MEMORANDUM OF CHAIRMAN ECCLES
ON H.R. 2413

The proposed bill would extend for 3 years the existing temporary authority, under the Second War Powers Act, whereby Federal Reserve Banks may purchase up to 5 billion dollars of Government securities to meet temporary deficiencies in Treasury balances with the Reserve Banks.

The bill would restore to a limited degree an authority which the Federal Reserve System had from its inception in 1914 until the Banking Act of 1935. A provision was inserted in that Act requiring all purchases of Government securities by Federal Reserve Banks to be made in the open market, which means purchased chiefly from dealers in Government bonds. Those who inserted this proviso were motivated by the mistaken theory that it would help to prevent deficit financing. According to the theory, Government borrowing should be subject to the "test of the market." The so-called "test" could only be applied to marketable securities, and the test would be meaningless unless applied to them in an entirely regulated market. There could be no such market except at the risk of chaotic conditions in the bond market and incalculable added costs to the Government in managing the public debt.

Congress vested in the Federal Reserve authority to create reserves for the banking system primarily by purchases of Government securities in the open market. Purchases as well as sales of Government securities are made by the Open Market Committee, established by Congress for that purpose. Policy governing these operations is determined on the basis of the broad needs of the economy at any given time. Through these operations the Government bond market has been kept relatively stable, notwithstanding the vast increase in the public debt as a result of the war, and the Treasury has had an assured market for new as well as refunding issues at interest rates satisfactory to the Government.

Nothing constructive would be accomplished by the proviso that the Reserve System must purchase Government securities exclusively in the open market. About all that such a ban means is that in making such purchases a commission has to be paid to Government bond dealers. The prohibition would not restrict the total amount of Government financing, nor would it affect the general level of interest rates, and that is the only way in which the "test of the market" could be manifested. Interest rates on Government securities have been and will continue to be determined by the Open Market Committee in consultation with the Treasury. Finally, it is unrealistic to presume, as this theory does, that if Congress votes for expenditures but does not vote for sufficient taxes to cover the expenditures, the money market should erect barriers to discourage the practice.

The purpose for which the direct purchase authority has always been used in the past and would be used in the future is simply one of meeting temporary needs of the Treasury which, if met in other ways, would entail either needless additional costs in managing the public debt or equally needless fluctuations in the securities and money markets for brief periods. What is involved in the proposed bill is not a question of monetary theory or policy, but simply a question of efficient, economical and businesslike management of the public debt.

The direct purchase authority merely provides a line of available credit for use if needed. Without it, the Treasury would feel obliged to carry much larger cash balances, which means that it would have to borrow more and thereby increase the amount and cost of the public debt. In other words, having the authority, even though there may be no need to use it, enables the Treasury to carry smaller balances than would otherwise be possible and thus reduces interest charges. For every billion dollars of Treasury balance that can be saved in this way, interest costs would be reduced by at least 4 million dollars.

As the Committee knows, with a huge public debt, much of it in short maturities, frequent, periodic refunding operations are necessary. For example, more than 10 billion dollars of Treasury bills, certificates and notes fall due in March, some 8 billions in April, and so on through the year. The same will hold true for years to come -- as long as we have a debt of this magnitude. To have an uncertain or periodically tightened money market in view of this situation would be as impracticable as it is needless.

I append to this statement a table which shows the number of occasions on which the direct purchase authority, granted temporarily in the Second War Powers Act of 1942, has since been used. The table shows that in 1942, 1943 and again in 1945 there were approximately 60 days, all of them falling at periods when the Treasury had to meet large payments, generally for interest or for redemption of maturing debt, a few days before large tax receipts were deposited. The Treasury temporarily borrowed from the Federal Reserve Banks for these few days when the Treasury balances at the Federal Reserve Banks were less than the amounts needed to meet withdrawals. Subsequently these deficiencies were overcome and the Treasury balances at the Reserve Banks were built up again as deposits were made to these accounts of tax payments received by Internal Revenue collectors.

The temporary borrowing did not mean that the Treasury had no funds. It had large deposits in War Loan Accounts with commercial banks at all these periods. Sufficient funds could have been transferred from the War Loan Accounts to the Federal Reserve Banks to cover all expenditures. However, transfer of funds from the commercial banks to the Federal Reserve Banks for this purpose would have left the Treasury, after the tax receipts had come in, with a much larger balance at the Reserve Banks than it needed and thus would have unduly reduced bank reserves for an extended period. If commercial banks are faced at tax periods not only with deposit withdrawals to meet tax payments but also with drains on their War Loan Accounts, they would have to follow one of four courses: If they had sufficient excess reserves with the Federal Reserve Banks they could reduce their reserve balances to the extent necessary. If they did not have excess reserves -- this normally is the case -- they would have to sell sufficient securities to obtain the funds, or they could withdraw correspondent balances, or they could borrow from the Reserve Banks. All of these alternatives would tend to tighten money market conditions at a time when taxpayers would be drawing on their bank accounts to make their tax payments. In other words, if the Treasury could not borrow temporarily from the Federal Reserve Banks at these tax payment periods, and in this way avoid withdrawals from its War Loan Accounts to pay off maturing obligations, money conditions would unduly tighten and tend to unstabilize the money market and the Government securities market.

This can be avoided by the temporary borrowing until the tax payments again build up Treasury accounts at the Reserve Banks and provide the Treasury with funds. The operation simply stabilizes the market. That is all that happens. The amounts of special certificates shown in the table are relatively small compared with the size of the public debt and the recurring maturities. For instance, on June 16, 1942 and for four days thereafter, the Treasury had borrowings varying from 58 to 94 million dollars. The largest occurred in the middle of March of 1943, when the highest amount borrowed was $1,302,000,000 on March 15. The borrowing was entirely paid off by the end of the month.

As I have indicated, the authority existed for more than twenty years prior to 1935. It is more needed than ever today because of the size of the debt and the refinancing operations. The fact that tax collections are also very large, currently about 40 billions a year, means that quarterly withdrawals from the banking system are going to continue to be heavy, so that it will be desirable to have the authority to help in stabilizing the money market at tax dates.

HOLDINGS OF SPECIAL SHORT-TERM TREASURY CERTIFICATES
BY THE FEDERAL RESERVE BANKS, 1942-45
(In millions of dollars)

Date	Amount	Date	Amount
1942 - June 16	58	1943 - Mar. 18	836
19	70	19	778
20	47	20	768
22	34	22	603
23	94	23	700
		24	512
Sept. 15	324	25	432
16	189	26	384
17	286	27	304
18	76	29	104
19	53	30	40
Nov. 27	139	June 15	805
28	329	16	659
30	422	17	350
		18	256
Dec. 1	98	19	212
10	16		
15	145	Sept. 8	11
		9	126
1943 - Jan. 29	115	10	243
30	202	11	246
		13	214
Mar. 2	3	14	179
4	174	15	424
5	354	16	258
6	543		
8	591	1945 - Mar. 15	4
9	648		
10	632	Dec. 4	107
11	790	5	318
13	1,043	6	374
15	1,302	7	484
16	1,250	8	484
17	981	10	202