AMENDMENT OF SECTION 14(b) OF THE FEDERAL RESERVE ACT

HEARING

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

EIGHTY-FIFTH CONGRESS

SECOND SESSION

ON

H. R. 12586

JUNE 12, 1958

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THURSDAY, JUNE 12, 1958

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met, pursuant to notice, at 9:30 a. m., Hon. Brent Spence (chairman) presiding.

Present: Representatives Spence (presiding), Brown, Patman, Rains, Multer, Addonizio, Barrett, Mrs. Sullivan, Messrs. Reuss, Ashley, Vanik, Healey, Rutherford, Coad, Anderson, Breeding, Talle, Kilburn, Widnall, Betts, Mumma, McVey, Hiestand, Bass, Seely-Brown, and Henderson.

The Chairman. The committee will be in order.

We are meeting to consider H. R. 12586, a direct-purchase authority bill. The witness is Mr. Baird, the Under Secretary of the Treasury for Monetary Affairs. We will be glad to hear you, Mr. Baird.

If you want to proceed without interruption, you may now read your statement.

Mr. Baird. Thank you, sir.

The Chairman. You will then be subject to any questions the members may have.

(The bill H. R. 12586 follows:)

[H. R. 12586, 85th Cong., 2d sess.]

A BILL To amend section 14 (b) of the Federal Reserve Act, as amended, to extend for two years the authority of Federal Reserve banks to purchase United States obligations directly from the Treasury

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 14 (b) of the Federal Reserve Act, as amended (U. S. C., 1952 edition, supp. V, title 12, sec. 355), is amended by striking out "July 1, 1958" and inserting in lieu thereof "July 1, 1960" and by striking out "June 30, 1958" and inserting in lieu thereof "June 30, 1960".

STATEMENT OF JULIAN B. BAIRD, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

Mr. Baird. Mr. Chairman, I believe there has been distributed to each member of the committee a copy of this prepared statement, but with your permission I will read it.

I am glad to have this opportunity to appear before you today to present the views of the Treasury Department in support of H. R. 12586. This bill would extend until June 30, 1960, the present authority of the Federal Reserve banks to purchase public-debt obligations directly from the Treasury in amounts not to exceed $5 billion outstanding at any one time.

The Treasury Department recommended that the proposed Financial Institutions Act, pending before this committee, be amended to include a provision which would accomplish this 2-year extension. In view of the fact that the Financial Institutions Act has not yet been enacted and in order to avoid the lapse of this authority, we are requesting your consideration of H. R. 12586 at this time. The extension has been endorsed by the Board of Governors of the Federal Reserve System.

I am sure you are familiar with the purposes and the background of this legislation. You will recall that the Federal Reserve banks under the original Federal Reserve Act had authority to purchase Government obligations either in the market or directly from the Treasury without limitation on their holdings up until 1935. The Banking Act of 1935 limited this authority, however, to open-market transactions. In 1942 the Second War Powers Act restored the authority of the Federal Reserve banks to make purchases directly from the Treasury up to $5 billion outstanding at any one time.

This authority, which was initially granted only through December 31, 1944, was subsequently extended by Congress from time to time. It will expire June 30, 1958, unless it is extended further by the Congress.

This direct-purchase authority permits the Treasury, in cooperation with the Federal Reserve System, to smooth out the effect on the economy of short-run fluctuations in its cash receipts and disbursements. This is especially important at the quarterly tax dates. The short-run fluctuations involve large figures. For example, total deposits into the Treasury from all sources this month are estimated to exceed $13 billion, of which $11 billion will be concentrated in the last half of the month. During the fiscal year 1957, the total of all cash funds paid into the Treasury and out of the Treasury on all accounts, including budgetary operations, trust-fund activities, and public-debt issues and redemptions, exceeded $400 billion. These are tremendous amounts to deal with and the Treasury must have tools to operate efficiently and effectively. Sound financial management requires that the disturbing effect of such a tremendous flow of funds be held to a minimum. This direct-borrowing authority is one of the tools that the Treasury and the Federal Reserve System use for this purpose. The authority is used only occasionally and for short periods. It was used last on March 17 and 18, 1958. On March 17 the Treasury borrowed $143 million from the Federal Reserve banks, and on March 18 we borrowed $64 million. These amounts were repaid on March 19 from collections of the March 15 installment of corporate income taxes. There have been other quarterly tax dates when our advance estimates indicated there would be some necessity of utilizing this direct borrowing authority, but when the actual flow of receipts and expenditures was more favorable than had been estimated, the need for direct borrowing did not materialize. The attached table indicates the amount of direct borrowings from the Federal Reserve banks since January 1952.

During the wartime period of low and controlled interest rates the Treasury paid interest at the rate of one-fourth of 1 percent on these direct borrowings. Since the authority was so infrequently used, this rate carried over after the war without any change. Recently, however, the Treasury agreed with the Federal Reserve System that the rate on these special borrowings should be a more realistic rate. Effective in November 1957, the rate was fixed at one-fourth of 1 percent less than the rediscount rate at the Federal Reserve Bank of New York. Currently this will involve a rate of 1½ percent as against the rediscount rate of 1¾ percent now in effect at that bank.

The direct borrowing authority is an essential tool to meet our temporary requirements in connection with the day-to-day operations of the Treasury. We should not overlook the fact also that it is a safeguard that could be used in the event of any sudden nationwide emergency requiring heavy cash payments from the Treasury before public-debt obligations could be sold in the public markets to provide such funds.

There is always a delay of a week or 10 days in order to get out a public offering, I may say.

It has been the Treasury's policy never to use this borrowing authority on other than a temporary basis, and we have no intention of changing this policy. We recognize that we are dealing with powerful forces because selling obligations of the Government direct to Federal Reserve banks creates high-powered money, and it is for that reason we think the Treasury should make a biennial accounting to the Congress of the manner in which it has exercised this borrowing authority. The authority has been used, as the record shows, with great restraint, but it is the kind of thing that carries the possibility of abuse.

It has never been necessary to use as much as $5 billion but nevertheless we recommend continuation of the present $5 billion limitation to give the Treasury and the Federal Reserve System sufficient flexibility to cover emergency situations if they should arise. Any borrowing under the authority is, of course, subject to the statutory debt limit.

Now, if you will turn to the table, then, that is appended, you will notice that the longest period of time since 1942 that it was used at one time was 28 days, back in 1943. It was used once for a continuous 20-day period in 1953, or a 13-day period in 1954. It was not used at all in 1955, 1956, or 1957. And it was used twice—no, it was used once, excuse me, in 1958 for a period of 2 days.

Direct borrowing from Federal Reserve banks

Year	Days used	Maximum amount at any time	Number of separate times used	Maximum number of days used at any one time
		Millions		
1942	19	$422	4	6
1943	48	1,320	4	28
1944	None			
1945	9	484	2	7
1946	None			
1947	None			
1948	None			
1949	2	220	1	2
1950	2	108	2	1
1951	4	320	2	3
1952	30	811	4	9
1953	29	1,172	2	20
1954	15	424	2	13
1955	None			
1956	None			
1957	None			
1958	2	207	1	2

That concludes my statement, Mr. Chairman.

The CHAIRMAN. You are only asking for the extension of present authority without any amendments, just the laws that now exist?

Mr. BAIRD. That is correct, sir. It has been extended successively since 1942, and as I indicated before, we think it is well to have this reviewed by Congress every 2 years, because the powers could be abused by an administration of the Treasury or an administration of the Federal Reserve, and the Congress should review the way they have performed under these powers.

The CHAIRMAN. When was this power first given to you?

Mr. BAIRD. The original act, Federal Reserve Act, gave the power without limit. Then it was repealed in 1935, and in 1942, the war being on, this special $5 billion power was given for 2 years and has subsequently been renewed for 2-year intervals, always after the Treasury's report to Congress.

The CHAIRMAN. So the Treasury is the only Department that is asking for this?

Mr. BAIRD. The Treasury is the only Department that is asking for it. The Federal Reserve Board has indicated that they approve of it as a good procedure.

The CHAIRMAN. The Treasury makes the request?

Mr. BAIRD. Yes, sir.

The CHAIRMAN. How many years have you had this power and failed to use it?

Mr. BAIRD. Well, this chart that is appended shows that since 1942 there have been 7 years in which it was not used at all.

The CHAIRMAN. You have no intention of using it for anything except to meet the deficiencies that may exist by reason of the shortage of funds?

Mr. BAIRD. That is correct. We would be very much opposed to using it for anything but this temporary purpose.

I would give you an analogy. This is a dangerous kind of a drug to use. A doctor can use drugs under prescription once in a while to the great benefit of the patient. But we don't want to get to be an addict, because there are many governments around the world—many treasuries have gotten into difficulty and have in this last year, due to the fact that the central bank authorities have permitted the treasury officials to finance deficits by direct borrowing and it reaches a point where there is no restraint and it destroys the integrity of their monetary system.

The CHAIRMAN. I will call the committee on the 5-minute rule. Dr. Talle.

Mr. TALLE. Thank you, Mr. Chairman.

Reviewing the history of this proposed legislation, Mr. Baird, I might say that the Federal Reserve Act enacted in December 1913, and put into effect the following year left this wide open, so that the Treasury could have recourse either to the Federal Reserve banks or to the open market; that is correct, isn't it?

Mr. BAIRD. That is correct, sir.

Mr. TALLE. And that prevailed until 1935.

Mr. BAIRD. That is correct, sir.

Mr. TALLE. Then it was changed and for 7 years the recourse was only to the open market.

Mr. BAIRD. That is correct, sir.

Mr. TALLE. And not to the Federal Reserve banks.

Following that, in 1942, this method has been employed, up to $5 billion. And I note that your table points out how sparingly the authority has been used.

Now, I would like to quote a few statements from your testimony. I quote now:

> This direct purchase authority permits the Treasury in cooperation with the Federal Reserve System to smooth out the effect on the economy of short-run fluctuations in its cash receipts and disbursements.

It is obvious to everyone that the inflow to the Treasury is irregular. However, the Government must pay its bills. If it doesn't, the people will quickly know about it and the reaction will not be favorable.

It seems to me it is quite necessary that you do have this authority. I quote again from the same page, No. 2:

> Sound financial management requires that the disturbing effect of such a tremendous flow of funds be held to a minimum.

Even such a thing as weather, Mr. Baird, can influence the Treasury situation, can't it?

Mr. BAIRD. It surely can.

Mr. TALLE. A heat wave in the Middle West would affect it, wouldn't it?

Mr. BAIRD. That is right, and if airplanes are held up for a few days, where there is a holdup of heavy tax receipts, it can make a difference of hundreds of millions in our cash position.

Mr. TALLE. That is right. I know that in some years you have not used the authority at all. While it was necessary to use it last March, you used it for only 2 days.

Mr. BAIRD. Yes, sir.

Mr. TALLE. So it is a very convenient way of meeting a situation which must be met unless the Government runs the risk of very bad public psychology.

It seems, therefore, most reasonable that this should be extended, and so far as I am concerned it is the kind of bill that could very well go on the Consent Calendar, except for the fact that we do have in the House a limitation of $1 million on Consent Calendar bills. If they amount to $1 million or more, we don't consider them on the Consent Calendar. Which is quite all right. I don't criticize that. It is good policy and good practice.

Thank you very much for your testimony.

Mr. BAIRD. Thank you.

The CHAIRMAN. Mr. Brown.

Mr. BROWN. No questions, Mr. Chairman.

The CHAIRMAN. Mr. Kilburn.

Mr. KILBURN. I would like to have your reaction to the amendment Mr. Reuss proposes to your bill. Did you see it?

Mr. BAIRD. I just had an opportunity before the meeting. Mr. Reuss handed me a copy of his amendment. I have studied it very briefly. My observation on it would be this: If that bill were enacted, it would not make one whit of difference in the way the Treasury or the Federal Reserve would handle this.

We are so imbued with the idea that we are dealing with a powerful drug here and it should be used with such great restraint that we would not handle it in any other way. But I feel very strongly that whatever the intention of Mr. Reuss in putting this amendment in is—and I am sure it is a worthy intention—I think it is the kind of thing that would be construed by the financial community in this country and abroad as being the opening wedge and as an expression of the Congress that they didn't treat this device with quite the same seriousness that they have in the past, that under this amendment, as I read it, it would be perfectly permissible for the Treasury to place $1 billion over in the Fed if they are going into open market purchases in the next 6 months to that extent—I am not suggesting they will, but if they were they could take the billion directly from the Treasury and let it lodge there until the 2 years have elapsed.

Now, you can argue that there isn't much difference whether the Treasury sells Treasury bills in the open market and Fed goes and buys them in the open market. But that is one of the fetishes that has grown up in the financial community. And as I said earlier, the world—in Latin America and many of the countries of Europe, there has been abuse of the privilege of the central bank taking directly from the treasury of those countries their bills. And it has caused these gross inflations. They have lost control of their monetary situations.

So that idea has been built up in the minds of the financial community. And I think the enactment of that amendment would cause consternation.

There are certain people who represent a group of very conservative economists over the country who think we should not have the power at all to do it.

You can make an excellent case for that, if there is any chance of its being abused.

The Treasury likes the idea of the 2-year extension as a precedent because there will be other administrations, of both the Treasury and the Federal Reserve, in times to come. We think the Congress in a matter as important as this should review this each 2 years and force the Treasury to account for the way it has behaved.

Now, I mention that because I am trying to show the sensitivity of the financial community over the world to this idea of putting direct Treasury obligations into the Fed. And when reasons are cited of economy or in interest rates or that it would help in fighting a recession or any of those reasons, they just say, "Yes, that is the first step. If $5 billion, why not $10 billion next time? And why not, instead of 2 years, let it ride?" Those are the dangers people see.

Now, that is a long answer, Mr. Kilburn, but that is the Treasury's reaction to that amendment.

Mr. KILBURN. I certainly didn't mean to steal anything from Mr. Reuss, because, of course, I know that his offering of the amendment is absolutely sincere, and he wants to do the best job he can. And I didn't know how it affected the Treasury. I thank you very much for your reply. This is all, Mr. Chairman.

The CHAIRMAN. Mr. Patman.

Mr. PATMAN. Mr. Baird, the $143 million and $64 million transactions; were they handled by the New York Federal Reserve Bank?

Mr. BAIRD. Yes; they were all handled by the New York Federal Reserve Bank.

Mr. PATMAN. Did you actually issue the securities of the Treasury and deliver them to the New York Federal Reserve Bank?

Mr. BAIRD. Yes, sir; we have a sample of the security we issued here.

Mr. PATMAN. I wish you would file that for the record.

Mr. BAIRD. We will file that for the record.

(The document referred to appears on p. 8.)

Mr. PATMAN. Let me see it. Do you have somebody around here that can hand it to me?

Thank you.

Now, did they handle it through the open market, or direct?

Mr. BAIRD. They handled that transaction direct; the one that we are talking of.

Mr. PATMAN. Handled direct, under this law, which requires it to be direct.

Mr. BAIRD. It doesn't require it to be direct.

Mr. PATMAN. What is that?

Mr. BAIRD. It permits it to be direct, Mr. Patman.

Mr. PATMAN. I thought it was compulsory. It just permits it, then?

Mr. BAIRD. Oh, no. The Federal is operating in the open market all the time.

Mr. PATMAN. Yes.

Mr. BAIRD. But it does give them the power to buy up to $5 billion from the Treasury.

Mr. PATMAN. That is right. Did the Federal Open Market Committee handle it then, or did the New York bank handle it?

Mr. BAIRD. The Board of Governors——

Mr. PATMAN. The manager of the account of the New York bank for the Federal Reserve Open Market Committee handled it, I assume, then.

Mr. BAIRD. It is handled by the New York bank under instructions from the Federal Reserve Board.

Mr. PATMAN. From the Federal Reserve Board. Well, did they handle it—did the manager of the account of the Open Market Committee handle it, or did the Federal Reserve bank handle it?

Mr. BAIRD. The Federal Reserve Bank handled it.

Mr. PATMAN. The Federal Reserve Bank handled it.

All right.

Now, we are keeping from $3 billion to $6 billion in the commercial banks at all times, interest free, upon which the people are paying the interest all the time and getting nothing for it, and this money can't be checked on by the Treasury. It has to be transferred to the Federal Reserve bank before checks can be given.

Have you given consideration to using this $5 billion authority to smooth out the rough places with the banks and not keep deposits in these commercial banks?

Mr. BAIRD. We think it would be unwise, Mr. Patman, to use this device frequently, unless we are almost compelled to do it.

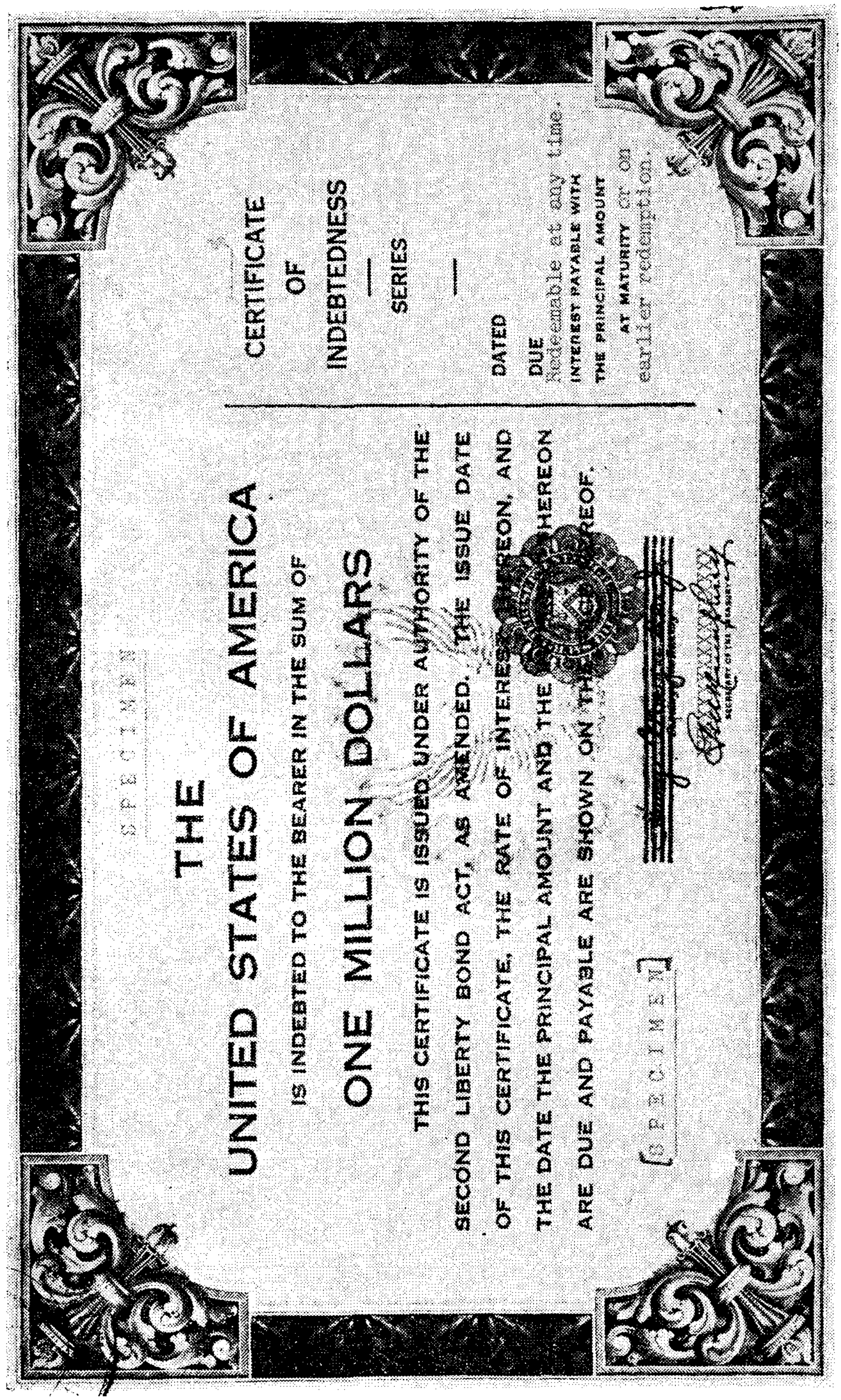
Mr. PATMAN. You state it is high-powered dollars.

Mr. BAIRD. Yes, sir.

Mr. PATMAN. Well, you have ways of offsetting the high-powered dollars. The Federal Reserve Board has ways of raising reserve requirements, doesn't it?

Mr. BAIRD. They can't whip reserve requirements up and down.

Mr. PATMAN. That is right.



SPECIMEN

THE

UNITED STATES OF AMERICA

IS INDEBTED TO THE BEARER IN THE SUM OF

ONE MILLION DOLLARS

THIS CERTIFICATE IS ISSUED UNDER AUTHORITY OF THE SECOND LIBERTY BOND ACT, AS AMENDED. THE ISSUE DATE OF THIS CERTIFICATE, THE RATE OF INTEREST THEREON, AND THE DATE THE PRINCIPAL AMOUNT AND THE INTEREST THEREON ARE DUE AND PAYABLE ARE SHOWN ON THE FACE HEREOF.

SECRETARY OF THE TREASURY

SPECIMEN

CERTIFICATE OF INDEBTEDNESS

SERIES —

DATED

DUE

Redeemable at any time.

INTEREST PAYABLE WITH THE PRINCIPAL AMOUNT AT MATURITY or on earlier redemption.

Mr. BAIRD. From week to week.

Mr. PATMAN. In other words, if they buy—if you sell direct to the Federal Reserve banks and the high-powered dollars are in play 6 to 1, the Federal Reserve Board can offset that by raising reserve requirements if they want to, can't they?

Mr. BAIRD. Yes, sir.

Mr. PATMAN. In other words, there couldn't be any danger if they did that.

Mr. BAIRD. Well, it is not a facile tool. You raise reserve requirements with notice and you do it infrequently. But you can't adjust from day to day and week to week by moving reserve requirements up and down. It is not a practicable method, Mr. Patman.

Mr. PATMAN. May I keep this, or do you have an extra copy?

Mr. BAIRD. Can he keep it?

Mr. PATMAN. Or is this for your files?

Mr. BAIRD. You may keep it.

Mr. PATMAN. All right.

Now, in connection with the use of this, you are not objecting to any policy that Congress fixes. If Congress wants to fix the policy, you carry it out. You would be glad to do that, wouldn't you?

Mr. BAIRD. If you granted us the authority that this amendment did, which means that you thought it was all right if we left half a billion or 1 billion or 5 billion in the Federal for up to 2 years, the present administration of the Treasury would not use it, Mr. Patman.

Mr. PATMAN. Would not use it.

Mr. BAIRD. Would not use it.

Mr. PATMAN. Well, suppose Congress passed the law, a directive to use it——

Mr. BAIRD. If Congress passes a directive I think any Secretary of the Treasury would follow that directive.

Mr. PATMAN. Certainly you would have to follow out the directive. And if Congress wanted to pass an amendment like Mr. Reuss' or one even stronger—I agree with you it is not too strong, but I think it does leave the impression that you don't have to be so strict with this as you have been in the past, and it could be used a little bit more in the public interest and save the taxpayers more money than as it has been used in the past.

The Federal Open Market Committee, then, doesn't have anything to do with these direct purchases?

Mr. BAIRD. Not to my knowledge.

Mr. PATMAN. Is that right or not?

(Mr. Baird confers.)

Mr. BAIRD. They are acquainted with it, but——

Mr. PATMAN. They are acquainted with it.

Mr. BAIRD. The Board of Governors passes a resolution and sends it to the Federal Reserve Bank in New York, which stands——

Mr. PATMAN. But you realize, Mr. Baird, the Federal Open Market Committee is separate and distinct from the Federal Reserve Board.

Mr. BAIRD. I do.

Mr. PATMAN. And it is separate and distinct from the Federal Reserve System.

You see, those 12 members of the Federal Open Market Committee—the members of that Committee are not sitting there because 7 of them are members of the Board or because 5 of them are presidents of banks. They are sitting there because they have been designated by the statute passed by the Congress of the United States, designating them, 12 members, as the Open Market Committee, and they are under no obligations to carry out instructions as members of the Board or as presidents of banks. Is that your understanding?

Mr. BAIRD. They have a good deal of independent authority.

I think I should say here: I am not positive that the directive to the Federal Reserve bank is not by the Open Market Committee. I have never looked into it. They advise us that they have approved this procedure. Mr. Martin has told me that.

Mr. REUSS. Mr. Chairman, would the gentleman yield?

The CHAIRMAN. Mr. Betts.

Mr. BETTS. I just want to ask one question: Whatever borrowing is made, it has to be within the debt limit in the Treasury Department.

Mr. BAIRD. That is correct, sir.

Mr. BETTS. That is all.

The CHAIRMAN. Mr. MULTER.

Mr. MULTER. Mr. Baird, I don't think you answered one of Mr. Patman's questions, and I would like to get an answer to it, if I can.

He stated, with which I believe you agree is a fact, the United States Government carries average daily balances in the private banks of the country, running from $3 to $6 billion. That is an accurate statement, is it not?

Mr. BAIRD. No; I won't consider that an accurate statement. It goes much below $3 billion. There were times last year when it got down to less than one billion and a half.

Mr. MULTER. Well, what do you say——

Mr. BAIRD. This year.

Mr. MULTER. What do you say the average daily balance is? I didn't ask for the lowest, nor did Mr. Patman. We are talking about the average daily balances.

Mr. BAIRD. Three to three and a half billion, I would guess, is the average, Mr. Multer.

Mr. MULTER. Right.

Now, why shouldn't that three and a half billion dollars of average daily balances be kept in the Federal Reserve banks, which are owned by the United States Government, and checked out by the Treasury through the Federal Reserve banks rather than through the private banks of the country.

Mr. BAIRD. Well, there has been a great deal of testimony before this committee, and I will reiterate it, that if we were to shift these large amounts of money, $13 billion this month, out of the banking system into the Federal Reserve, we would cause a distortion that would prevent the banking system performing its legitimate function.

We must remember, always, that these deposits that you speak of that are in the commercial banks are not deposited by the Treasury in the banks.

If John Jones in the First National Bank of Podunk makes a check for $1,000 to buy a bond, or if a corporation pays $25,000 of taxes, instead of that money being drawn out of that bank that day and taken to the Federal Reserve bank it is placed to the credit of the Government on the books of the bank until the Government directs the bank to move it to the Federal Reserve bank.

But the monetary operation of the Federal Reserve bank—the Federal Reserve Board—can't be carried on unless they have some constant amount of reserves available to the banks. And the method you suggest would cause serious strains on the reserves of banks.

Mr. MULTER. You read into the question something that is not in the question, either of Mr. Patman or of myself. Nobody said—neither he nor I suggested you do it today or tomorrow or do it all at one fellswoop.

The question is why shouldn't this money be in the Federal Reserve banks, in the Government's bank, because it is the Government's money, and checked out by the Treasury as they need it, rather than checking it out of the private banks?

I am not suggesting that we take it out tomorrow or take it out at one time. But if taking this $3½ billion of the Government's average daily balances out of the billions of demand deposits, leaving aside the time deposits, in the private banks—if it is going to have such a tremendously bad effect on the banking system of the country, we don't have to take it out at one time.

But I don't agree it would have a bad effect if you drew out every dollar from the private banks of the country, particularly today when the reserve requirements have been reduced and the Federal Reserve Board tomorrow can reduce them again and make many more times reserves available for use by the private banking system, than results from leaving this $3½ billion with the private banks. I still would like to have a reason as to why the Treasury Department can't check out Government moneys through the Government bank, that is, the Federal Reserve banks. I know, as everybody here has heard time and time again, that most of the Government money that goes into the private banks, comes from the tax and the loan accounts—the bond accounts. As that money comes into these private banks from day to day, why can't they immediately remit it to the Federal Reserve bank to the credit of the Treasury, instead of letting it lay there in the private banks to the credit of the Treasury? Why can't you withdraw it except on notice? The Treasury presently has agreed not to withdraw such moneys except after notice. Why should the United States Government let the private banks use this money for nothing? In effect, they are time accounts. Every time account bears interest. But because these are kept in a so-called category of demand accounts, they bear no interest. Yet they are time accounts because they can't be withdrawn except upon notice.

Mr. BAIRD. My answer to your question would be this, Mr. Multer. The Treasury—you said "can they?" The Treasury could. I think it would be extremely unwise.

Now, here is an illustration. On June 19, the date coming up, our estimates are that the total receipts into the Treasury on that day would be $1,510 million.

The Federal Reserve Open Market Committee as a matter of policy has been keeping free reserves in the commercial banking system, in the general neighborhood of five to six hundred million dollars.

Now, if that were thrown in there on that day, the free reserves would go up that much.

Now, no money——

(Mr. Heffelfinger aside.)

Mr. BAIRD. Go down that much, excuse me. It would put that much strain on the banks because they would have to acquire free reserves sufficient to cover the withdrawal of funds by the Treasury.

Now, I don't see how any open market committee can operate the monetary system of this country having no power that it can maintain from day to day the amount of free reserves or negative reserves it wants to keep.

The CHAIRMAN. Mr. Mumma.

Mr. MUMMA. Mr. Baird, I am very much interested in the way you testify. It is the first opportunity I have had to hear you.

I just wonder how much background you have in the situation that you are discussing? Does your experience with the Treasury go back to 1933?

Mr. BAIRD. Well, Mr. Mumma, I am a commercial banker. I spent about 22 years in the investment banking business and then in the commercial banking business, but all with the same institution.

I am not a monetary economist. I wouldn't purport to be one such as Mr. Burgess was.

I have taken an interest in central banking and government finance because for the last 13 years I have been coming down to Washington either on the Federal Advisory Council of the Federal Reserve Board, on which I served 2 terms, or for a number of years on the government borrowing committee of the American Bankers Association which comes in to consult with the Treasury.

Mr. MUMMA. Have you ever been a member of the Federal Reserve Board?

Mr. BAIRD. I have not.

Mr. MUMMA. But your experience has been along the line you are talking about?

Mr. BAIRD. My main experience has been as an investment banker and a commercial banker.

I may have had a little more contact with this type of thing than the average commercial banker for the reasons I stated.

Mr. MUMMA. Isn't the bulk of this transient Government money that is in and out confined to much fewer banks than Government depositories? Not all your accounts are active, are they?

Mr. BAIRD. Yes, they are all active.

Mr. MUMMA. Well, I happen to have one in mind, that is near a big installation of the Air Force, of some 10,000 people. They were keeping maybe $75,000 in that bank. The bank was cashing checks for literally thousands of those people over a pay period. They felt that they ought to have an additional Government fund in return for the service they were rendering, and the Treasury did give them. I thought it was all right.

Mr. BAIRD. There are two classes of accounts, as you understand.

Mr. MUMMA. Yes.

Mr. BAIRD. The big group is the tax and loan accounts. There are 11,000 of those banks, all of which are active. The class A's are less active. They are the small banks. That is because they are not drawn on daily as the larger banks are.

Mr. MUMMA. There would be an awful lot of bookkeeping to adjust those every day.

Mr. BAIRD. The other accounts are where services are performed locally, that is, accounts maintained by United States courts and others, and where the accounts are given based on the amount of work and the volume of checks cleared by the accounts.

I think the account you are talking about is one in the latter kind, and they aggregate altogether $314 million.

Mr. MUMMA. I certainly am glad that you considered this proposition as sort of a sacred cow, intending to watch every different angle. Thank you.

The CHAIRMAN. Mr. Addonizio.

Mr. ADDONIZIO. Mr. Chairman, I don't have any questions, but I yield my time to Mr. Multer.

Mr. MULTER. Thank you.

May I proceed, Mr. Chairman?

Mr. Baird, I have in front of me the May 1958 Federal Reserve Bulletin. On page 608, Consolidated Condition Statement for Banks and the Monetary System, shows on December 31, 1957, the total deposits and currency in the banks of the System were $236 billion plus. It also shows on the same page for the year 1957 the lowest balance was as of January 30, of United States Government balances at commercial and savings banks, $1,900 million. On February 27 it was $2,800 million.

And for every other month of that year the amount varies from $3,300 million to a top figure of $5,300 million.

Now, are you serious, sir, when you say that to take out the average daily balance of $3½ billion from the private banking system of the country and keep it in the Federal Reserve System—that that would adversely affect the situation, with a banking system that has in excess of $230 billion in total deposits and currency?

Mr. BAIRD. I certainly am, sir, because you are talking about reserves. It isn't just an ordinary deposit.

If you transferred those receipts immediately to the Federal Reserve Bank you are taking reserves out of the banking system and that is high-powered money.

Mr. MULTER. That high-powered money and those reserves are the $3½ billion of United States Government funds; is that what you are talking about?

Mr. BAIRD. That is right.

Mr. MULTER. That you call reserves; is that right, sir?

Mr. BAIRD. Well, you are operating on reserves in this whole area, yes.

Mr. MULTER. What I am trying to find out, sir: Whether or not—you say the total amount of the deposits are the reserves.

Mr. BAIRD. No, I am not saying that total deposits are reserves.

Mr. MULTER. The $3½ billion——

Mr. BAIRD. I cited that exactly.

Mr. MULTER. The $3½ billion are certainly not the reserves.

Mr. BAIRD. I cited——

Mr. MULTER. They are only a very small part of the total balances. To the extent that is fixed by law, the reserves of a rural bank or a central reserve city bank or a reserve city bank, are a percentage of the total deposits, a percentage of that amount is fixed by the Federal Reserve Board as a reserve requirement; isn't that so?

Mr. BAIRD. That is correct.

Mr. MULTER. So at most it is only a fraction of the $3½ billion that goes into the reserves?

Mr. BAIRD. No; that is not correct, sir.

As I indicated on June 19, if that billion and a half of receipts that the Government would get was to be deposited by the Internal Revenue people directly to the Federal Reserve bank, that it would draw down the reserves of the banks of this country by one billion and a half.

Mr. MULTER. All right. So the private banks of the country, then, would be prohibited from lending out to their customers that billion and a half dollars.

Mr. BAIRD. It isn't just that billion and a half. It is the leverage on six times that.

Mr. MULTER. All right, six times the billion and a half. That gives us approximately $9 billion of lending power, that would be withdrawn from the banking system of the country.

Mr. BAIRD. But it is withdrawn one day and restored the next day, the way our deposits swing in and out, and no bank is going to know a week ahead what its reserves are going to be.

Mr. MULTER. Isn't that precisely what happens with the $236 billion that the banks have on deposit throughout the country?

Mr. BAIRD. No, sir.

Mr. MULTER. Why not?

Mr. BAIRD. Because if you draw a check on your bank, it does not operate on its central reserves. It merely reduces its deposits that much and therefore decreases its liability for 12 percent or 18 percent or whatever its reserve is that it holds.

Mr. MULTER. You are assuming——

Mr. BAIRD. It does not operate in reserves.

Mr. MULTER. You are assuming that that check I draw will be deposited in another commercial bank?

Mr. BAIRD. Yes.

Mr. MULTER. Suppose I buy Government bonds or I cash the check and put the cash in my pocket.

Mr. BAIRD. The same thing is true.

Mr. MULTER. It does not affect the reserves of the bank?

Mr. BAIRD. That bank—the reserves are affected by only the proportion that the required legal reserve is to the amount you took out. Now, if that were 12 percent and you took out $1,000, its reserves are affected 12 percent.

Mr. MULTER. Mr. Baird, I must say that if what you say about drawing down this average daily balance of $3½ billion out of total deposits of $236 billion, which is total deposits and currency, is that it would upset the banking system of our country, this country is in a terribly bad way, and I can't believe that is so.

The CHAIRMAN. Mr. McVey.

Your time has expired, Mr. Multer.

Mr. MCVEY. I have no questions, Mr. Chairman.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. Mr. Chairman, I am going to yield my time to Mr. Reuss, to give him an opportunity to explain his amendment.

Mr. REUSS. Thank you, Mr. Barrett.

Mr. Chairman, first of all, Mr. Baird is a midwesterner. I would like to welcome you here. Very glad to have you, sir.

Mr. BAIRD. Yes.

Mr. REUSS. For the record, he was president of the First National Bank of St. Paul, one of our oldest and finest banking institutions and a very distinguished one.

I also appreciated your taking the time to study my amendment and as a result of the colloquy of my colleague, Mr. Kilburn, I think the committee has a general idea of what it is all about.

However, let me very briefly summarize it so we are all talking about the same thing.

First, let me ask you: The $5 billion direct purchase power for which you ask extension for another 2 years is in terms of the statute wide open and untrammeled, is it not?

Mr. BAIRD. That is correct.

Mr. REUSS. Although if, as your testimony has indicated, you are the fellow who has to administer it, you are going to administer it on a cautious, short-term, no-more-than-necessary basis?

Mr. BAIRD. That is right. I think there is a legislative record of many years, of Secretaries or Under Secretaries of the Treasury testifying as to how they intended to use it.

Mr. REUSS. Well, with all friendliness, there I do differ with you a little, in that I do think Congress has a responsibility to use the right words in its laws and shouldn't rely too much on what is said at committee hearings.

So we can agree at the start that this power in legislative terms is a completely broad one.

Mr. BAIRD. I agree, sir.

Mr. REUSS. Now, my amendment, Mr. Kilburn, was drafted because I felt that we in the Congress have a duty to tell the Executive, to whom we delegate our power over the money supply, exactly what the criteria should be. And in my amendment, which Mr. Baird has already commented on, I set forth just two criteria which are to govern the Treasury and the Federal Reserve in their administration of the $5 million direct-purchase power. Those criteria are set forth under Arabic 2. All the rest of the statute is just as it is now.

Under Arabic 2, I say that those two criteria shall be (1), affecting the maximum interest savings that are possible consistent with the other criterion, and (2) you are to utilize this power in consonance with the general anti-inflationary or antirecession policy currently adopted for good and sufficient other reasons by the Federal Reserve.

Now, I think, Mr. Baird, that your understanding of what I am trying to do is first rate, from your answer to Mr. Kilburn, with one little particular that I would like to discuss with you.

You spoke of a hypothetical situation where the Federal Reserve has decided for good and sufficient reasons that it wants to move to ease credit. You then envisaged a situation where the Treasury may have been about to issue a long-term bond issue, as you did the other day, of $1 billion at three and a quarter percent, was it something like that?

Mr. BAIRD. Three and a quarter percent, at par and a half.

Mr. REUSS. Yes. Under such a situation you envisaged under my proposed amendment, the Treasury and the Federal would at least have to explore whether this issue should be sold instead to the Federal Reserve, the idea being that as long as the Federal Reserve held that issue the taxpayers would save the interest charges which would otherwise have to be paid out of the Treasury.

Now, I think you were quite correct in saying that under such a situation serious consideration ought to be given to just that sort of transaction.

However, you talked about holding it, then, by the Federal for 2 years. There I would call your attention to the fact that my proposed criterion talks not only about the expansion of the lending power of member banks but the contraction of the lending power of member banks. And just as I would want the Federal to expand credit when that is called for, so I would want the Federal to contract credit when that is necessary, and I would want and expect the Treasury to have about the same view.

So that when you say held for 2 years, that would be true only on the assumption that a continuous policy of expanding credit prevails. If we should then be visited with inflation, I think then both the Federal and the Treasury would have to give serious consideration to the Fed's getting rid of that particular issue, just as the Fed in its open market policy, in its rediscount policy, in its reserve policy, would pay similar heed to those anti-inflationary considerations.

With that explanation by me just now, do you feel that you understand what the amendment is all about?

Mr. BAIRD. Yes; I believe I understand it.

I am sure your motive in introducing this is to try to be helpful, Mr. Reuss, because our conversation before the meeting indicated that.

I won't enlarge on the point that I made earlier of this opening wedge which the financial world would interpret as a weakening in the policy that has been enunciated.

But I would point out that setting up as one of the criteria to effect the maximum possible savings in interest charges on the national debt is the kind of criteria which you can use to commit any kind of abuses.

We could put in obligations at no interest or a tenth of 1 percent, and on that guise people could argue, "Why, you just opened the floodgates," if that is the criteria.

I think that is the most dangerous part of your resolution.

Mr. REUSS. Fine. Let's discuss that, because I think we have sharpened the issue here, which is exactly what we want to do.

As I see it, you make two points. One is sort of a psychological opening wedge, "get your foot in the door."

Mr. BAIRD. That is right.

Mr. REUSS. Take your hat off, open the floodgates, kind of argument.

The other is more of an economic than a psychological argument. Let's take the second, first. Is there one partical of difference from the standpoint of inflation, from the standpoint of sound monetary management, between the Government engaging in a direct purchase transaction of $100 million worth of Government bonds to the Treasury, such as I freely concede would be permitted by my amendment, and a similar sale of $100 million of Government bonds to the banks financed by credit made available through the Federal Reserve System?

Mr. BAIRD. No.

Mr. REUSS. Is $1 more high powered than another?

Mr. BAIRD. No. If it is sold to the banks, yes. That is not high-powered dollars.

But I can carry it even closer. This is how elusive this whole subject is.

Mr. Reuss. May I interrupt you right there?

Mr. Baird. Yes, sir.

Mr. Reuss. You say it is not a high-powered dollar when money is created which the banks then use for buying?

Mr. Baird. If the Treasury sells to the banks $100 million of bonds.

Mr. Reuss. Yes.

Mr. Baird. Those are not high-powered dollars.

Mr. Reuss. Well, what do the banks use to purchase the bonds?

Mr. Baird. By high-powered dollars I mean they have not the multiplier of 5 or 6. But when the Treasury——

Mr. Reuss. May I stop you right there, because this is important. I recall reading the hearings on the extension of just this same bill back in 1947, on March 5, before this committee, when Mr. Albert Cole, now of FHA, who was a member of this committee, asked Mr. Mariner Eccles, the Chairman of the Federal Reserve, this precise question, as to whether there is any difference economically between the direct purchase by the Treasury and open-market transactions.

Mr. Baird. Oh, that is different.

Mr. Reuss. And Mr. Eccles said, no, there is absolutely not. It is inflationary to permit us to purchase indirectly and it is inflationary to permit us to purchase directly. "The important question," said Mr. Eccles, "is are we at this given time being inflationary or deflationary." And he went on to say, and I quote here:

> If the United States Treasury exercises its option to use the $5 billion privilege of selling securities directly to the Federal Reserve banks, the transactions would not be any more inflationary than going through the open market.

Mr. Baird. I quite agree with Mr. Eccles. And my original statement was still correct.

And I started to elucidate. There is no difference whatsoever in the actual effect if the Treasury put out $100 million of Treasury notes today to the banks and today the Federal bought it by open-market operations, or whether we sold it direct to the Fed's. But your question was if the banks buy, and I assume retain, the $100 million, that is not high-powered money. If the banks sell it under open market to the Fed, it becomes high-powered money.

Mr. Reuss. But open market transaction is just as inflationary or deflationary as a direct purchase transaction.

Mr. Baird. That is right. And it is a very subtle difference here. But human psychology the world over draws a real distinction.

The Chairman. Your time has expired, Mr. Reuss.

Mr. Reuss. I will be back, I hope.

The Chairman. Mr. Hiestand.

Mr. Hiestand. Mr. Baird, I very much appreciate this statement. I was much impressed by its forthrightness and its statesmanlike attitude of the Treasury under the present policy. It becomes obvious that the Treasury realizes its responsibility to not only finance the world's largest institution, the United States Government, but also to protect the integrity of the currency.

I see no more sacred responsibility than that. I commend the statement and the position of the Treasury. Thank you, Mr. Chairman.

Mr. Baird. Thank you, Mr. Hiestand.

The Chairman. Mr. Ashley.

Mr. ASHLEY. Mr. Chairman, I will yield my time to Mr. Reuss, so he can proceed with his questions, please.

Mr. REUSS. Thank you, Mr. Ashley, and Mr. Chairman.

Mr. Baird, we will return to our discussion.

It seems then to boil down to psychological considerations—not that those are not important, but I do want to try to identify them.

As I understand it your position is that there is a subtle difference between the Federal buying directly from the Treasury and the Federal buying through the Open Market Committee, even though in the direct purchase case we have a stern statutory $5 million ceiling whereas in the Open Market Committee situation the sky is in very truth the limit, and if I am not mistaken right now the Open Market Committee's purchases in the hands of the Federal Reserve banks total something around $28 billion——

Mr. BAIRD. $23 billion plus.

Mr. REUSS. $23 billion. A lot of money.

Now, what is the subtle difference?

Mr. BAIRD. Well, it is subtle, and it is hard to explain. It is one of these things that is deeply seated in people's minds in the financial world. Sometimes an analogy is the best thing to illustrate. The only value gold really has is for filling teeth and making wedding rings and so on. But people think it has monetary value, over the world. They have thought so for centuries. The whole thing is built on what is in men's minds.

Now, you can't prove that gold, as a metal, should have monetary value where others do not. But the world thinks so.

Now, the world thinks that if treasuries deal directly with central banks, the temptation to save interest and other temptations will be such, based on the precedent of what happens in other countries—they say, "just leave that alone, don't do it."

Mr. REUSS. What do you mean by the world? How many people on the streets of St. Paul or Milwaukee would have any knowledge of the whole subject matter that we are discussing?

Mr. BAIRD. Not very many, until it was pointed out by some people who become alarmed. It is the financial community in the first instance. The United States, whether it wished to be or not, has become the world's banker. We are watched very closely in everything we do.

I happened to read last night a copy of the London Economist, that circulates all over Europe, commenting on our recent financing, in great detail, and what its effect is and what it indicated as to our willingness to deal firmly with inflation that may come later.

Those things are watched.

This thing would be printed in the financial press of the world if the Congress of the United States said, "We've relaxed a little bit our standards and if you find you can save some money, sell directly from the Treasury to the Fed. We don't say keep it permanently, but we won't be as exacting as just use it for a few days." That would be very bad news for the soundness of the American dollar, in my opinion, and I am quite sure the Secretary would agree with me.

Mr. REUSS. Now, let me ask you if you are familiar with the work American Monetary Policy, published in 1953 by the Committee for Economic Development, and which was written by Mr. E. S. Goldenweiser, who had been for many years head of economic research for the Federal Reserve System?

Mr. BAIRD. I am not familiar with the book. I knew Mr. Goldenweiser personally and had a very high respect for him.

Mr. REUSS. I did, too. I think he was an absolutely first-rate economist. What he had to say on this is rather interesting. I would like to read it to you. He said—speaking of the proposal for direct purchase as a method of saving taxpayers' dollars, he said:

> This is a rational and temperate proposal and properly administered would introduce a useful device. However, if it would lead to misunderstanding by some and to apprehension, no matter how ill founded, by others, it might be wise to pursue a more conventional course and to create the necessary residual money by borrowing from the commercial banks. It would, to be sure, cost the Treasury more in interest.

Would you in general agree with that statement?

Mr. BAIRD. I agree to that, sir; yes, sir.

Mr. REUSS. In other words, what he is saying is that these psychological factors are in the realm of mythology and are ill founded, but nevertheless they exist and probably it will be thought that they should be observed even though it will cost the Treasury money.

Mr. BAIRD. Men act on what they think and what their attitude is, and not necessarily on what the facts are. In this whole realm, it is very touchy and very sensitive. There is a code that has been built up worldwide, among central bankers, in their attitude toward this, and direct dealing by treasuries with central banks is frowned on.

Mr. WIDNALL. Will the gentleman yield?

Mr. REUSS. Certainly, I will yield to the gentleman from New Jersey.

The CHAIRMAN. Mr. Bass.

Mr. BASS. No questions; I will yield to Mr. Widnall.

Mr. WIDNALL. Mr. Chairman.

Mr. Baird, under the Reuss amendment there will be a limitation of 2 years on the purchase of these obligations. But wouldn't it be true that the $5 billion that might be purchased during that period could be held in perpetuity?

Mr. BAIRD. I think that is correct, but I want——

Mr. REUSS. As the author of this language, I hope the gentleman will yield to me so I can explain.

Mr. WIDNALL. I can't yield, Mr. Reuss.

Mr. BASS. I yield to Mr. Reuss.

Mr. REUSS. In response to the question, it is certainly the intention of the author of this proposed amendment, myself, that this would not be held in perpetuity, certainly not. That is why the word "contraction" is in there. All that this amendment does, Mr. Widnall, is to say that wherever the Federal Reserve is pursuing a policy of monetary ease it should do so in a manner calculated to save the maximum number of dollars for the United States Treasury, a most modest proposal as far as I am concerned. When the reason for monetary ease ceases, then steps should be taken by the Treasury and the Federal Reserve to undo the transaction. So that while it could be that for years the Federal would be loaded up with these Treasury obligations, that would only be true if for years there was a situation in which the Federal felt that there needed to be monetary ease and that that amount of credit should be made available.

Mr. MULTER. Mr. Chairman, before we pass from Mr. Bass' time, may we ask Mr. Baird and his associate if they will comment on Mr. Widnall's question or answer it?

Mr. BAIRD. I would be glad to comment on it.

There is nothing in either the bill as the Treasury proposes it or in that amendment that expressly says that at the termination of 2 years any indebtedness created pursuant to this authority must be retired.

I quite agree with Mr. Reuss, that if the Federal were to reverse its policy and they were selling in the open market the borrowing might go out of the Fed. But there is nothing here in either the bill or the amendment to say that either these very temporary borrowings which we propose or the somewhat more permanent borrowings over a longer period that Mr. Reuss would permit must be eliminated at the end of the 2-year period. And if not at the end of 2 years, then I say it is indefinite.

Mr. MULTER. If Mr. Bass would yield to me further, I would like to make a comment that the statute says—and Mr. Reuss' amendment does not change that provision of the statute, which provides that up to the limit of this $5 billion, the bonds may be bought and sold without regard to maturities.

Mr. BAIRD. That is the maturity——

Mr. MULTER. That is in the existing statute.

Mr. BAIRD. That is the maturity of the security that is sold.

Mr. BAIRD. Yes, sir.

Mr. MULTER. Yes, sir.

The CHAIRMAN. Mr. Vanik.

Mr. VANIK. Mr. Chairman, this is a very worthwhile discussion. I will yield my time to Mr. Reuss.

Mr. REUSS. Thank you, Mr. Vanik.

Mr. Chairman, I don't think I will take the full time that Mr. Vanik has generously yielded, but I would want to ask a couple more questions.

Mr. Baird, you have given your objections to my proposed formulation very honestly and clearly, and have framed the issue between us, which is exactly what I hoped would be done.

Let me ask you this: Here, after all, you are coming up and asking for a $5 billion direct purchase authority. I am sure you recognize the duty and desire of Congress to give constructive guidance to the executive branch—the Treasury and the Federal Reserve—on how they shall handle the power we delegate to them, of managing our monetary system.

Now, you have made objections, very sincere ones, to the criteria I have proposed. What criteria should we propose? Surely we shouldn't just give an open end, wide open power to the Treasury and the Federal. Sure, you have given us assurances, and I believe them, that you aren't going to use it for inflationary purposes. I don't know what is going to happen tomorrow, however. It seems to me that we need to have something in here to tie us down. What do you suggest?

Mr. BAIRD. Mr. Reuss, I don't find any substantial quarrel with your point of view.

I think this statute might have originally been drawn to point out some criteria, that it was intended to be used only for short periods, under certain conditions. That would have been all right. It has been in this form. It has gone on this way.

If this committee has any feeling that either this administration or the Federal Reserve or the Treasury in this 2-year period to come would abuse it, then we ought to scratch our heads and see if we couldn't get up some language that would set up criteria to try to make it conform to the standards I think you and I believe it is in fact being made to conform to.

But if you think we are not going to abuse it this next 2 years, I will say that if I am still around in 2 years, we will propose the extension the next time with some of those criteria in, that carry out the beliefs that we stand for.

Mr. REUSS. Well——.

Mr. WIDNALL. Will you yield to me, Mr. Reuss?

Mr. REUSS. If Mr. Vanik has the time, would you yield to Mr. Widnall?

Mr. VANIK. Yes.

Mr. REUSS. All right.

Mr. WIDNALL. Isn't the report of the 12 Federal Reserve member banks published every week showing the use of these funds?

Mr. BAIRD. Yes; Mr. Heffelfinger tells me it is published weekly.

Mr. WIDNALL. So that Congress can know almost immediately if there is any abuse of funds.

Mr. BAIRD. Oh, yes.

Mr. WIDNALL. We don't have to wait until the end of the 2-year period to find out what you are doing?

Mr. BAIRD. No; you do not. And each year—you wouldn't wait 2 years in any event. Each year it is in the Federal Reserve Board reports. No; you could know week to week what we are doing.

Mr. WIDNALL. All right.

Mr. REUSS. I would say just this. It is a little difficult to tell whether there is any abuse of the power we give if we don't define what the power is, and I am seeking by my amendment or some improvement on it to tell the Treasury and the Fed what we want done. So far I haven't heard any better criteria than save money and do your best to avoid inflation or recession.

I yield back the balance of my time.

The CHAIRMAN. Mr. Seely-Brown.

Mr. SEELY-BROWN. Mr. Baird, this present law has been in existence since 1942; that is correct, is it not?

Mr. BAIRD. By successive reenactment; yes, sir.

Mr. SEELY-BROWN. That is correct. And during that time we have had many Secretaries of the Treasury.

Mr. BAIRD. We have had several; that is right. And in each instance, regardless of who was Secretary of the Treasury, the Treasury has used that borrowing authority very sparingly.

Mr. SEELY-BROWN. That is correct.

Mr. BAIRD. Yes, sir.

Mr. SEELY-BROWN. And would it be because every Secretary of the Treasury that we have had during that time has felt that any time any central government tries to finance itself directly by a central bank, the end result is uncontrolled inflation, which is ruinous to everyone?

Mr. BAIRD. I think that is true. There has been no administration of this country yet that has stood for anything but sound money.

Mr. SEELY-BROWN. That is all, Mr. Chairman. Thank you.

Mr. BAIRD. In its public pronouncements, at least. [Laughter.]

The CHAIRMAN. Mr. Healey.

Mr. HEALEY. No questions.

Mr. PATMAN. Public what?

Mr. SEELY-BROWN. Public pronouncements.

Mr. PATMAN. What?

Mr. BAIRD. Public pronouncements.

The CHAIRMAN. Mr. Henderson.

Mr. HENDERSON. Yes, Mr. Chairman.

Mr. Baird, would you once again set forth your objections to the Reuss amendment? We seem to have had a good bit of conversation since you first set them forth. I would like to have them reexplained to me.

Mr. BAIRD. Mr. Henderson, I think that the Reuss amendment would be construed by the financial community in this country and abroad as permitting a retreat in the policy that has been pursued by the Treasury and by the Federal Reserve.

Because it raises a new criteria. If you can save some money, it is all right to go to some direct borrowing for a while. And we would hate to see that said by the Congress.

I think it would be construed as a weakening of the general policy of never, except for very short periods, in case of an immediate emergency, using the direct borrowing power between the Treasury and the Federal Reserve System.

Mr. HENDERSON. Now, I believe that in answer to one of the questions that was proposed, you indicated that there had been examples in other countries in which a similar policy has led to a weakening of the financial structure. Maybe I misinterpreted your reference, but I believe you said that.

Mr. BAIRD. That is correct.

I would have a harder time naming the countries that haven't abused that privilege. And that is the part of the chaotic exchange situations and currency situations we have over the world.

Mr. HENDERSON. Can you give us an example in which there has been an abuse?

Mr. BAIRD. I can say this, that there has been no Latin American country south of the isthmus, except possibly one, that hasn't abused it, if that will answer your question.

Mr. HENDERSON. It does.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Mr. Rutherford.

Mr. RUTHERFORD. No questions, Mr. Chariman.

The CHAIRMAN. Mr. Coad.

Mr. COAD. No questions.

The CHAIRMAN. Mr. Anderson.

Mr. ANDERSON. Mr. Baird, your chief opposition to Mr. Reuss' amendment, as I understand it——

The CHAIRMAN. Will you talk into the amplifier, Mr. Anderson?

Mr. ANDERSON. Is that there would be a fear, as you put it, of the temptation to save interest.

Now, in this case the Government is the customer and the interest of which you are speaking is the price for the use of certain money that the Government uses.

Now, as I understood the testimony, part of this money, which is in the commercial banks and which may be borrowed by the Government, belongs to the Government. I believe your testimony was that there is an average of about $3 billion of Government money in the banks on which no interest is being drawn.

The question, then, it would seem to me, is who is entitled to the interest? Is there anything morally wrong or financially wrong about saying that if this is the Government's money, that the Government should be entitled to the interest on at least that much of their money?

Mr. BAIRD. I am not quite sure, Mr. Anderson, what the connection is with the interest on tax and loan accounts from the banks and this question of direct borrowing. Would you just elucidate that a little bit more for me?

Mr. ANDERSON. Well, I have the feeling that Mr. Patman's questions concerning the amount of Government money which is in the commercial banks would be related to the amount that you would be likely to purchase directly under the Reuss amendment.

Mr. BAIRD. It seems to me a rather tenuous connection. If we were to keep very much smaller balances in the banks and then run in and out of the Fed on direct borrowing, I suppose that could operate that way.

I may say this. I am not clear—Mr. Reuss hasn't explained just how this proposal of his would save any interest.

He has very carefully said that he didn't want the Fed to use this, except where they are expanding reserves. So it doesn't end up with any more securities in the portfolio of the Fed. In other words, it is what was their source, primary source? Was it from the Treasury or the open market?

Now, they are buying securities in the open market, which are the lowest rate securities. They are bearing less than 1 percent. It is mostly Treasury bills. They are buying those. Any interest the Fed gets, 90 percent of it comes back to the Treasury anyway, under our agreement with them.

So I really fail to see where there is any interest saving involved in this thing. But perhaps I am overlooking something.

Mr. REUSS. Will the gentleman yield?

Mr. ANDERSON. I will yield to the gentleman from Wisconsin.

Mr. REUSS. The interest saving, of course, would come in situations where the Federal Reserve rather than the commercial banking system came to own a given portion of the national debt. As it is now, the banking system I think owns some $58 billion of the national debt. If in the case put the Federal Reserve owned $1 billion of that and the banking system $57 billion, then the 3 percent annual interest, coming to $30 million, would accrue to the Treasury, less, of course, the small charge which the Federal Reserve retains.

Mr. BAIRD. Yes, but, Mr. Reuss, under your Arabic 2B, this would only be utilized—

to the extent to which the expansion or the contraction of the lending power of the member banks is deemed advisable by the Board.

Therefore, it seems to me there is no net change involved in your suggestion in the total amount of Treasury securities held by the Fed. It is only whether they buy them in the open market, if they are expanding or whether they buy them direct.

Mr. Reuss. Well, there would be, though, if in the total composition, assuming there is $60 billion of the Federal debt which is held on an inflationary basis—that is, by the banking system or by the Treasury—on a credit-created basis. If instead of $60 billion held by the commercial banking system and zero by the Federal there is $59 billion by the banking system and $1 billion by the Federal, you then save the interest charges on $1 billion, or 30 percent, which is $30 million a year, and not hay as far as the taxapyers are concerned.

Mr. Baird. That is right. But you set up this point, that it isn't going to change the amount they are going to have. They have about, let's say, $24 billion now. If they want to expand to $25 billion in the next year, they will buy either in the open market or from the Treasury under your suggestion $1 billion. In either event, we pay interest on it. In both cases we get back 90 percent of any of the interest from the Fed.

Mr. Reuss. All you are saying, Mr. Baird, is that the Open Market Committee may be doing all on its own exactly what I would have the Treasury and the Federal Reserve Board of Governors do. That is perfectly true. If it is good for the Open Market Committee, it is good for the Federal Reserve Board and for the Treasury.

The Chairman. Mr. Breeding——

Mr. Anderson. Will the gentleman yield?

Mr. Breeding. Mr. Chairman, I yield my time to General Anderson.

Mr. Anderson. Mr. Baird, I would like to continue the line of questioning I was on at the time I yielded to Mr. Reuss.

Mr. Baird, aren't you being a little inconsistent in saying first that the weakness of this amendment is that it would provide a temptation to save interest and then in saying that you don't see how it would actually save any interest.

Mr. Baird. I think it is an apparent inconsistency, but we are dealing in the realms of psychology. I think if there is any interpretation by the financial world of this thing, that it is in the direction of weakening, just a little, the compulsion that has been put on us not to do direct borrowing from the Fed, except under exceptional and unusual circumstances.

Mr. Anderson. So that you do agree, then, that there is an opportunity to save interest?

Mr. Baird. No; I don't agree there is an opportunity to save interest, that is, if I understand it correctly. I hadn't seen this amendment until today.

Mr. Anderson. You say, "If I understood it correctly." Now, if this sort of thing is to be interpreted to the business community and to the people by the bankers, as you indicated, the interpretation that the public is going to get is the interpretation that is going to be placed on it by the financial world, whom I judge are reasonably well educated. Then why do you say there would be a fear of the temptation to save on one hand and then on the other say that there would be no saving involved?

Mr. BAIRD. Because, Mr. Anderson, if that amendment were passed and the Treasury and the Fed were of the mood, it would look as if it were carrying out the intent of Congress, if the Fed decided it was expanding its open market operations by $1 billion, if we sold them $1 billion and it just lay there month after month, until they reversed their policy.

Now, we don't want to give, we in the Treasury, any impression that we want to move in that direction, and we hope the Congress won't want to give any intimation that it wants to move in that direction, because we think that is a thoroughly bad point of view.

Mr. ANDERSON. What you spoke of as an apparent inconsistency in your testimony still looks to me like a very real inconsistency, Mr. Baird.

Mr. Chairman, I yield back the balance of his time to Mr. Breeding.

Mr. BREEDING. That is all, Mr. Chairman.

The CHAIRMAN. The committee will adjourn and meet tomorrow morning at 10 o'clock to vote on the bill.

(Whereupon, at 11:05 a. m., the committee adjourned to reconvene at 10 a. m., Friday, June 13, 1958.)

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