. TAYLOR. With the Open Market Committee. It is with the Fed.

Mr. BARNARD. In the history of this program, I notice it has never gone over \$2½ billion. That is the highest one-time amount that has been negotiated. Has there ever been any thought about how much this ceiling would be? I suppose it would be the national debt.

Mr. TAYLOR. Do you mean the ceiling on—

Mr. BARNARD. On these negotiations.

Mr. TAYLOR. \$5 billion is the statutory ceiling.

Chairman MITCHELL. Just one more. The decision process starts with the Open Market Committee staff, then the Treasury, and then final approval is really with the Federal Reserve; correct?

Mr. TAYLOR. Yes, sir.

Chairman MITCHELL. In effect, then, are you saying that the Federal Reserve really has a sort of veto power over the decision?

Mr. TAYLOR. Yes, it is they loaning us funds. So, it is up to them to say yes or no. They have the authority to do that.

Chairman MITCHELL. Well, I mentioned somewhere in my opening statement about possibilities for mischievous behavior. I was not referring to the Fed at that time, but all sorts of strange things can happen. Again, it is one of those matters that I think we ought to look at, whether or not we have had a negative experience, whether or not a veto power ought to rest with the Fed.

Mr. BARNARD. Mr. Taylor, does the Fed maintain enough liquidity that it could invest in these Treasury bills? Now, they are investing reserves; aren't they?

Mr. TAYLOR. I am not positive as to how that works.

Mr. BARNARD. It looks like to me, if they had this liquidity in their operations, they could have already had it invested.

Mr. TAYLOR. I think their loan to us has the effect of increasing bank reserves.

Chairman MITCHELL. Thank you very much, sir, for being with us.

I would ask the members who are present if they could remain available a while and have some coffee, at least until 9, in hopes that some other members would get here.

Gentlemen, thank you very, very much for being here.

[Whereupon, at 8:33 a.m., the hearing was adjourned.]

