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Statement by

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before the

Subcommittee on Domestic Monetary Policy

of the

Committee on Banking, Finance and Urban Affairs

House of Representatives

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I appreciate the opportunity to appear today to comment for the Board on the two bills the Subcommittee is considering that deal with the authority of the U. S. Treasury to borrow directly from the Federal Reserve System. H.R. 2281 would extend the existing authority for 5 years. H.R. 421 would substitute instead a new authority that permits the Treasury to meet its emergency cash needs by borrowing securities from the Federal Reserve for resale in the secondary market.

Last June, I met with this Committee to explain why the Board strongly supported a bill then being considered which was similar to H.R. 2281 in that it called for a simple extension of the System's existing authority to purchase U. S. Government obligations directly from the Treasury in amounts up to $5 billion. Because the Board's view on this issue has not changed, I would like to resubmit that earlier testimony for the record. The major points offered then remain equally applicable today.

Since the Treasury now often relies on short-dated cash management bills to cover low points in its cash balance prior to key income tax payment dates, the direct borrowing authority of the Treasury has come to be used only infrequently. In fact, since 1975, the authority has been activated only once. The Treasury had made more use of the facility in earlier years, usually to offset cash drains just before funds were available from quarterly income tax payments. But the direct borrowing authority is still important as a standby facility to be used in emergency situations. Such an arrangement provides assurance that the Treasury will be able to honor its commitments without delay if unexpected developments suddenly shrink its cash holdings. The Treasury, at its own initiative, can quickly arrange to borrow from the Federal Reserve, even on the same day of the request.

It continues to be the judgment of the Board that this direct borrowing authority has functioned well whenever needed and that the facility contains prudent safeguards and limits. In addition to the $5 billion limit on drawings contained in the legislation, the Federal Open Market Committee has imposed an operating ceiling of $2 billion on purchases that can be made by its Open Market Account Manager without special authorization from the Committee.

H.R. 421 would substitute a more elaborate technique for providing the Treasury with funds in the event of an unexpected need. In such instances, this alternative proposal would permit the Treasury to borrow securities from the Federal Reserve for reselling into the open market. The Treasury would be required to repay the borrowed securities within 6 months. The bill, as now written, does not limit the amount of securities that could be borrowed, nor does it specify whether the value of the securities borrowed would represent an addition to the public debt--two issues that require clarification. We assume that it is not the intent of the bill to give the Treasury a way of circumventing the Federal debt ceiling through large scale borrowing and resale of securities from the Federal Reserve's portfolio. And we are concerned about the apparently open-ended grant of power to the Secretary of the Treasury to borrow securities from the Federal Reserve without prior consultation or approval from the FOMC.

Even after these questions are resolved, however, the proposed alternative to the direct borrowing authority does not appear as desirable as the present arrangement. Since Treasury cash management bills can be announced, offered, and delivered within a few days under present debt management procedures, what the Treasury appears to us to need in addition is a back-stop facility that permits it to acquire a sizable volume of funds immediately without resort to the market.

If the Treasury were to meet such needs by borrowing securities from the Federal Reserve and then reselling them in the market, it might well be forced to pay a substantial premium over its ususal borrowing rate. The action would probably take market participants by surprise and might have to be accomplished fairly late in the day. In highly unsettled market circumstances, moreover, the Treasury could find it difficult or impossible to sell all of the securities needed. We understand that the objective of the bill is to insure that Treasury borrowing always be subjected to the discipline of the market.. While the Board endorses such a concept as a general rule, in emergency cases of the sort contemplated here that test could well be abnormally unfavorable and not in the public interest.

The existing direct borrowing authority of the Treasury was established in 1942 when war-time financing required that the Federal Government raise enormous volumes of funds through securities markets. The authority was needed to provide assurance that the Treasury at all times could meet its expanding obligations. Under any future conditions of national emergency occasioned by war or natural disaster, the Treasury might again face unanticipated needs for immediate funds at a time when securities markets are in general disarray. While the Congress probably would be in a position to reestablish an emergency borrowing authority quickly in such circumstances, it seems far more efficient to maintain the existing standby direct borrowing procedures in order to assure the Treasury the capacity to finance for at least a limited period-- without the necessity of such Congressional action.

In conclusion, the Board sees no need to introduce a new mechanism for the Treasury to raise temporary funds since the present direct borrowing authority has functioned effectively. Instead, we believe that the Federal Reserve System should be empowered to continue lending directly to the Treasury under the carefully drafted constraints of the current authority. Favorable action on H.R. 2281 will achieve this objective, and the Board endorses the bill.

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