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Statement by

Philip E. Coldwell

Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Domestic Monetary Policy

of the

Committee on Banking, Currency and Housing

House of Representatives

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I am pleased to meet with the Committee today to present the views of the Board of Governors on H.R. 7507, a bill that would amend Section 14(b) of the Federal Reserve Act to extend for two years the authority of Federal Reserve Banks to purchase United States obligations directly from the U.S. Treasury. The current authority expires on the 31st of this month.

Since first authorized by Congress in 1942, the direct purchase authority of Section 14(b) has been used sparingly from the standpoint of frequency, amount, and duration alike. In fact, since Congress last extended this authority on October 28, 1974, it has only been used on three occasions. Nonetheless, in such instances, it has proven of great value in facilitating the economic management of the Treasury's cash and debt positions.

The authority has been used exclusively at times when the Treasury has been faced with an abrupt temporary depletion of its cash balance, chiefly just prior to the receipt of quarterly tax payments. Rather than issue debt in the market to borrow funds needed for only a few days, the Treasury has sold securities directly to the Federal Reserve Banks under this provision of law. Then, immediately after tax payments were received, these special debt obligations were retired. Timely use of this direct lending authority has thus enabled the Treasury to minimize its public financing activity--thereby avoiding unnecessary strains on financial markets--and to achieve a more efficient management of its cash balance.

In both March and August of the current year, the Treasury has found it useful to issue special obligations directly to the Federal Reserve. During the first period, which surrounded the March 15 income tax date, the daily average of System holdings of such obligations amounted to about $750 million, and the largest amount held on any one day was a little over $1.0 billion. In the second period--which encompassed a major Treasury refinancing that also raised some new money--the Federal Reserve Banks held special Treasury debt obligations on most days between August 5 and August 17. The average of holdings on these days was about $520 million, and the highest amount held on any one day was $965 million.

In addition to serving as an instrument for achieving short-run cash management objectives, the Board believes that the direct purchase authority of Section 14(b) has provided and will continue to provide the Treasury with a desirable safety valve against an unexpected shortfall in its cash balance. Such a shortfall could develop if estimates of government receipts and expenditures, which are difficult to project, should suddenly turn out to be materially in error. Also the sheer volatility of the Treasury balance and the unpredictability of some fluctuations constantly threaten shortfalls or an overdraft. If Treasury is to manage its balances to the minimum needed then some protection should be provided. Since there is little cost to the direct purchase arrangements and since they have been used quite sparingly, it would seem logical to us that the authority be renewed. Direct purchase authority, moreover, would prove particularly valuable if a period of national emergency were to develop, since it would enable the Treasury to respond immediately to any financial strain that such conditions might create. Unusual strains which might threaten the immediate sale of securities in a disorderly market could also be covered by the special purchase arrangements.

From the standpoint of Federal Reserve operations, the special purchase authority has been only a minor complication. When the direct purchase takes place and the Treasury expends these funds, the Federal Reserve may take some offsetting actions in order to maintain the monetary policy environment deemed desirable for the financial needs of the economy. Thus, to a considerable extent, such special sales to the Federal Reserve are then translated into System sales to the market. Of course, System open market responses to the use of the special purchase arrangements in any given period will depend upon the duration, size, and timing of the Treasury use, and the particular reserve needs of the moment.

In the Board's view, if this special purchase arrangement were not to be extended, then some other emergency device would be needed to enable the Treasury to meet the unexpected. Obviously, if the Treasury were to abuse the special authority or if the program were sharply enlarged, the Board would have some concern. But given the small use and the modest size of the special authority the Board has no reason for objecting to its use. In summary, it is the Board's view that the Federal Reserve System's authority to purchase obligations directly from the Treasury should be extended.

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