TO EXTEND THE AUTHORITY OF THE FEDERAL RESERVE BANKS TO PURCHASE U.S. OBLIGATIONS DIRECTLY FROM THE TREASURY

HEARING

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

NINETY-SECOND CONGRESS

FIRST SESSION

ON

H.R. 7632

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 U.S. OBLIGATIONS DIRECTLY FROM THE TREASURY

S. 1700

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JUNE 15, 1971

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TO EXTEND THE AUTHORITY OF THE FEDERAL RESERVE BANKS TO PURCHASE U.S. OBLIGATIONS DIRECTLY FROM THE TREASURY

TUESDAY, JUNE 15, 1971

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

The committee met, pursuant to recess, at 10:05 a.m., in room 2128, Rayburn Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Sullivan, Ashley, Gonzalez, Minish, Hanna, Annunzio, Brasco, Chappell, Mitchell, Johnson, Brown, Williams, and McKinney.

The Chairman. The committee will please come to order.

Today the committee holds hearings on H.R. 7632 and S. 1700, which would extend for 2 years, from July 1, 1971, until June 30, 1973, the authority of the Federal Reserve banks to purchase U.S. obligations directly from the Treasury. This direct purchase authority was initially enacted during World War II, and has been extended on a temporary basis ever since that time. The main purpose of that legislation is to allow the Treasury Department to borrow directly from the Federal Reserve banks on a very short-term basis during the period just prior to tax payment days, and as a standby authority to provide an immediate source of funds in the event of a marked disruption.

(The text of H.R. 7632 and S. 1700 follows:)

[H.R. 7632, 92d Cong., first 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 (12 U.S.C. 355), is amended by striking out "July 1, 1971" and inserting in lieu thereof "July 1, 1973" and by striking out "June 30, 1971" and inserting in lieu thereof "June 30, 1973".

[S. 1700, 92d Cong., first sess.]

AN ACT 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 (12 U.S.C. 355), is amended by striking out "July 1, 1971" and inserting in lieu thereof "July 1, 1973" and by striking out "June 30, 1971" and inserting in lieu thereof "June 30, 1973".

Passed the Senate May 13, 1971.

Attest:

Francis R. Valeo,
Secretary.

The CHAIRMAN: As indicated in the document sent to the members of the committee on June 10, the Treasury has used this authority very sparingly since 1942. The maximum number of days that the authority was used at one time was 28 days in 1943. Other times the authority has been used only for 1, 2, and 3 days.

Also it is indicated in the memorandum sent to the members on June 10, that if time permits the committee will meet immediately after the hearing to mark up this legislation.

To the best of my recollection, at one time there was no limit on this amount. But later on I think we put in $5 billion. We commenced by putting in $5 billion, and we have extended it every 2 years since.

Mr. Volcker, we are glad to have your testimony. You may proceed in your own way.

STATEMENT OF HON. PAUL A. VOLCKER, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

Mr. VOLCKER. Thank you. I have a short statement here that I will read, with your permission, Mr. Chairman.

I appreciate your scheduling H.R. 7632 for prompt consideration, and I am happy to appear in support of this proposed legislation. As you have indicated Mr. Chairman, the bill would extend until June 30, 1973, the existing authority of the Federal Reserve banks to purchase directly from the Treasury public debt obligations up to a limit of $5 billion outstanding at any one time. In the absence of action, this authority will expire at the end of this month.

This legislation is designed to assist the efficient management of the public finances. On the basis of the record, I do not believe it is controversial. The authority was first granted in its present form in 1942 for a temporary period. It has been used prudently on a limited number of occasions and has been renewed on fifteen separate occasions since that time.

The value of the direct purchase authority does not rest on its frequent or extensive use. Rather, it serves two related purposes. Simply by being available as a backstop for all our Treasury cash and debt management operations, it permits more economical management of our cash position over the years. It also assures our ability to provide needed funds almost instantaneously in the event of a national emergency.

The reasons we feel that maintenance of this authority is essential can be summarized under three points. First, it provides us with the margin of safety that is necessary if we are to permit our cash balance to fall to low levels during periods of seasonally lean revenues. This, in turn, reduces the need for high balances during periods of flush revenues and allows the public debt to be kept to a minimum, thus saving interest costs to the Government.

Our current cash position illustrates the benefit of having this backstop. In May, as a consequence of providing foreign governments with investment opportunities for dollars flowing into their central banks during the recent currency disturbances, our cash balance was built up. It was, therefore, possible to reduce the public borrowing necessary to tide us over pending the receipt of June tax payments. Some of this foreign money proved to be short-lived, however, and our cash balance in recent days has been depleted abnormally. As a result, and in anticipation of heavy receipts after June 15, we have borrowed from the Federal Reserve banks for the past seven days. This is the first time we have used the authority since September 1969.

In the second place, there is always the possibility that erratic swings in money market conditions or international flows of funds may produce changes of a character that rather suddenly reduce our borrowings from other sources. In those circumstances, the availability of direct access to Federal Reserve credit would permit us the flexibility required to draw on our cash and to arrange alternative financing plans.

Finally, the direct purchase authority is available to provide an immediate source of funds for temporary financing should this be required by a national emergency. It is, unfortunately, possible to visualize the kind of situation in which our financial markets would be disrupted at a time when large amounts of cash had to be raised to maintain governmental functions and meet the emergency. Consequently, the direct purchase authority is a key element in all our financial planning for a national emergency or a nuclear attack. This is a major reason why this authority is required for at least $5 billion, even though, in the past, little more than a fifth of that amount has ever been used.

Consistent with these three points, I want to emphasize that the direct purchase authority is viewed by us as a temporary accommodation to be used only under unusual circumstances. The Treasury fully agrees with the general principle that its new securities should meet the test of the market. Moreover, this direct purchase authority should not be considered a means by which the Treasury may independently attempt to influence credit conditions by circumventing the authority of the Federal Reserve to engage in open market operations in Government securities. 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.

This borrowing authority has not been abused in the past. The accompanying table, providing details on the instances of actual use, shows clearly that it has been used infrequently and for limited periods. The borrowings are promptly shown on both the weekly Federal Reserve and daily Treasury statements, assuring the widespread publicity that is the best possible deterrent to abuse. In addition, the Federal Reserve includes the information in its annual report to the Congress. And, of course, this borrowing, is subject to the debt limit.

As an insurance policy against financial emergency and an essential backstop to our cash management, this authority must be kept available in case of need.

(The table referred to by Mr. Volcker 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	1,320	4	28
1944	(1)			
1945	9	484	2	7
1946	(1)			
1947	(1)			
1948	(1)			
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	(1)			
1956	(1)			
1957	(1)			
1958	2	207	1	2
1959	(1)			
1960	(1)			
1961	(1)			
1962	(1)			
1963	(1)			
1964	(1)			
1965	(1)			
1966	3	169	1	3
1967	7	153	3	3
1968	8	596	3	6
1969	21	1,102	2	12
1970	(1)			
1971 [2]	7	610	1	7

1 None.
2 Through June 14, 1971.

Mr. VOLCKER. Thank you, Mr. Chairman. That completes my statement.

The CHAIRMAN. Thank you, Mr. Volcker.

Heretofore, we have used this legislation as a springboard to get the information that was more meaningful than is ordinarily presented about the Government's credit. The Federal Reserve, under the leadership of Dr. Burns is more responsive to our request than the Board has been in the past. So far we have had no trouble in getting the information we desire. Therefore it is not necessary for us to use opportunities like this to go into this field more fully.

And so in that spirit of cooperation between this committee and the Federal Reserve, with the cooperation our committee has had in its effort to get information that we want when we want it, I don't think I will ask any questions on this particular bill.

Off the record.

(Off the record.)

The CHAIRMAN. Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman. I do not have any questions. I think Mr. Volcker has made an excellent statement here spelling out very clearly the purpose and the need for H.R. 7632.

I agree with you, Mr. Chairman, I think this is a bill that should be reported out as soon as possible.

Thank you.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. Mr. Chairman, I just want to ask a rather academic question.

This temporary authority came into existence in 1942?

Mr. VOLCKER. That is correct.

Mr. BARRETT. You have used it 15 times, and approximately 250 days in total?

Mr. VOLCKER. Yes, sir. It has been used in 15 years. I have not got the addition here of how many days we have used it, but I think your figures are roughly correct.

Mr. BARRETT. Does this legislation control the money in circulation?

Mr. VOLCKER. No, I don't think this does at all control the money in circulation, Mr. Barrett. The Federal Reserve can control the money supply in the Nation through its operations. This in a sense affects the reserve base, but they have the tools which they can use to offset or supplement whatever effect this might have. So I don't think it is fair to say that this authority in itself influences the money in circulation. The totality of Federal Reserve operations do. This could be a component at times. They have sufficient other authority to offset or supplement, as I suggested.

Mr. BARRETT. I notice that yesterday, two U.S. banks raised their prime interest rate from 5½ to 5¾. About 2 months ago, I should say, the Fed was trying to hold the money supply down, that is, hold the increase in the money supply to somewhere around 6 percent. I read a few days ago that the money supply has increased by about 16 percent. Isn't this inflationary?

Mr. VOLCKER. The money supply figure that you are referring to, Mr. Barrett, has fluctuated quite erratically in recent months. Last month it was a rather high figure when you move it to an annual rate basis, which is the basis you were quoting. It is true there has been a substantial increase in a couple of earlier months as well. Then there was a period last year when the increase was rather small. So if you average it together, say, in a 6-month period, then you come up with a substantially smaller rate of increase than these figures that you were quoting.

There is not a good and precise control over this figure from week to week or month to month. You get a less alarming sounding figure if you look at what has happened over a period of time and do not just focus on the last few months. It is true that the figures for the last few months have been high.

Mr. BARRETT. Isn't it true that in order to get the interest rates down the banks have cut down the prime interest rates several months ago.

Mr. VOLCKER. The prime rate was reduced——

Mr. BARRETT. Mortgage interest rates as well?

Mr. VOLCKER. Interest rates in general were reduced rather sharply the latter part of last year, continuing into the first couple of months of this year. In the past 3 months, roughly, market rates have turned up again. Some of the decline has been retraced. There was an increase in the prime rate sometime ago of one-quarter percent. One bank yesterday did announce a further one-quarter percent increase.

Mr. BARRETT. Mr. Secretary, one final question I would like to ask you. Was there not at one time an accord between the Department of the Treasury and Federal Reserve regarding the purchase of debt obligation?

Mr. VOLCKER. During World War II and in the years immediately thereafter, the Federal Reserve purchased Treasury obligations at a more or less fixed rate. In 1951, the so-called accord was an agreement

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that the Federal Reserve would cease buying Treasury obligations at those so-called pegged rates. And thereafter the Treasury securities have not been pegged in the market.

Mr. BARRETT. Let me close by asking you this, then. We are being asked to amend section 14(b). That is the section of the Federal Reserve Act that you are asking to amend to give you this temporary authority?

Mr. VOLCKER. To extend it.

Mr. BARRETT. To extend it for 2 years.

Would not the accord, kept in existence, be the vehicle that you could use for the same purpose that you are now asking to extend authority for another 2 years for?

Mr. VOLCKER. I don't really think that they serve quite the same purposes, Mr. Barrett. We had this authority, the Treasury had this authority and the Federal Reserve had this authority, during the period that they were pegging Government securities. This provides authority to borrow directly from the Federal Reserve. In the days when they were supporting government bond prices and Government bond rates they still didn't buy directly from the Treasury. We still sold in the market and they supported the market. Clearly when they are doing that it assures us of a good and receptive market, and in a sense it reduces perhaps the need for this kind of legislation. But nonetheless we had to go through the market, and we couldn't do it on the emergency type basis that is possible with this legislation.

Mr. BARRETT. It is also done to stabilize the market.

Mr. VOLCKER. It was done to stabilize the market during World War II. That was the purpose of it.

The CHAIRMAN. Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman.

Mr. Secretary, in this temporary power that was granted back in 1942, what were the fluctuations that existed in the years anterior to 1942? I mean, we had a national emergency at that time, but in the years anterior to that how, for example, did the Federal Reserve Board or the Treasury Department deal with the problems that you have enumerated in your statement?

Mr. VOLCKER. I think the answer to that, Mr. Crane, must have been the Treasury, in absence of this authority, would have had to be perhaps more cautious and less economical in the management of their cash balances than is possible when you have this authority. The major operating benefit day in to day out, so to speak, from this authority is that we can afford to operate somewhat closer to the vest in terms of cash balances than would otherwise be prudent. Now, in the early days of the Federal Reserve system they had such authority. It wasn't special authority, it was implicit in the general authority. From roughly 1933 to 1942 such authority did not exist. That was generally a period when it was easy to finance in the markets, interest rates were low, and no great emergency arose, and there were not any severe problems that I am aware of that arose from lack of this authority. But I think under the circumstances that the Treasury could not operate as efficiently as when they have this authority. Of course, the amounts involved then were a small fraction of the kind of money that runs through the Treasury these days.

Mr. CRANE. Mr. Secretary, in the years since 1945, which years would you classify as national emergency years?

Mr. VOLCKER. I don't think we ever had, fortunately, to use this authority in response to the kind of emergency to which I alluded in my statement. We count our blessings in that respect. But you always have to be prepared in case such an emergency arises. The use that has been made of this authority is a much more technical kind of use. It has permitted us to carry lower cash balances than otherwise would have been possible, and for technical reasons in smoothing the money market it has been useful, upon rare occasions, to borrow temporarily from the Federal Reserve. We certainly would not categorize that in any way as an emergency.

Mr. CRANE. Mr. Secretary, one final question.

When the Federal Reserve System turns to borrowing of this nature instead of borrowing from individuals in the risk of perhaps a slightly higher interest rate does this not have an inflationary effect insofar as there is a momentary and unusual expansion in the money supply?

Mr. VOLCKER. I don't think it would be fair to say that of the kind of uses that we have made of this authority. It has been in limited amounts. The Reserve has been fully aware of the circumstances. They have been taken into account in arranging their operations. Therefore, it doesn't have the effect that you suggested. If we went ahead and borrowed and made large use of this authority at unsuspected times when they were not able to take it fully into account in their own operations, it might have that effect.

Now, in practice, I don't think it can have that effect, because in the end they have the control. They must willingly lend the money. It is not our demand upon them that must be met. They must accede. And so they have control of the nature, amount and timing of the operation in the end, which provides protection against the danger of the kind that you are rightfully cautious about.

Mr. CRANE. Thank you, Mr. Secretary.

I yield back the balance of my time.

The CHAIRMAN. Mrs. Sullivan.

Mrs. SULLIVAN. No questions. Thank you.

The CHAIRMAN. Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

Secretary Volcker, when you recently borrowed under the terms of this authority what kind of rates did you pay?

Mr. VOLCKER. The present arrangement with the Federal Reserve is that we pay one-quarter percent less than the discount rate, which is currently 4¾ percent, so we would pay 4½ percent.

Mr. FRENZEL. So even though you have this friendly rate you don't use it very much?

Mr. VOLCKER. We quite explicitly and consciously used it at infrequent intervals. We don't want any connotation of abuse of this kind of authority. And we fully agree that it is appropriate for us in ordinary circumstances to borrow in the market and pay whatever rate the market demands.

Mr. FRENZEL. Thank you, Mr. Chairman. I yield the balance of my time.

Mr. CHAIRMAN. Mr. Reuss.

Mr. REUSS. Thank you, Mr. Chairman.

Welcome again, Secretary Volcker.

I think the Treasury deserves this authority renewed. I am sorry that your cash balance has been depleted abnormally in recent days.

You will be delighted to know that this date, June 15, I have mailed you a little check. If I had known you were coming I would have given it to you personally. I think it will tide you over.

Mr. VOLCKER. We are looking forward to the receipt of that check with some eagerness.

The CHAIRMAN. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Mr. Volcker, I notice that in your third point, you speak of a nuclear attack. Really, is this a significant consideration?

Mr. VOLCKER. I don't know how you define significant.

As I indicated earlier we have never faced one of these emergencies, and we have never had to use this kind of authority, fortunately, in this kind of emergency. But if you ask me whether there are circumstances under which the financial market might be disrupted in the midst of a national emergency, I can't sit here and tell you that there is not that kind of possibility. And I think it is proper and appropriate that we be provided with the means of handling it, however remote it might be.

Mr. BROWN. I just think that your language is a little bit poignant for the legislation.

Mr. VOLCKER. I must say that I noticed that in reading it myself. But we still live in a world in which war and emergency are not entirely absent.

Mr. BROWN. Mr. Secretary, you said that the Fed is not obligated to accept a loan on your paper.

Mr. VOLCKER. That is right.

Mr. BROWN. But as a matter of fact, if you request it they always do come through; isn't that right?

Mr. VOLCKER. Well, they always have——

Mr. BROWN. May I rephrase my question. Has the Fed ever refused to pick up your paper and permit you to borrow at the advantageous rate that you can from Fed?

Mr. VOLCKER. Not to my knowledge. But we have always made these requests when they fully understood the circumstances and were in basic agreement with the logic of using the authority. If we used it in the way that Mr. Crane posed, I would expect that they would raise some questions about it.

Mr. BROWN. Mr. Secretary, in connection with the hearings on the Export-Import Bank legislation, some of us explored the possibility of having the Fed in effect pick up the paper temporarily, make a loan, if you will, to the Export-Import Bank, but only at those times when the Eximbank was put in a precarious position insofar as carrying on its export of financing is concerned due to increased cost of its money, similar to the crisis the Treasury is put in when you utilize the provisions of this legislation.

The Federal Reserve at that time testified that this would be very bad, because it would be putting hot dollars into the economy, even though we attempted to say that if such a provision were adopted, safeguards would be imposed. Is there a great deal of difference between the two?

Mr. VOLCKER. I think there is, Mr. Brown. I think the issue that is raised with the Eximbank is whether the Federal Reserve should directly provide credit for special purposes in the economy, however worthy. And I happen to think that this is a worthy special purpose.

But there are a variety of worthy special purposes. I think that is somewhat different than providing an emergency backstop for the U.S. Government itself. The Eximbank can borrow from the Treasury, and then, of course, it is a budgetary expense, appropriately. It seems to me it is better not to provide direct access to Federal Reserve credit to a particular area of the economy aimed at a particular problem, however important—and I think this is an extremely important one. If there is a general problem that in a sense affects the whole Government, then the Treasury itself has that access.

Mr. Brown. Mr. Secretary, you are saying, then, that the access to Fed in connection with a short-term need by Treasury is much more important and significant, and almost a different animal, shall I say, than the precarious position that we might find ourselves in with respect to balance of payments and balance of trade?

Mr. VOLCKER. I yield to no one in my concern about the balance of trade and the balance of payments. But I don't think that is a a problem that requires a direct access by the Export-Import Bank to the Federal Reserve.

Mr. BROWN. Let me stop you there and say, do you think that the problem of the balance of trade and the problem of our balance of payments is really somewhat unrelated to the financing of exports?

Mr. VOLCKER. No. I want a good, adequate, aggressive export financing effort. And I think that will be of assistance in our balance of payments and balance of trade. I believe we can have that kind of an export credit effort without providing direct access of the Export-Import Bank to the Federal Reserve.

Mr. BROWN. Mr. Secretary, I think you have very adroitly picked the duck without touching a feather.

Mr. ANNUNZIO. Mr. Chairman, may we have a rollcall?

The CHAIRMAN. We have a quorum.

Do you want a rollcall?

Call the roll, Mr. Clerk.

The CLERK. Mr. Patman?

The CHAIRMAN. Here.

The CLERK. Mr. Barrett?

Mr. BARRETT. Here.

The CLERK. Mrs. Sullivan?

Mrs. SULLIVAN. Here.

The CLERK. Mr. Reuss?

Mr. REUSS. Here.

The CLERK. Mr. Ashley?

Mr. ASHLEY. Here.

The CLERK. Mr. Moorhead?

(No response.)

The CLERK. Mr. Stephens?

(No response.)

The CLERK. Mr. St Germain?

Mr. ST GERMAIN. Here.

The CLERK. Mr. Gonzalez?

Mr. GONZALEZ. Here.

The CLERK. Mr. Minish?

(No response.)

The CLERK. Mr. Hanna?

Mr. HANNA. Here.

The CLERK. Mr. Gettys?
(No response.)
The CLERK. Mr. Annunzio?
Mr. ANNUNZIO. Here.
The CLERK. Mr. Rees?
Mr. REES. Here.
The CLERK. Mr. Bevill?
(No response.)
The CLERK. Mr. Griffin?
Mr. GRIFFIN. Here.
The CLERK. Mr. Hanley?
Mr. HANLEY. Here.
The CLERK. Mr. Brasco?
Mr. BRASCO. Here.
The CLERK. Chappell?
(No response.)
The CLERK. Mr. Koch?
Mr. KOCH. Here.
The CLERK. Mr. Cotter?
Mr. COTTER. Here.
The CLERK. Mr. Mitchell?
(No response.)
The CLERK. Mr. Widnall?
(No response.)
The CLERK. Mrs. Dwyer?
(No response.)
The CLERK. Mr. Johnson?
Mr. JOHNSON. Here.
The CLERK. Mr. Stanton?
(No response.)
The CLERK. Mr. Blackburn?
(No response.)
The CLERK. Mr. Brown?
Mr. BROWN. Here.
The CLERK. Mr. Williams?
Mr. WILLIAMS. Here.
The CLERK. Mr. Wylie?
(No response.)
The CLERK. Mrs. Heckler?
(No response.)
The CLERK. Mr. Crane?
Mr. CRANE. Here.
The CLERK. Mr. Rousselot?
(No response.)
The CLERK. Mr. McKinney?
(No response.)
The CLERK. Mr. Lent?
(No response.)
The CLERK. Mr. Archer?
Mr. ARCHER. Here.
The CLERK. Mr. Frenzel?
Mr. FRENZEL. Here.
The CLERK. 21 Members present.
The CHAIRMAN. That is a quorum.
Mr. Ashley.

Mr. ASHLEY. Secretary Volcker, the last time you used this was just a few weeks ago, I take it?

Mr. VOLCKER. We are using it right now, Mr. Ashley.

Mr. ASHLEY. And $610 million was taken out?

Mr. VOLCKER. We are in debt to the Federal Reserve under this authority now.

Mr. ASHLEY. I see that over the years, since 1942, the most that was ever borrowed at any time was $1,320 million, and it has only been over a billion on five occasions in 30 years. So I am wondering why the authority is as broad as it is. The average, of course, is around $300 million.

Mr. VOLCKER. That is right. The actual use made of this authority has been very limited. Part of its value, the major part of its value, is having it there whether or not we use it. Because it does enable us to operate more economically than would be possible if we didn't have this authority and we got in a bind. We can run a little closer to the margin of prudence, the margin of safety, knowing that if an unsuspected problem comes along, as it has in the past week, we have this authority. This past week I think is a good example. We got a lot of extra money into the Treasury during May. And we knew that for that reason we could limit our borrowing in the market, which would have at that point just added to excess cash balances. We also know that we could not be sure how long this foreign money would stay in the Treasury. Some of it has now left us. We could have come back, say, last week, on a kind of emergency basis and borrowed a lot more money in the market. We only needed the money for a week, however, because we are going to have tax payments from Mr. Reuss and others beginning today. And it seemed reasonable under those circumstances to use this authority.

Mr. ASHLEY. I quite agree. And I am for it, certainly, in principle and in practice. It does seem to me that the amount of authorization is certainly sufficient unto the purpose. It is very substantially more than has ever been made any use of.

Has it always been $5 billion?

Mr. VOLCKER. It has always been $5 billion. And I think the $5 billion amount is probably more related to these emergencies that fortunately have not developed. We don't need that much for these more or less technical operations.

The CHAIRMAN. I think a correction should be made. At first, there was no limit at all, isn't that right?

Mr. VOLCKER. In the early days of the Federal Reserve, that is right. There has been a limit of $5 billion ever since this type of authority has been available to us.

I would make one other point in that connection. The $5-billion limit was put in during World War II. We had thought the budget was big then. It is much bigger now. Our debt financing operations are much bigger. So in a sense the $5 billion is relatively much smaller than it used to be.

Mr. ASHLEY. A good point. Thank you very much, Mr. Volcker.

The CHAIRMAN. Mr. Archer.

Mr. ARCHER. I yield my time, Mr. Chairman.

The CHAIRMAN. Mr. St Germain.

Mr. ST GERMAIN. Mr. Volcker, the last time we met was in another committee, we disagreed completely. Today I agree with you on this and I have no questions.

Mr. VOLCKER. Thank you, sir.

The CHAIRMAN. Mr. Johnson?

Mr. JOHNSON. I just want to welcome the esteemed gentleman here this morning. I have no questions.

Mr. VOLCKER. Thank you, Mr. Johnson.

The CHAIRMAN. Mr. Gonzalez.

Mr. GONZALEZ. I don't have any questions on this bill, Mr. Chairman.

The CHAIRMAN. Mr. Hanna.

Mr. HANNA. I just have one question, Mr. Secretary, on this bill. There are three classic cases under which the authority will be utilized. And you have also made it equally clear that the third category has not up to this time ever occurred.

Mr. VOLCKER. That is correct.

Mr. HANNA. On the other two, as I understand them, one comes when the tax intake is somewhat slow as compared to the need for cash in the Treasury, and the other is when you have some influence from the international flows.

Mr. VOLCKER. It might be domestic, too.

Let me take a kind of a case that I don't think has arisen, but could arise. Suppose we are in the midst of a large financing operation, which was planned and will be adequate to take care of our needs. And some disturbance arises in the money markets, so that we don't raise all the money that we anticipate in that financing operation, and as a result, our balance is depleted. We could then go to the Federal Reserve and use this authority. That is the kind of circumstance that we have in mind. And while we have never actually been faced with that circumstance to a degree that forces us to use this authority, we have been faced with very uncomfortable market circumstances when we were glad that we had this authority, and we might have had to use it.

Mr. HANNA. What I want to find out from you is, in view of the rather increased problems in the international money circumstances, do you think that there is any more likelihood of this coming into the picture than was true in the past?

Mr. VOLCKER. Yes, I do, Mr. Hanna. And I think this current use is rather fully related to the rather massive international flows of funds recently. And if we are going to have those kinds of massive flows, which in some instances affect our cash position, this authority becomes all the more important.

Mr. HANNA. I think it is worth emphasizing the fact that because of the period we are moving into, and we are now in——

Mr. VOLCKER. I think you are exactly correct in emphasizing that.

Mr. HANNA. The other question I had, has nothing really to do with this bill. But I wonder, has the Treasury testified yet on that Senate bill that has a provision for Federal control by the use of differential reserves for uses of credit?

Mr. VOLCKER. I don't believe we testified or requested to testify on that bill, Mr. Hanna, to the best of my memory.

Mr. HANNA. I have no further questions.

The CHAIRMAN. Mr. Annunzio.

Mr. ANNUNZIO. Mr. Chairman, the Secretary has made a fine statement and all the questions have been answered, as far as I am concerned. We have a quorum and we are losing that quorum fast, and therefore I would like to suggest that we have a rollcall on this bill.

The CHAIRMAN. I don't think it would be in order, Mr. Annunzio, until each member has had an opportunity to question.

Mr. ANNUNZIO. I relinquish the balance of my time.

The CHAIRMAN. Mr. Rees.

Mr. REES. No questions.

The CHAIRMAN. Mr. Bevill.

Mr. BEVILL. No questions, Mr. Chairman.

The CHAIRMAN. Mr. Griffin.

Mr. GRIFFIN. No questions.

The CHAIRMAN. Mr. Hanley.

Mr. HANLEY. No questions.

The CHAIRMAN. Mr. Brasco.

Mr. BRASCC. No questions, Mr. Chairman.

The CHAIRMAN. Mr. Koch.

Mr. KOCH. No questions, Mr. Chairman.

The CHAIRMAN. Mr. Cotter.

Mr. COTTER. No questions, Mr. Chairman.

The CHAIRMAN. All right. I want to make one observation on what the Undersecretary said about this accord in 1951.

Who was in that accord, who was a party to that accord?

Mr. VOLCKER. Essentially, the Treasury and the Federal Reserve.

The CHAIRMAN. How about the President?

Mr. VOLCKER. The President was certainly involved, too.

The CHAIRMAN. But he didn't sign that accord, didn't agree to it. How do you have an accord without the President of the United States in a matter of this nature? He called the Federal Reserve Board in, and some of the reporters who wrote stories said the President called them names. He said, "you can't raise interest rates, if you do, why, you will be doing a great disservice to this country." And he just told them they couldn't do it, he wasn't agreeing to any accord to raise rates. Now, the treasury did raise the rate from 2½ to 2¾. But it was in nonnegotiable bonds only, and it didn't mean as much as a 2½-percent effective rate, for the reason that if you had the 2¾-percent nonnegotiable, you had to trade them for short-term purpose and take a loss, then you would sell the short-term paper at a loss. So effectively it did not raise the rates at all.

And may I invite your attention to the fact that that was in early 1951. And although it was a major issue during 1951 and 1952 while Mr. Truman was in power, they never raised those rates above 2½ percent. All during that time, when the long-term Government interest rate was 2½ percent and less, and even after Mr. Eisenhower came in, on January 10, 1953, the rate they asked for money, the President did under Mr. Humphrey, he wanted high rates, they were able to get that money for 2⅜ percent in their first issue, and on the next issue 2½ percent. And then Mr. Humphrey, the Secretary of the Treasury, arbitrarily asked for bids on a billion dollars—and he had more than that in the Treasury, and they didn't ever need it, but solely for the purpose of effectuating an increase in interest rates. It almost caused a depression. And then when they commenced raising rates, they were playing for keeps, and they kept going up until recently.

So this accord, I think, has been overplayed.

You don't have a copy of that accord, do you, Mr. Volcker?

Mr. VOLCKER. I don't have one with me, no, sir.

The CHAIRMAN. You don't have one any place, do you?

Mr. VOLCKER. I am sure we have one.

The CHAIRMAN. I was here at the time, but I have never seen one.

Mr. VOLCKER. My recollection is that there was a statement issued by the Treasury and the Federal Reserve.

The CHAIRMAN. It was an accord just between themselves, wasn't it?

Mr. VOLCKER. I will not challenge your recollection as to the events of 1951, in that respect, Mr. Chairman, You were here then and I was not.

The CHAIRMAN. I felt like I was a little close to it.

Mr. WILLIAMS. Mr. Chairman.

The CHAIRMAN. Mr. Williams.

Mr. WILLIAMS. I would like to suggest to you that the conditions have changed dramatically since 1951, both as far as our national debt is concerned and as far as our unfavorable balance of payments are concerned. I would like to move the previous question.

The CHAIRMAN. I am ready to agree to that, because we want to get through while we have a quorum, but, first, I want to make one little announcement. This is the birthday, June 15, 1971, of the biggest payment that was ever made in history by the American Government, the biggest single transaction. On this date in 1936, every veteran of World War I received a letter from Uncle Sam and the post office, either by general delivery or post office box or by city carrier or rural carrier, every one of the 3½ million veterans received a letter. Each letter said you are entitled to so much money in payment of your adjusted service certificates. Some people called it a bonus. It wasn't a bonus, it was just pay. And it said, if you will take this letter to the nearest bank you can get your money in cash right now, or you can leave it and deposit it and you will get interest on it. And that involved $1,015 each for 3½ million veterans, or nearly $3 billion.

Mr. VOLCKER. I didn't realize that, Mr. Chairman. But we celebrated that anniversary by paying the 10 percent retroactive increase in social security benefits beginning today.

The CHAIRMAN. Have they got it?

Mr. VOLCKER. They will very shortly.

The CHAIRMAN. Well, make it June 15, so it will coincide.

Any other discussion?

Mr. BROWN. Mr. Chairman?

The CHAIRMAN. Mr. Brown.

Mr. BROWN. I would just like to inquire of the Chair, if I may, since he has such a continuing and long-standing knowledge of money and finance, and since I have heard him say on many occasions that the real cause of our inflation is the increasing cost of money, interest rates, I would just like to ask him, because I can't understand it, why interest rates have gone down as much as 30 percent or more and still inflation is increasing.

The CHAIRMAN. It is understandable, because the prime interest is the one that has been going down——

Mr. BROWN. Mr. Chairman, home mortgages in my district are just the same. And it seems to me that we would have a reduction in inflation.

The CHAIRMAN. You would have a reduction in inflation if you had stabilized interest rates. But as long as you let the banks just arbitrarily——

Mr. BROWN. I suggest that there has been a greater stabilization in interest rates over the past several months than there has been in any other thing.

The CHAIRMAN. Yesterday, they raised the rates at a time when they had more money than they ever had in history.

Mr. BROWN. There are bound to be fluctuations in things. Interest rates at least fluctuate, but other things never go down in price.

The CHAIRMAN. If they believed that, then they should have raised the rates.

Mr. Volcker, we appreciate your appearance. If there are no other questions that the members desire to ask you, we will excuse you, sir, with the thanks of the committee.

Mr. VOLCKER. Thank you very much.

The CHAIRMAN. Mr. Barrett.

Mr. BARRETT. I move the committee adopt the bill S. 1700, and that the committee report the bill favorably, and let the chairman take all the necessary action to get further consideration for the legislation, and that the staff be given the authority to make any technical changes in the legislation.

The CHAIRMAN. Would you be willing to ask that the rule requiring the filing, and so forth, be waived, so as to get the bill expedited, if necessary?

Mr. BARRETT. I so insert that in my motion.

The CHAIRMAN. If we get two-thirds vote it would be all right.

All right, are you ready for the question?

As many as favor, let it be known by saying, "aye."

(Chorus of "ayes.")

All opposed, say "no."

(None.)

Rollcall.

The CLERK. Mr. Patman?

The CHAIRMAN. Aye.

The CLERK. Mr. Barrett?

Mr. BARRETT. Aye.

The CLERK. Mrs. Sullivan?

Mrs. SULLIVAN. Aye.

The CLERK. Mr. Reuss?

(No response.)

The CLERK. Mr. Ashley?

Mr. ASHLEY. Aye.

The CLERK. Mr. Moorhead?

(No response.)

The CLERK. Mr. Stephens?

(No response.)

The CLERK. Mr. St Germain?

Mr. ST GERMAIN. Aye.

The CLERK. Mr. Gonzalez?

Mr. GONZALEZ. Aye.

The CLERK. Mr. Minish?

(No response.)

The CLERK. Mr. Hanna?
Mr. HANNA. Aye.
The CLERK. Mr. Gettys?
(No response.)
The CLERK. Mr. Annunzio?
Mr. ANNUNZIO. Aye.
The CLERK. Mr. Rees?
Mr. REES. Aye.
The CLERK. Mr. Bevill?
Mr. BEVILL. Aye.
The CLERK. Mr. Griffin?
Mr. GRIFFIN. Aye.
The CLERK. Mr. Hanley?
Mr. HANLEY. Aye.
The CLERK. Mr. Brasco?
Mr. BRASCO. Aye.
The CLERK. Mr. Chappell?
(No response.)
The CLERK. Mr. Koch?
Mr. KOCH. Aye.
The CLERK. Mr. Cotter?
Mr. COTTER. Aye.
The CLERK. Mr. Mitchell?
(No response.)
The CLERK. Mr. Widnall?
Mr. WIDNALL. Aye.
The CLERK. Mrs. Dwyer?
(No response.)
The CLERK. Mr. Johnson?
Mr. JOHNSON. Aye.
The CLERK. Mr. Stanton?
(No response.)
The CLERK. Mr. Blackburn?
Mr. BLACKBURN. Aye.
The CLERK. Mr. Brown?
Mr. BROWN. Aye.
The CLERK. Mr. Williams?
Mr. WILLIAMS. Aye.
The CLERK. Mr. Wylie?
(No response.)
The CLERK. Mrs. Heckler?
(No response.)
The CLERK. Mr. Crane?
Mr. CRANE. No.
The CLERK. Mr. Rousselot?
(No response.)
The CLERK. Mr. McKinney?
(No response.)
The CLERK. Mr. LENT?
(No response.)
The CLERK. Mr. Archer?
Mr. ARCHER. No.
The CLERK. Mr. Frenzel?
Mr. FRENZEL. Aye.
The CLERK. 22 "ayes", one "nay."

The CHAIRMAN. The motion prevails, and every effort will be made to expedite the passage of the bill.

Is there anything else before the committee at this time?

If not, without objection, the committee will stand in recess subject to the call of the Chair.

(Whereupon, at 10:50 a.m., the committee adjourned subject to the call of the Chair.)