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Statement by

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before the

Subcommittee on Domestic Monetary Policy

of the

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I appreciate the opportunity to present the views of the Board of Governors of the Federal Reserve System on the direct borrowing authority of the U.S. Treasury. As the Committee is aware, this authority permits the Federal Reserve to purchase obligations of the United States directly from the Treasury in amounts up to \$5 billion.

The purpose of the direct borrowing authority is to aid the Treasury in the management of its cash and debt positions. The authority provides assurance that the Treasury can meet its obligations without delay in the event of temporary need. This supplemental source of funding can be of particular value if there are large unforeseen drains on the Treasury's cash position--as when the timing of Federal receipts and expenditures is more erratic than expected--or in the event of a national emergency.

Since the establishment by Congress of the direct borrowing authority in 1942, it has been needed on 44 occasions--and only once since 1975. In every instance, the volume of funds borrowed was well under the maximum permitted by law, and was outstanding only a short time. In most cases, the amount borrowed was below \$1 billion, and in the great majority, the indebtedness was terminated in less than 10 days. The largest single borrowing amounted to \$2-1/2 billion; and the longest duration was 28 days. Thus, the record indicates that the Treasury has utilized this borrowing authority infrequently, in limited amounts, and for very brief periods.

The principal need for the authority, historically, has arisen on the occasion of sharp declines in the Treasury's cash balance just

prior to quarterly tax payment dates. Instead of going to the financial markets for funds that would be needed only temporarily, the Treasury borrowed directly from the Federal Reserve and repaid this indebtedness immediately upon receipt of the tax revenues. In recent years, however, the frequency of direct borrowing for this purpose has been reduced significantly with the introduction of short-dated cash-management bills.

The direct purchase authority has always been exercised at the initiative of the Treasury. Due to the close operational relationship between the Federal Reserve and the Treasury, a direct borrowing transaction can be accomplished quickly, even on the day it is requested. Thus, temporary accommodation of the Treasury can be achieved when needed without delay.

The terms and conditions of direct Federal Reserve purchases of Treasury obligations are established by the Federal Open Market Committee. At present, the interest rate paid by the Treasury on such obligations is one-quarter of 1 per cent below the discount rate at the Federal Reserve Bank of New York. In addition, the Federal Reserve is fully aware of its responsibility to ensure that the authority for direct purchases is used prudently. Thus, the FOMC's authorization for direct purchases has consistently limited the System's holdings to amounts well below the statutory maximum. At present, that limit is \$2 billion. A request for greater accommodation would be subject to review by the FOMC before it is honored.

There are other safeguards and limitations on the Treasury's direct borrowing authority, beyond the FOMC's monitoring of this

activity. All direct borrowing is reported promptly in the Treasury's daily financial statement and in the weekly statements of condition of the Federal Reserve Banks, all of which are available to the public. Use of the authority is also reported by the Federal Reserve in its Annual Report to the Congress. Also, direct borrowing is subject to the Federal debt ceiling imposed by the Congress.

In recent years, the Treasury's need to offset cash drains just before tax payment dates has been met principally by means of cash-management bills. These debt instruments can be issued with maturities of very short duration and are sold in the market in relatively large amounts on short notice. And since the cash drains experienced in recent years generally have been within the ranges expected, the Treasury has had less need to fall back on its direct borrowing authority before tax payment dates.

Nonetheless, other circumstances may require the Treasury to resort to direct borrowing to meet its debt-management and cash disbursement obligations in an orderly and timely manner. Such an episode occurred last fall when the Treasury borrowed \$2-1/2 billion directly from the Federal Reserve to bolster its cash position in contemplation of the expiration of the temporary ceiling on the public debt. It should be emphasized that this borrowing was not undertaken to circumvent restrictions imposed by the Congress on Treasury indebtedness, but was an interim measure to assure timely discharge of the Treasury's obligations until the Congress took action on a new temporary debt ceiling.

In conclusion, the Board believes that the direct purchase authority has been effective in enabling the Treasury to meet unexpectedly

large cash drains and to achieve its debt-management objectives. The assurance that the Treasury would have the option of obtaining immediate--though limited--funds outside the financial markets in times of unanticipated and temporary need is a desirable safeguard. It is analogous to the ability of member banks to turn to the Federal Reserve as a temporary source of funds through the discount window, or to the arrangement for funding temporary credit needs that the Congress has mandated for various Federal agencies with the Treasury. For these reasons the Board continues to support strongly the extension of the direct purchase authority.

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