TO AMEND THE FEDERAL RESERVE ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON DOMESTIC MONETARY POLICY

OF THE

COMMITTEE ON BANKING, CURRENCY AND HOUSING HOUSE OF REPRESENTATIVES

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

H.R. 14848

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

SEPTEMBER 22, 1976

Printed for the use of the
Committee on Banking, Currency and Housing

U.S. GOVERNMENT PRINTING OFFICE
77-649 WASHINGTON : 1976

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TO AMEND THE FEDERAL RESERVE ACT

WEDNESDAY, SEPTEMBER 22, 1976

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY
OF THE COMMITTEE ON BANKING, CURRENCY AND HOUSING,
Washington, D.C.

The subcommittee met at 9:20 a.m. in room 2220 of the Rayburn House Office Building; Hon. Stephen L. Neal (chairman of the subcommittee) presiding.

Present: Representatives Neal, Hannaford, Allen, and Hansen.

Mr. NEAL. Mr. Mosso, if it's all right with you, we will go ahead and begin and we will try to get a quorum in a few minutes.

Mr. Mosso. Fine.

Mr. NEAL. Let me say at this time, for the record, that this morning the Subcommittee on Domestic Monetary Policy will hear testimony on H.R. 14848, which would extend for 2 years the authority of the Federal Reserve to purchase U.S. obligations from the Treasury on a direct basis. Extensions for this authority have been granted on 19 occasions so far since originally being granted by Congress in 1942. This authority has been described as a debt management tool particularly useful in tax anticipation periods. The Treasury also has argued in the past that the authority reduces short-term borrowings and thus interest costs. On the other hand, the authority makes it possible for the Treasury to use the Fed as its handmaiden and thus to avoid the discipline of the marketplace. If abused, this could cause excessive money creation and inflation.

[The text of H.R. 14848 follows:]

94TH CONGRESS
2D SESSION

H. R. 14848

IN THE HOUSE OF REPRESENTATIVES

JULY 26, 1976

Mr. REUSS introduced the following bill; which was referred to the Committee on Banking, Currency and Housing

A BILL

To amend section 14 (b) of the Federal Reserve Act, as amended, to extend for five 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 (12 U.S.C. 355), is amended (1) by striking out "November 1, 1976" and inserting in lieu thereof "November 1, 1978"; and (2) by striking out "October 31, 1976" and inserting in lieu thereof "October 31, 1978".

I

Mr. NEAL. Our witness this morning is Fiscal Assistant Secretary of the Treasury David Mosso. Immediately following the hearing the subcommittee will proceed to mark up the bill.

Incidentally, I would like to mention here that there is an error in the title of the bill which states that the extension is for a 5-year period. That should read 2 years.

I have a letter from the Chairman of the Board of Governors of the Federal Reserve System, Hon. Arthur F. Burns, that, without objection, will be placed in the record at this point.

[The letter referred to follows:]

CHAIRMAN OF THE BOARD OF GOVERNORS
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

September 20, 1976

The Honorable Stephen L. Neal
Chairman
Subcommittee on Domestic Monetary Policy
Committee on Banking, Currency and Housing
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

The Board strongly supports H. R. 14848, a bill which amends section 14(b) of the Federal Reserve Act, as amended, to extend until October 31, 1978, the authority of the Federal Reserve Banks to purchase United States obligations directly from the Treasury. We strongly urge that this legislation be enacted into law during the remaining days of this session of the Congress.

Sincerely yours,

Arthur F. Burns

Mr. NEAL. Mr. Mosso, we are delighted to have you this morning. You may proceed as you wish.

STATEMENT OF DAVID MOSSO, FISCAL ASSISTANT SECRETARY OF THE TREASURY

Mr. MOSSO. I am pleased to appear in support of H.R. 14848, which would extend until October 31, 1978, the existing authority of the Federal Reserve banks to purchase directly from the Treasury up to $5 billion of public debt obligations. In the absence of congressional action, this direct-purchase authority will expire at the end of October 1976.

The purpose of the direct-purchase authority is to contribute to the efficient management of the public finances. It was first granted in its present form in 1942, and it has been renewed for temporary periods on 19 separate occasions. The authority lapsed on three occasions in recent years: from July 1 until August 14, 1973; from November 1, 1973, until October 28, 1974; and from November 1 to November 12, 1975. In some cases, these lapses traced to unrelated and controversial amendments which had been attached to the borrowing authority bill. The authority itself has never been controversial.

Since 1942 the authority has been used on only a limited number of occasions. However, its value does not rest on the frequency or extensiveness of its use but its availability as a backstop for Treasury cash and debt operations, permitting more economical management of our cash position and assuring our ability to provide needed funds almost instantaneously in the event of any kind of emergency. During the periods when the authority was not available, the Treasury had to maintain higher cash balances, and a higher public debt, than would otherwise have been the case.

The direct-purchase authority is available to provide an immediate source of funds for temporary financing in the event of a national emergency on a broader scale. During emergencies it is possible that financial markets would be disrupted at a time when large amounts of cash had to be raised to maintain Government functions. Consequently, the direct-purchase authority has for many years been a key element in all of the Treasury's financial planning for a national emergency. This is a major reason why the authority should be continued for at least $5 billion, even though $1.3 billion is the largest amount that has ever actually been used in the past.

The Treasury Department views the authority as a temporary accommodation to be used only under unusual circumstances. In that connection, it is important to emphasize that any direct recourse by the Treasury to Federal Reserve credit under this authority is subject to the discretion and control of the Federal Reserve itself. With that safeguard, and in view of the fact that the authority has never been abused, the Department recommended a 5-year extension, to October 31, 1981. As introduced, however, H.R. 14848 provides for a 2-year extension, to October 31, 1978, which we understand reflects the position of your committee. The Department would prefer the longer authority and believes that it can be justified in terms of its limited use, but in view of the committee's position, we do not object to this change in the Treasury draft bill.

The accompanying table provides details on the instances of actual use. The borrowings are promptly shown in the Daily Treasury Statement and the weekly Federal Reserve Statement, assuring the widespread publicity that is the best possible deterrent to abuse. The Federal Reserve also includes the information in its annual report to the Congress. And, of course, this borrowing, like other Treasury borrowing, is subject to the debt limit.

[The table referred to by Mr. Mosso follows:]

DIRECT BORROWING FROM FEDERAL RESERVE BANKS, 1942 TO DATE

Calendar year	Days used	Maximum amount at any time (millions)	Number of separate times used	Maximum number of days used at any one time
1942	19	$422	4	6
1943	48	1,302	4	28
1944	None			
1945	9	484	2	7
1946	None			
1947	None			
1948	None			
1949	2	220	1	2
1950	2	180	2	1
1951	4	320	2	2
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
1959	None			
1960	None			
1961	None			
1962	None			
1963	None			
1964	None			
1965	None			
1966	3	169	1	3
1967	7	153	3	3
1968	8	596	3	6
1969	21	1,102	2	12
1970	None			
1971	9	610	1	7
1972	1	38	1	1
1973	10	485	3	6
1974	1	131	1	1
1975	16	1,042	4	7
1976	None			

Source: Office of the Fiscal Assistant Secretary, Sept. 20, 1976.

Mr. Mosso. As an essential backstop to our cash management operations and as an insurance policy against financial emergency, this authority should not be allowed to expire.

That concludes my statement, Mr. Chairman. I will be glad to respond to any questions.

Mr. Neal. Thank you, Mr. Mosso. I note that you have included in your statement a list of the times from 1942 to date when this authority has been used. Could you tell us for the record some of the reasons why this authority was used, aside from the financing needs during World War II?

Mr. Mosso. Well, it has been used a number of times in the more distant past as an offset to the impact on the banking system, in terms of impact on bank reserves, as an offset to tax payments that would be coming in in large amounts. The present schedule is, of course, April 15, but in earlier days it was in January. So it was sometimes used in that context, in order to provide the banking system with reserves in anticipation of large tax payments.

In more recent years it has been used on occasions to keep the Government from having to carry a larger than necessary average cash balance at times when borrowing requirements were otherwise heavy. But, more important, it has been used as a cushion for estimating errors in our estimates of cash flow and borrowing requirements.

What it comes down to is this: when we plan our borrowings for the coming months or quarter, whatever the period is, we do it on the basis of what we estimate our cash balance will be. Now, those estimates, as with any estimates, are subject to error, and they have been subject in recent years to a fairly wide range of error because of the high volatility of the balances. So when we have this authority as a standby, we can run our cash balances as low as we think is prudent, based on our estimates, and then we can go ahead and do our financing and announce it in advance. If we miss our estimate on the low side, we have this backstop authority that lets us take up the slack. So it just permits more orderly financing for us.

Mr. NEAL. You say that the importance of the authority is its availability as a backstop for Treasury debt and cash obligations.

How would the absence of this authority affect Treasury cash and debt operations?

Mr. MOSSO. Well, it essentially would require us at certain times to carry a little higher cash balance than we would otherwise feel is necessary.

In other words, we would have to conduct our borrowing operations in a way that gave us a cushion in the cash balance, a cushion against unforeseen net outlays that might otherwise drain off the cash. So it comes down simply to the fact that we would be carrying, on the average, a higher cash balance.

Mr. NEAL. Would you agree that many times in the past the Fed has acted as the Treasury's handmaiden by monetizing the Federal debt?

Mr. MOSSO. Not through use of this authority, no, sir. There is no instance that I am aware of where this authority has been used in that sense.

Mr. NEAL. I didn't really mean to limit it to this particular authority.

Mr. MOSSO. Well, in a broader sense, I don't think it's right to use the term "handmaiden," although, certainly, the Federal Reserve is conscious of what is going on in the money and securities markets, so that, undoubtedly, they have conducted operations at times that would make for orderly markets. Now, that would be of benefit to the Treasury, but it is also a part of their central bank responsibility for conducting monetary policy. So I really think it is a matter of carrying out their own responsibilities rather than doing something for the Treasury.

Mr. NEAL. I thank you, Mr. Mosso. I have no further questions at this time.

Mr. Hannaford?

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

Mr. NEAL. Mr. Allen?

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

Mr. NEAL. Mr. Hansen?

Mr. HANSEN. I understand this has been relatively noncontroversial and still remains so. I don't think there is any need to belabor it. So I just thank the gentleman for appearing this morning.

[Whereupon, at 9:35 a.m., the subcommittee adjourned to reconvene immediately to mark up the subject bill.]