PERSONAL AND CONFIDENTIAL April 21, 1947.

Mr. Robert C. Hill,
Clerk, Committee on
Banking and Currency,
United States Senate,
Washington, D. C.

Dear Mr. Hill:

Attached is a statement that the Senator might wish to consider using in case two amendments to the direct purchase bill are offered on the floor. One would reduce the 5-billion-dollar limitation to 3 billions; the other would limit the borrowing period to 60 days or some other arbitrary, short time.

The trouble, I think, with the enclosed statement is that it is somewhat technical. As you know, it is impossible to go into the details of this matter without technicalities. The Senator may wish merely to state that the bill has had careful consideration by the Banking and Currency Committees of both the Senate and the House. The Senator who is likely to offer the amendments is not a member of the Senate Committee, was not present at the hearings, and did not offer his suggestions to the Committee where they could have been given proper consideration. It is inconceivable that the Federal Reserve Bank presidents, the Board of Governors, the Federal Advisory Council, and the committee of the American Bankers Association would be unanimously in favor of this bill without these further limitations if they felt there was the remotest danger. In other words, they unquestionably would have suggested such further limitations if they had felt there was any need or reason whatever for them.

Please let me know if there is any information or anything else that we can do to be of assistance in case any is needed to get the bill squared away.

Sincerely yours,

Elliott Thurston
Assistant to the Chairman.

Attachment

ET:b

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I hope that the Senate will pass this bill, H.R. 2413, in the form in which it has been reported unanimously from the Banking and Currency Committee and has already been passed by the House, after approval of its Banking and Currency Committee. It is desired by the Treasury and the Federal Reserve System merely as a convenience in the management of the public debt. No question of monetary theory or policy is really involved in the bill, which provides simply for a mechanism that will make for efficient, economical and businesslike management of the Government's debt.

It renews for three years the existing authority of the Federal Reserve Banks to purchase up to 5 billion dollars of Government securities directly from the Treasury. Most of the purchases of Government securities by the Federal Reserve Banks are made through so-called open market operations and come from the dealers in Government bonds. By having the right, however, to purchase up to 5 billion dollars directly from the Treasury, the Federal Reserve Banks are able to extend what amounts to a line of credit for this amount to the Treasury on which it can draw if need arises, as it sometimes does, chiefly at tax payment periods. With this available line of credit, even if not used, the Treasury is in position to carry smaller cash balances than otherwise and this means that outstanding debt can be further reduced and interest costs saved.

As you will note, there are two limitations in the bill at present -- the amount of securities bought directly from the Treasury that the Reserve Banks may hold at any one time shall not exceed 5 billion dollars and the authority will expire on June 1, 1950, unless further extended by Congress, as I have no doubt will be necessary.

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I can see no reason for putting further restrictions or limitations on the bill because it has been very carefully considered by people whom I consider fully competent to know exactly how it has served in the past and would serve in the future in mechanically aiding in smoothing out Treasury operations. It has no other significance. It has the united support of all of the twelve presidents of the Reserve Banks as well as of the Board of Governors of the Federal Reserve System. It has been endorsed unanimously by the Federal Advisory Council of the Federal Reserve System which is composed of twelve prominent bankers representing the local banks in all of the Federal Reserve districts. And it has also been recommended by the Committee on Government Borrowing of the American Bankers Association, which likewise is composed of outstanding bankers who thoroughly studied the matter.

It was the judgment of all of these responsible groups that the bill should be passed in the form which the Banking and Currency Committee has reported it and the House has passed it. I do not profess to be an expert in the intricate problems involved in public debt management, but I am satisfied that the bill would not have this general approval if it were undesirable or unsound. I am entirely willing to accept the opinion and judgment of the various banking groups and others far more expert than myself. And I would be reluctant, in fact, to superimpose a contrary opinion and judgment on my part unless I distrusted the competency of those who advocate this bill or felt that I had a wisdom superior to theirs.

The limitation of 5 billion dollars seems entirely reasonable in view of the magnitude of the public debt and the size of the monthly maturities which the Treasury must meet. Much of the debt is in short maturities, which

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means that refunding operations are frequent and necessary, and careful planning is required. There were, for example, maturities of Treasury bills, certificates, and notes of about 10 billion dollars in March, and I understand that the maturities will amount to about 8 billions this month. Next September they will probably exceed 10 billions. This situation, involving tremendous refunding operations, will continue as long as we have a huge public debt.

It should be borne in mind also that a large part of the debt is equivalent at all times, potentially at least, to a demand liability on the Treasury. The holders of savings bonds and notes, which together are outstanding in the amount of 5.8 billion dollars, may cash them at will. Accordingly, 5 billion dollars seems a modest line of credit for the Treasury to have in relation to the size of the debt, the monthly maturities, and the varying demands for redemption of outstanding issues.

Nothing useful would be accomplished by making this relatively small limitation still smaller. All it would do would be to cramp the Treasury operations needlessly and require them to carry more cash balances and pay more interest than they otherwise would need to.

This direct purchase authority, which under the original Federal Reserve Act existed without practical limitation until 1935, was revived in 1942 as an aid in war financing operations. It has been used only for limited times almost entirely at periods of heavy Treasury payments when offsetting receipts were coming in more slowly than outgoes. As I understand it, frequently around tax dates the Treasury also has to make large payments for interest, debt retirement, or other purposes, and these payments may be due

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before taxes and proceeds of sales of new Government securities are received and credited to Treasury deposits. At the same time there are heavy drains on the banks as people draw out money by check to pay their taxes to the Internal Revenue collectors, who deposit these checks with the Federal Reserve Banks to the Treasury's account. As long as the Treasury can meet temporary needs by borrowing directly from the Reserve Banks for a few days, it is not obliged to carry as much in its War Loan or Federal Reserve Accounts as would otherwise be needed. By temporary borrowing from the Federal Reserve Banks the Treasury can also avoid transferring funds to the Reserve Banks from its War Loan Accounts in commercial banks at the very time when tax payments are already putting a heavy strain on those banks.

If large Treasury maturities have to be refunded at the same time, the strain is still greater. Ultimately, of course, the funds that are gathered in by the tax collectors are paid out by the Treasury to meet expenses and find their way back into the banking system. This period of time is usually relatively brief, but this borrowing mechanism helps to ease the strain and to prevent needless fluctuations in pressures on interest rates.

The supporters of the bill felt it would be unnecessary and unwise to put any arbitrary limitation on the length of time that Federal Reserve Banks could extend any such credit because emergencies could arise when the accommodation might be needed for an indefinite period until money market conditions became normal.

Such limitations would not in fact restrict the Federal Reserve in following a sound general monetary policy of supporting Treasury finance. The

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fact is that, with or without this authority, the Federal Reserve Banks are not limited for all practical purposes either as to the amount or the maturities they may purchase in the open market. So a restrictive time limitation put into this bill, already limited to only 5 billion dollars, would accomplish nothing except, possibly, to have a nuisance value in case of some unforeseen development.

I suppose the theory for some such limitation as I have indicated is that if the Treasury could only sell directly to the Reserve Banks a 60-day paper -- and this is much shorter than the Treasury's shortest term market issue which consists of 90-day bills -- it would stop the Government from selling long-term issues to the central banks and thus in some way deter the Government from financing itself through the central banking mechanism. The theory is unrealistic because the same thing can be accomplished by Federal Reserve purchases in the open market. Actually, the total amount of securities held by the Federal Reserve System and its purchases and sales are determined by the Federal Open Market Committee on the basis of the demands of the country for currency and needs of the banking system for reserves. The System's general policy is based upon the general credit situation at the time -- whether credit expansion is to be discouraged or encouraged and what market conditions and what rates of interest shall prevail. Securities purchased directly from the Treasury or in the open market have the same effect upon the supply of bank reserves. The only difference is a matter of short-term money-market and public-debt management.

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The place to stop inflationary Government financing is in the Congress. If Congress authorizes appropriations which it fails to cover by taxation, the Treasury must borrow. When Government obligations fall due they must be paid or refunded. The Treasury has no choice. The classical inflations all originated in parliaments or dictators, whose will was not thwarted by putting obstacles in their path through the money markets. They have generally been the result of war, when the needs of war finance required more spending than the taxing authorities were willing to cover by taxation. The celebrated fiat money inflation in France originated in the National Assembly. Nothing then could stop the printing presses. But even crediting the theory with validity, it is hardly applicable when we consider that the public debt is nearly 260 billion dollars and the most that the Treasury can obtain from Reserve Banks by this mechanism is 5 billions.

I hope the bill will not be complicated by such needless amendments that were not thought necessary or desirable by the various banking groups who are familiar with this authority and its purpose and use in the past. It has the same purpose now and would be put to the same use.

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