

FEDERAL RESERVE-TREASURY DRAW AUTHORITY

HEARING
BEFORE THE
SUBCOMMITTEE ON
DOMESTIC MONETARY POLICY
OF THE
COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES
NINETY-SIXTH CONGRESS

FIRST SESSION

ON

H.R. 2281

A BILL TO AMEND THE FEDERAL RESERVE ACT TO
EXTEND THE AUTHORITY OF THE FEDERAL RESERVE
BANKS TO BUY AND SELL CERTAIN OBLIGATIONS

H.R. 421

A BILL TO AMEND THE FEDERAL RESERVE ACT TO PRO-
VIDE AUTHORITY FOR FEDERAL RESERVE BANKS TO LEND
OBLIGATIONS TO THE SECRETARY OF THE TREASURY
AND FOR THE SECRETARY OF THE TREASURY TO BORROW
SUCH OBLIGATIONS TO MEET THE TREASURY'S SHORT-
TERM CASH NEEDS

MARCH 5, 1979

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FEDERAL RESERVE—TREASURY DRAW AUTHORITY

MONDAY, MARCH 5, 1979

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, D.C.

The subcommittee met at 8:40 a.m. in room 2220 of the Rayburn House Office Building; Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

Present: Representatives Mitchell and Hansen.

Chairman MITCHELL. Good morning, ladies and gentlemen.

The purpose of this morning's hearing is to consider testimony concerning legislation, H.R. 2281, that would extend the Treasury draw authority of the Federal Reserve banks until 1984 and an alternative way of dealing with the same problem. Since the current authority, which was authorized by Public Law 95-534, is scheduled to expire on April 30, 1979, it is necessary to reextend the authority, or to legislate a different procedure to deal with unforeseen Treasury cash shortages.

While past legislation has not been substantively altered, there is presently a proposal that would replace the current extension mechanism. The bill, H.R. 421, introduced by our colleague George Hansen, the ranking minority member of this subcommittee, would provide authority to the Treasury to borrow securities instead of cash from the Federal Reserve.

In effect, the Hansen proposal would allow the Treasury, faced with an unforeseen cash shortage, to borrow securities from the Federal Reserve's portfolio, sell them in the open market, and subsequently replace them when moneys from other sources become available.

In the past, both the Treasury and Federal Reserve have strongly supported extension of the current authority. And although extensions of this authority have been granted only for limited periods, usually a year to two, since initial congressional approval in 1942, it nonetheless has proven an effective mechanism for Treasury debt and cash management operations. Treasury draw authority is a safeguard against uncertainties associated with estimating the amount and timing of receipts and expenditures, as well as a mechanism which provides the Treasury with a flexible debt management tool. Nonetheless I have an open mind about the Hansen proposal.

[The texts of H.R. 2281 and H.R. 421 follow:]

96TH CONGRESS
1ST SESSION

H. R. 2281

To amend the Federal Reserve Act to extend the authority of the Federal Reserve banks to buy and sell certain obligations.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 21, 1979

Mr. MITCHELL of Maryland introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

A BILL

To amend the Federal Reserve Act to extend the authority of the Federal Reserve banks to buy and sell certain obligations.

- 1 *Be it enacted by the Senate and House of Representa-*
- 2 *tives of the United States of America in Congress assembled,*
- 3 That section 14(b) of the Federal Reserve Act (12 U.S.C.
- 4 355) is amended by striking out "May 1, 1979" and inserting
- 5 in lieu thereof "May 1, 1984", and by striking out "April 30,
- 6 1979" and inserting in lieu thereof "April 30, 1984".

I—E

○

96TH CONGRESS
1ST SESSION

H. R. 421

To amend the Federal Reserve Act to provide authority for Federal Reserve banks to lend obligations to the Secretary of the Treasury and for the Secretary of the Treasury to borrow such obligations to meet the Treasury's short-term cash needs.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 15, 1979

Mr. HANSEN introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

A BILL

To amend the Federal Reserve Act to provide authority for Federal Reserve banks to lend obligations to the Secretary of the Treasury and for the Secretary of the Treasury to borrow such obligations to meet the Treasury's short-term cash needs.

1 *Be it enacted by the Senate and House of Representa-*
 2 *tives of the United States of America in Congress assembled,*
 3 That (a) the first sentence of section 14(b)(1) of the Federal
 4 Reserve Act (12 U.S.C. 355(1)) is amended by repealing the
 5 proviso and inserting in lieu thereof a period.

I—E

1 (b) Section 14(b)(2) of the Federal Reserve Act (12
2 U.S.C. 355(2)) is amended by inserting, "and to lend, under
3 the direction and regulations of the Federal Open Market
4 Committee, any such obligations to the Secretary of the
5 Treasury".

6 (c) Section 14 of the Federal Reserve Act is amended
7 by inserting at the end thereof the following:

8 “(h) The Secretary of the Treasury shall have the au-
9 thority to borrow obligations referred to in subsection (b)(2)
10 from any Federal Reserve bank and to sell such obligations
11 in the open market for the purpose of meeting the short-term
12 cash needs of the Treasury. Within six months after the date
13 of sale of such obligations, the Secretary of the Treasury
14 shall repurchase the obligations and return them to the Fed-
15 eral Reserve bank from which they were obtained.”.



Chairman MITCHELL. Our witnesses today are the Honorable J. Charles Partee, member of the Board of Governors, Federal Reserve System, and Paul H. Taylor, Deputy Fiscal Assistant Secretary, Department of the Treasury. Before asking you both to testify, I am going to ask my colleague, Mr. Hansen, to make his opening statement.

Mr. Hansen?

Mr. HANSEN. Thank you, Mr. Chairman. We are up pretty early. Did you get the cow milked before you came?

Chairman MITCHELL. No.

Mr. HANSEN. It's not often that those of us on this side of the aisle have the opportunity to hear testimony on one of our own bills, and I thank you, Mr. Chairman, for this opportunity. This should stand as an enviable example of fairness among other committees of Congress.

The authority for the Treasury to borrow directly from the Fed instead of in the open market in the event of an unforeseen shortage

of cash has been in existence since 1942, except for some relatively brief interruptions. I believe I am correct in saying that at the time the draw authority was put in place the market for Government securities was not so well developed as it is today.

Now we have such things as repurchase agreements, book entry securities, and telephone transactions involving even the largest sums. While the draw authority may have been the only reasonable method available in 1942 to supply emergency deficiencies of Treasury cash, I doubt that the same can be said today. If we were starting all over again, I don't think the mechanism of direct loans by the Fed to the Treasury would be adopted.

The reason I say this is because there are one or two disadvantages to the draw authority. Most importantly, it involves the creation of new money to supply Treasury needs. Ordinarily, of course, the amounts involved are not large enough, nor is the borrowing outstanding long enough to present serious difficulties for monetary management by the Fed. Nevertheless, the possibility exists that use of the draw authority might increase the money supply by 1 percent, say, for a period of several weeks. In such an event, monetary policy management by the Fed would be complicated by the draw authority.

The other disadvantage of the draw authority is that it involves negotiations between the Treasury and the Fed that are not directly subject to any market check as regards the terms of the borrowing. The fact that the authority avoids the open market is exactly the reason Congress has kept such a short rein on it for all these years, limiting the amount that can be outstanding at any one time and making the authority only temporary, requiring periodic renewal.

The mechanism I have proposed in H.R. 421 does not have these disadvantages. In brief, it involves borrowing securities from the Fed's portfolio instead of the creation of money. When the Treasury runs short of cash, it would be able to borrow securities from the Fed, sell them on the open market, then repurchase them and send them back to the Fed when the shortage was ended. The Treasury, in effect, would be borrowing already-circulated money from the public, so no difficulties would be encountered in monetary policy management.

Likewise, because the securities would have to be sold and then repurchased on the open market in competition with all other borrowers, there would be a direct market test of the terms of the borrowing. Moreover, abuse of the securities borrowing authority would be more difficult by far than abuse of the draw authority, because of this market test.

Because the mechanism proposed in H.R. 421 has neither of the disadvantages of the draw authority, the reasons for keeping a short legislative rein on it are not present, and so H.R. 421 is a permanent authority which would not require periodic renewal. The market will perform the oversight that has had to take up congressional time under the draw authority. As busy as our schedules are, I think this is a particularly notable advantage of my proposal.

I should note, by the way, that legislative counsel tells me that the value of the securities borrowed would be included automatically within the public debt subject to statutory limit, so in that respect the securities loan would be on the same footing as the draw, and would not expand total Treasury borrowing authority.

As I stated earlier, I think that if we were considering this matter without any previous history for the draw, we would establish instead a securities borrowing authority. The Fed knows how to loan securities from its portfolio and the Treasury knows how to sell and buy its own securities. With modern markets based on electronic bookkeeping and telephone transactions, the securities borrowing authority is clearly preferable to a draw authority that operates outside the market, creates new money for Treasury spending, and is subject to abuse since it can be fixed up between just a few people at the Fed and the Treasury.

Of course, since the draw has been in place for nearly 40 years, securities borrowing does involve a new way of doing things, always a difficult subject for a bureaucracy to master. But the need for using the authority seldom arises, and it seems reasonable to ask the Fed and the Treasury to make a small effort to follow a little different procedure when occasion demands. If they will cooperate, then we can avoid the disadvantages of the old way and be relieved of this burden of periodically having to renew the draw.

Mr. Chairman, I welcome the witnesses and look forward to hearing the reasons they will offer for not changing to a more modern and, I should say, more up to date proposal. And again, I thank you for this opportunity to discuss one of my legislative ideas. I hope this exemplary spirit of cooperation will be imitated by our colleagues. For myself, I promise to continue in that spirit.

Thank you, Mr. Chairman.

Chairman MITCHELL. Thank you, Mr. Hansen. And the Chair renews its commitment to be completely bipartisan, as it has in the past. I am completely open-minded about the Hansen proposition, and there certainly are, in my opinion, advantages. A market check on borrowing is something that the draw does not now have and which could be meritorious. In addition, I think the idea that my colleague has advanced would eliminate the direct creation of new money or the injection of new reserves. Those are advantages that I see. I hope that both witnesses will address these points.

Mr. HANSEN. Mr. Chairman, would you yield?

Chairman MITCHELL. Delighted.

Mr. HANSEN. I think there is a real advantage to this in a day and age when we are feeling high interest rates and monetary shortages and everybody's trying to get away from this program, which is so aggravating to people in middle and low-income situations.

And I know the concern the chairman has for this, which I share because I represent a pretty normal constituency, too. Anything we can do to give relief to these people and do those things necessary for their convenience rather than for the convenience of the bureaucracy would be well-taken.

Chairman MITCHELL. Fine. We will hear from the witnesses.

We have copies of your testimony from both gentlemen. If you so desire, those copies can be entered into the record and you can speak from them; or if you desire to read the entire testimony, it's up to you. Would you lead off Governor Partee?

STATEMENT OF HON. J. CHARLES PARTEE, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Governor PARTEE. Thank you, Mr. Chairman, Mr. Hansen. I think maybe I will read mine. It is very, very short, and it does speak to some of the questions that have been raised here.

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

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

Since the Treasury now often relies on short-dated cash management bills to cover low points in its cash balance prior to key income tax payment dates, the direct borrowing authority of the Treasury has come to be used only infrequently. In fact, since 1975, the authority has been activated only once. The Treasury had made more use of the facility in earlier years, usually to offset cash drains just before funds were available from quarterly income tax payments.

But the direct borrowing authority is still important as a standby facility to be used in emergency situations. Such an arrangement provides assurance that the Treasury will be able to honor its commitments without delay if unexpected developments suddenly shrink its cash holdings. The Treasury, at its own initiative, can quickly arrange to borrow from the Federal Reserve, even on the same day of the request.

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

H.R. 421 would substitute a more elaborate technique for providing the Treasury with funds in the event of an unexpected need. In such instances, this alternative proposal would permit the Treasury to borrow securities from the Federal Reserve for reselling into the open market. The Treasury would be required to repay the borrowed securities within 6 months. The bill, as now written, does not limit the amount of securities that could be borrowed, nor does it specify whether the value of the securities borrowed would represent in addition to the public debt—two issues that require clarification. However, I understand in the latter case that it would represent such an addition by permitting very large transactions.

We assume that it is not the intent of the bill to give the Treasury a way of circumventing the Federal debt ceiling through large-scale borrowing and resale of securities from the Federal Reserve's portfolio. And we are concerned about the apparently open-ended grant of power to the Secretary of the Treasury to borrow securities from the Federal Reserve without prior consultation or approval from the FOMC.

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

If the Treasury were to meet such needs by borrowing securities from the Federal Reserve and then reselling them in the market, it might well be forced to pay a substantial premium over its usual borrowing rate. The action would probably take market participants by surprise and might have to be accomplished fairly late in the day.

In highly unsettled market circumstances, moreover, the Treasury could find it difficult or impossible to sell all of the securities needed. We understand that the objective of the bill is to insure that Treasury borrowing always be subjected to the discipline of the market. While the Board endorses such a concept as a general rule, in emergency cases of the sort contemplated here that test could well be abnormally unfavorable and not in the public interest.

The existing direct borrowing authority of the Treasury was established in 1942, when wartime financing required that the Federal Government raise enormous volumes of funds through securities markets. The authority was needed to provide assurance that the Treasury at all times could meet its expanding obligations.

Under any future conditions of national emergency occasioned by war or natural disaster, the Treasury might again face unanticipated needs for immediate funds at a time when securities markets are in general disarray. While the Congress probably would be in a position to reestablish an emergency borrowing authority quickly in such circumstances, it seems far more efficient to maintain the existing standby direct borrowing procedures in order to assure the Treasury the capacity to finance for at least a limited period—without the necessity of such congressional action.

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

Chairman MITCHELL. Thank you, Governor Partee.

Mr. Taylor, it is good to see you again.

Mr. TAYLOR. Thank you.

Chairman MITCHELL. Thank you for being here. You will proceed now.

STATEMENT OF PAUL H. TAYLOR, FISCAL ASSISTANT SECRETARY OF THE TREASURY

Mr. TAYLOR. Mr. Chairman and members of the subcommittee, I am pleased to have the opportunity to comment on proposed legislation, H.R. 2281, to extend for 5 years, through April 30, 1984, the authority of Federal Reserve banks to purchase directly from the Treasury up to \$5 billion of public debt obligations. Under current legislation, Public Law 95-534, approved October 27, 1978, the authority will expire at the end of next month.

The authority has existed since 1942, and has generally been extended for 2-year periods, although there have been some lapses in recent years. In the last Congress the Department submitted proposed legislation to extend the direct-purchase option to October 31, 1981.

Your committee, however, suggested a 1-year extension with the view to holding oversight hearings on the authority. While those hearings were conducted on June 27, 1978, the committee bill was not enacted into law until the fall—providing the Department, in effect, with a 6-month extension. The approval of a 5-year extension would provide clear recognition of the noncontroversial nature of this backstop to the Treasury's cash management responsibilities.

The primary purpose of the authority, as stated, is to serve as a backstop for Treasury cash and debt operations, permitting more effective and efficient management of our cash and credit reserves, and allowing us to target lower than otherwise required cash balances in our demand accounts with Federal Reserve banks.

There have been observations made that the authority has not been used frequently in recent years and therefore the need for its continuance may have diminished. We acknowledge that the lapse of the authority on a number of occasions in recent years has prompted the Treasury to design cash management bill financing techniques which afford a considerable shortening of the time needed for raising significant sums of money.

However, the value of the direct borrowing authority from the Fed does not rest on the frequency or extensiveness of its use or on its relation to other Treasury cash and credit initiatives, but rather rests on its availability as an emergency backstop for Treasury cash needs, by assuring our ability to obtain needed funds almost instantaneously in the event of any kind of unpredictable or unanticipated financial emergency, such as unexpected cash drains or unexpected interruption of cash inflows.

The Treasury normally makes allowance in its cash and debt management planning for relatively minor financial emergencies. This is possible only because the Treasury has adequate recourse to short-term funds through our regular weekly bill issuances and the aforementioned cash management bills, which can provide funds to the Treasury in as few as 3 days. As a result of these instruments, from the close of calendar year 1975 to the present, we have made only a single use of the direct Fed borrowing option.

Despite the quick cash-raising techniques developed by Treasury and the related lack of usage of the authority in the past few years, we are still convinced that we need the Fed borrowing authority, which provides for almost instantaneous or "same day" availability of funds in the case of extreme financial emergencies.

At this point, I would also like to point out that any borrowing under the Fed authority is subject to the public debt limit, is promptly reported in the daily Treasury statement of cash and debt operations, is also publicly reported in a weekly Federal Reserve statement, and in the Federal Reserve Board's report to the Congress.

The subcommittee has requested the Department also to comment on a bill, H.R. 421, which provide a substitute source of short-term funds for the Treasury by a modification of the present authority.

The methodology provided in H.R. 421 would be cumbersome from the standpoint of Treasury's fiscal operations and would not provide for immediate funding of emergency cash needs since market sales of such securities in any significant size would have to be accomplished by early afternoon of any particular day in order to avoid undue disruption to the market. This contrasts to the practice under the current authority of accomplishing the Fed borrowing at any time prior to the closing of the transcripts of activity in the accounts for the day. Thus, the bill would not meet the Treasury's need for a backstop in the form of immediately available funds.

We understand that the intent of H.R. 421 is to assure that Treasury borrowing activity is subject to market forces. I would like to reiterate Treasury's past testimony that we would not attempt, through the direct-purchase option, to influence credit conditions or otherwise avoid the discipline of the marketplace. Our policy has been and continues to be that our debt obligations should be offered directly in the market and that purchases of Treasury obligations by the Federal Reserve should normally be made through that same market.

H.R. 421 also raises a number of broader questions from the standpoint of Treasury debt management policy and possible adverse effects of the market for Treasury securities. We would like to submit further comments on these aspects of the bill, and as you heard, the Federal Reserve representative's comments on the bill addressed the implications for open market operations.

In conclusion, I would summarize the Treasury position as favoring a 5-year extension of the present authority. Mr. Chairman, the Department views the authority as a temporary accommodation to be used only under the most unusual financial circumstances. We believe that adequate controls exist for its use, since it is fully disclosed and is subject to the discretion and control of the Federal Reserve itself; and that the authority is too important as a cash management tool to be permitted to periodically lapse because of erratic extensions. Therefore, we urge prompt consideration of H.R. 2281 to assure continuity of this authority through April 30, 1984.

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

Chairman MITCHELL. Thank you very much, Mr. Taylor.

In both sets of testimony, you emphasize the time factor that under the present arrangement—that it can be a 1-day operation. Would the Hansen proposition suggest any inordinate delay if it is operative?

Under the present operating procedures, you could move quickly. Under the Hansen arrangement, maybe not that same afternoon, but certainly by the next day, the next afternoon, things could be worked out. May I hear from you on the problem that you see with reference to the time factor in the Hansen bill?

Mr. TAYLOR. As it is right now, if we have an emergency we could very well not know the extent of it until the close of a particular day. And at that point, we could then draw on the Fed or ask the Fed for that exact amount of funds to cover whatever our particular shortage would be on that particular day.

As I understand Mr. Hansen's bill, it would mean that—let us say we would know by the close of business today that we had a cash shortage—we would not be able to cover that cash shortage until the next day, because we would have to then get together with the Fed and find out which securities they would be able to loan us from the portfolio, or we would have to anticipate in advance an emergency draw, which we may not be able to do.

I am just saying the Fed authority gives a little more flexibility, in that we would be able to know, by the end of a day, how much we needed; and under Mr. Hansen's bill we would have to anticipate that need, say, at least a day before in order to sell the next day and be able to cover that shortage.

We may or may not have that kind of lead time. That would be my concern.

Chairman MITCHELL. If we are talking about a disaster or a problem of great magnitude, such as what you anticipated for the authority, wouldn't there be any way you could anticipate it?

Mr. TAYLOR. No; this would also be true of just a plain estimate. In other words, we haven't estimated that cash exactly as we should have. Normally, there are very large out flows of cash in the first 10-day period of a month, the trust funds alone draw out about \$10 billion. So you could just mis-estimate, even though I think we've got a very good system now, and we have some very good cash forecasters.

But as I say, it would give us a little extra time in the present authority versus, I think, Mr. Hansen's suggestion.

Governor PARTEE. I think it is a question of just a day or two, Mr. Chairman. I believe that the Government markets typically operate on the basis of sale one day and payment the next. And you would have to first make the security sale for cash, which would be a peculiar thing. And then you would have this business of what time of the day it took place. The last go-around that the manager would conduct up in New York ordinarily prior to 1 o'clock? And the Treasury's need could very well be an afternoon event, making the security sale just a little out of the ordinary.

It would mean a poorer price, possibly, for the Treasury security. There would be a little loss because of the poorer yield, the poorer price on the security, and a little inefficiency that otherwise wouldn't occur.

It is not a major issue, but it represents a difference between two bills.

Chairman MITCHELL. That is what caused me to ask the question. I really don't see where the time factor is really that different in the Hansen bill. What time does your day officially end? You say at the end of the day. What does that mean?

Mr. TAYLOR. We actually get in our reports by, I would say, 8 o'clock the next morning. In other words, our information flows from the Fed cash balances by teletype, and we have all our reports, I would say, in by around 8 o'clock.

Chairman MITCHELL. Then obviously, you have got time the next day to operate under the Hansen bill, haven't you? What would be the holdup? What would be the hangup? You state your reports are really in at 8 o'clock. You find out whether you need more money or not at that time, right?

Mr. TAYLOR. Yes.

Chairman MITCHELL. You are going right into a business day?

Mr. TAYLOR. Well, that is true.

Chairman MITCHELL. OK.

Governor PARTEE. My point simply was that if the Treasury finds it needs money on a particular day and goes about selling securities, it won't get the money until the following day. There is a 1-day delay in payment for securities.

Chairman MITCHELL. You might even be able to get it that same day?

Governor PARTEE. But it is a special technique if you have to get it the same day. Ordinarily, the government securities market deals on a 1-day turnaround basis. You buy it 1 day, pay for it the next. That is the way it works.

Chairman MITCHELL. OK. This is going to be difficult, because I am going to ask both of you gentlemen to think through a position that is opposite to the position that you have taken. You advocate a 5-year extension, which appears reasonable no matter what mechanism is in place. Maybe that is reasonable. What are any dangers that you see at all in a 5-year extension? Suppose some abuses do take place during that time. It would take some extraordinary action on the part of the Congress to clean up those abuses. I realize we have had no abuses up to this point and I would anticipate that none would take place. But I am a little concerned about whether there are any dangers at all, and I will turn to my colleague a little later on for the same question. Are there any dangers at all that you perceive on such a long extension?

Governor PARTEE. I see none whatsoever, Mr. Chairman. In fact, I would make it indefinite and subject it to oversight because there are many corporations that have standby authority to buy with the approval of the Secretary. The Federal Homeowners Bank and the Securities Investment Protection Corporation have such authority, and I believe that FNMA and FDIC all have it. These are all indefinite extensions.

It seems to me that this is simply the last step in the linkage—that is, the Treasury's ability to draw on the Federal Reserve—that makes the whole thing cash effective. I would just extend it indefinitely, if it were up to me.

Mr. TAYLOR. I would see no problem with that at all, particularly based on the past history of how it has been used.

Chairman MITCHELL. What is the average number of securities traded in a day, the dollar volume?

Governor PARTEE. It is billions and billions. Often, the manager of our one account will trade a couple of billion in a day.

Chairman MITCHELL. Then I am concerned about your testimony where you point out that there could possibly be some disruptions in the market under the Hansen arrangement. You are talking about a maximum of \$5 billion as the top. We have never gone that high, have we?

Mr. TAYLOR. \$2½ billion is the highest.

Chairman MITCHELL. Would \$2½ billion really disrupt the market?

Mr. TAYLOR. I am not a market expert, so—

Governor PARTEE. No, it certainly wouldn't. My point, Mr. Chairman, was the other way around. If a market were disrupted, it might be very difficult to consummate the transaction. If the market were already disrupted because there had been an earthquake because the San Andreas Fault had broken up and down California, or if war had been declared, or if some major event of that kind had occurred, you might find the market would not be functioning very well.

If the Treasury needed money at that time, they couldn't get it whereas they could get it by this emergency if they could borrow for a day or 2 from the Federal Reserve.

Mr. TAYLOR. Let me make the point again. I probably didn't emphasize it correctly. When you mentioned about when we had our reports and closed our books for the previous day, at that point, say it is 8 o'clock the next morning, we are actually getting our accounts in for the previous day. If we had to cover that shortage by Mr. Hansen's methods we would have to sell in the market that day, for the quickest we could get delivery or settlement would be for that day.

So it would not cover, in that aspect, the previous day's balance. We would be covering the overdraft 1 day later.

Chairman MITCHELL. 24-hour life?

Mr. TAYLOR. Yes.

Chairman MITCHELL. One other question for Governor Partee. On page 2 of your testimony, I think your points on the Hansen bill are well taken. The bill does not limit the amount of securities that could be borrowed. I think that is just a technical thing to put into the Hansen bill. It also doesn't specify any type of approval for the borrowings. I think the correct language could be worked out without a great deal of difficulty.

Would changing the Hansen proposal with regard to these two areas of concern make the bill a little more acceptable?

Governor PARTEE. I certainly think those problems concerning the amount and the approval of the FOMC ought to be corrected because it is the FOMC's securities that are going to be borrowed.

Chairman MITCHELL. More specifically, my question was, if we get those difficulties worked out would you support the Hansen bill?

Governor PARTEE. No. As I say on the next page, even after you resolve these questions, presumably favorably, we still regard it as a more cumbersome and less effective procedure than now exists. This is principally because it might not give fail-safe funds in an emergency, due to the condition of the Government securities market.

Chairman MITCHELL. Mr. Hansen?

Mr. HANSEN. Thank you, Mr. Chairman.

Following up from where you left off, Mr. Chairman, Governor Partee are you familiar with page 2 of the bill? Do you have one before you?

Governor PARTEE. Yes. Page 2?

Mr. HANSEN. Section 14(b)(2) of the Federal Reserve Act is amended by inserting, "and to lend, under the direction and regulations of the Federal Open Market Committee, any such obligations to the Secretary of the Treasury".

Now, doesn't that give you the supervision and the control between the Fed and the Treasury you are talking about? It seems to me you are not very familiar with this legislation.

Governor PARTEE. Yes. There is no limit on the volume of securities borrowed. Mr. Hansen: "* * * any such obligations to the Secretary of the Treasury." "* * * under the direction and regulations of the Federal Open Market Committee," means we could have rules and might imply an approval process of the kind we have had before.

Mr. HANSEN. You were discounting something you hadn't even read?

Governor PARTEE. It is all right. My people told me it was not clear. Let me look into that question, because this is obviously in my testimony as a result of this concern with your proposal that we have not had, under our present authority.

Mr. HANSEN. My concern, Governor Partee, is that in following you through your testimony and picking out—this is just an example—picking out some of the remarks you had about this proposed legislation, it is obvious it has not been given adequate study by either you or the Treasury. Before you come up here and make recommendations like you have made, for or against any piece of legislation, whether it is this or anything else, you really ought to take more time, or your people, your analysts down there, ought to take more time to be sure that your facts are correct, that the bill has been analyzed properly.

I sincerely feel that your testimony today has been ill-prepared by whoever is responsible for helping you.

Governor Partee, does the Fed now loan securities?

Governor PARTEE. Yes; to the Government securities dealers.

Mr. HANSEN. And what amounts of such loans have been made?

Governor PARTEE. They could be quite large at times. We do it to provide the specific issues for delivering the market needs on a day-to-day basis.

Mr. HANSEN. How long does it take to initiate and complete such a loan?

Governor PARTEE. The arrangement of the loan, which is called a scale-purchase agreement, is done in the morning, either for that day or for the next day, just as would be the case with the Treasury.

Mr. HANSEN. Would it take any longer to loan to the Treasury?

Governor PARTEE. No; you can lend to the Treasury the same way, whether by direct borrowing or by providing securities.

Mr. HANSEN. You talk about the concern of being too late in the day and not being able to take care of a transaction until the next day, and you might be under some kind of an emergency circumstance.

Isn't it conceivable that the transaction or the securities could be acquired in the evening and the negotiation completed the next morning, early? Aren't you really begging a point when you are talking about any delay that might be incurred that would be significant beyond what you are able to do now on the borrowing authority?

Governor PARTEE. Our concern, Mr. Hansen, is that the Treasury might not know until after the normal trading day had ended—typically at 1:30 or so—that it had a problem. And its problem would be for the next day.

And so, the transaction would need to be as of the end of the day or as of the opening of the next day, so that the Treasury had the money good.

Mr. HANSEN. You could initiate the proceedings for the change the night before?

Governor PARTEE. If you knew the Treasury were going to have this problem, absolutely.

Mr. TAYLOR. There is a possibility that on a day that we have this shortage, that the market would not be open. There are occasions when the market is not open. Again, I am not making any big deal, but that could be a consideration.

Chairman MITCHELL. Would the gentleman yield just a moment?

Mr. HANSEN. Surely.

Chairman MITCHELL. Has that ever occurred. Have you ever faced a shortage when the market was not open?

Mr. TAYLOR. I can't say that we have or haven't. We haven't had the problem in this context.

Mr. HANSEN. If the market isn't open, do you need the money?

Mr. TAYLOR. If you have got to sell the next day to cover the shortage of the previous day, yes, that would be a consideration. It would be an additional length of time that you had your overdraft uncovered.

Mr. HANSEN. If the market's open, you can't sell?

Mr. TAYLOR. I am saying if the market's not open the next day after we had a shortage, then you could have a problem. Again, I am not making a big deal out of it. I am saying that is another possibility.

Mr. HANSEN. Gentlemen, would you please explain in detail the circumstances surrounding the last use of the draw authority on October the 1st, 1977. The real differences between that and my bill is that you couldn't do it in secret if my proposal were in place, isn't that correct?

Mr. TAYLOR. Again, if you are saying secret, I don't think that was done in secret, and the aspect of it was publicized.

Mr. HANSEN. Maybe that is a heavy use of the word. In confidence or in private.

Mr. TAYLOR. You would like us to go through the mechanics of what we did or what?

Mr. HANSEN. Surely. I think that would be a good exercise.

Mr. TAYLOR. As you know, I think this was September 30, 1977, that you are speaking of. At that point, it looked very possible that Congress would not extend the debt ceiling, the debt authority, and it would lapse and go back to its statutory ceiling of \$400 billion.

At that point, we were trying to make sure that the Government was in the best possible position to pay its bills. We wanted to make sure that the Government didn't default on paying its bills. So we had some latitude within the ceiling before it expired, the temporary ceiling, before it expired on September the 30th.

We had, I believe, about \$2.5 billion within that ceiling. So what we did was use that \$2.5 billion to get additional cash, so that until Congress was able to pass the debt extension, we would make sure that we had a maximum amount of cash to carry us over.

It is my responsibility to see that we have cash to pay our bills. So we were trying to make sure that we had the maximum amount of cash for the very reasons I mentioned. And, of course, in doing that, we consulted with the Federal Reserve Bank of New York, the open market desk, to make our needs known.

And we borrowed that \$2.5 billion within the ceiling. It was to maximize our cash and put us in a position to be able to pay the Government's obligations. I think that is a good purpose.

Mr. HANSEN. When did we find out about this? How many days expired before this became known?

Mr. TAYLOR. You mean before the use of it?

Mr. HANSEN. Yes.

Mr. TAYLOR. I don't know.

Governor PARTEE. It would have been in the Federal Reserve statement the next Wednesday.

Mr. HANSEN. September 30th was a Friday. I don't think anyone found out about it until the next week. Is that correct?

Mr. TAYLOR. By Tuesday, I would imagine.

Mr. HANSEN. I guess in a day and age of open government, even if we are just talking about some minute differences, isn't it best that we adopt the approach that best assures things being done in the open?

And I can't see, where you have only used the draw authority once in all these years, I can't envision anyplace where the extreme urgency that you seem to think might happen would occur where one system would be that much better than the other.

And you are saying, Governor Partee, that you think there ought to be an ongoing authority. Well, my bill provides an ongoing authority and it does it without the tinkering of a printing press. It does it with legitimate exchange, in a day and age when it can be done effectively and efficiently.

I guess I can't understand why you get the mental block over there that is so obvious this morning about being able to change and do something a different way.

Mr. TAYLOR. I am pointing out from a cash management standpoint that one is, I think, a little more flexible than the other.

Obviously, there is a difference of opinion or you wouldn't have put H.R. 421 in. The present draw authority in my opinion is more flexible.

I do apologize for not having comments on debt management implications in the testimony. That will be up no later than the end of this week.

Although I am not a market expert, a surprise in the market is one of the worst things to do to the market. And it would be a surprise to have \$2.5 billion worth of securities unannounced.

I think, as Governor Partee mentioned, that could drive the yields up or our price down. And so, we do a little worse on it. Again, that is not being a market expert. I can't give you all the nuances of it. I do know that the market's very jittery and just doesn't like surprises of any kind.

But again, I would bow to our experts in Treasury to give you the comments on the market impact. And I do apologize for not having that this morning.

Mr. HANSEN. One further point. It does seem, if you are talking about flexibility, that you have to have flexibility governed by certain restraints in Government. And it appears to me that there are proper restraints and constraints envisioned in the approach in H.R. 421 that probably ought to be in Government, constraints which are not unnecessarily encumbering. This might be for your good, as well as the Nation's considering the fact that you are being accused much of the time, at the Fed at least, of having a runaway printing press.

I would think if you could properly handle the draw in a different way, this would improve your public image, the public image of this Government, as being responsible—through transactions that are taken care of just as they would be under any other circumstances. I don't think you can show me where there would have been much of an impairment on what you needed to do, if you had done it under the new proposal, and there are many pluses for doing it this way.

Maybe we have got an idea that can work if its given a chance.

That is the last point, Mr. Chairman. I just don't see where that concern voiced by these gentlemen really would hold up or that the kind of problem they envision would occur

Chairman MITCHELL. Comments, gentlemen?

Governor PARTEE. One comment on the printing press. I really don't see that there's any difference in the two techniques from the standpoint of money supply or the Federal Reserve statement.

If the Treasury borrowed securities from us, we would show a loan to the Treasury, that is, a loan to the Treasury on our asset side, just as we do when we deal with the Government securities dealers. We don't take those Governments off our books because we have an obligation to repurchase them, and we would have a similar obligation to repurchase from the Treasury.

Therefore, it would show as an additional loan. In either case the Treasury would have more funds, so that we would have the same money supply impact as the cash advance procedure—unless it is offset by Federal Reserve market operations.

I haven't fully thought through the accounting of this, but I don't think that there is a difference of the kind that Mr. Hansen says.

My only argument for the way that we have been doing it, Mr. Hansen, is my fear that the Government securities market ultimately would not be there because of some catastrophe to permit the Treasury to pay its bills. It would only be 2 or 3 days at the rate of expenditure, and the Congress might not be there for 2 or 3 days to establish a special new authority.

Mr. HANSEN. Don't you have emergency bank regulation No. 1 for that kind of situation?

Governor PARTEE. Emergency bank regulation No. 1?

Chairman MITCHELL. Governor Partee or Mr. Taylor, would you please answer that? You are talking about operating a bank and I think one of the biggest problems you could foresee would be that of the national debt ceiling limit. You can see that one coming down the track, because it has happened before. You know, you have to vote on it.

Governor PARTEE. I can't envision a problem on that.

Chairman MITCHELL. I don't expect you to make a decision until after we have received your testimony, Mr. Taylor, on debt management.

I think this Congress, the 96th and the 97th and 98th and all future Congresses are going to be concerned with new approaches, not for the sake of newness, but in terms of efficiency and effectiveness and good government.

Ruminate on this, if you will, and let me hear from you. If we can iron out some of the questions to which Governor Partee alluded to, what is the possibility of having two draw authorities: The Hansen

proposal for operating in a "normal" situation, and the present authority, in reserve, to be used for extraordinary, catastrophic disasters? Governor PARTEE. In an emergency?

Chairman MITCHELL. Yes; if you will think on that. At least it gives us an opportunity possibly to try this new approach to see if it works. And if at any time it doesn't, then you have got the other authority to back you up.

Mr. TAYLOR. We will look at it.

Chairman MITCHELL. Can you examine that proposition, please, and let me know as soon as you possibly can whether it has merit or not?

Mr. TAYLOR. Yes; we will do that.

[Subsequently the following letter was received for the record:]



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D. C. 20220

MAR 16 1979

Dear Mr. Chairman:

I am pleased to respond to your letter to Paul Taylor of March 5, 1979, regarding the debt management implications of H.R. 421, "To amend the Federal Reserve Act to provide authority for Federal Reserve banks to lend obligations to the Secretary of the Treasury and for the Secretary of the Treasury to borrow such obligations to meet the Treasury's short-term cash needs".

We understand that H.R. 421 is being considered as a substitute or, with amendments, as a supplement to the Treasury's current authority to borrow up to \$5 billion from the Federal Reserve banks, which was discussed in detail in Mr. Taylor's testimony before your subcommittee on March 5.

H.R. 421 would repeal the present authority of the Federal Reserve to purchase up to \$5 billion of obligations directly from the Treasury and would authorize the Federal Reserve to lend obligations, without limitation on the amount, to the Treasury from the Federal Reserve's portfolio. The Treasury could then sell such obligations in the open market for the purpose of meeting its short-term cash needs and would be required to repurchase the obligations and return them to the Federal Reserve within six months.

We understand that the intended purpose of H.R. 421 is to help assure that Treasury borrowings from the Federal Reserve will have essentially the same monetary and market effects as Treasury's direct market borrowings. As indicated below, we believe that this purpose would not be furthered by H.R. 421.

Under the present authority, Treasury borrowings have taken the form of special certificates of indebtedness which are issued to the Federal Reserve. These borrowings have provided the Treasury with an immediate source of funds to meet unforeseen developments which generally occur within a day or two when there is insufficient time to raise funds through the issuance of securities in the market. They can be redeemed as soon as the events which necessitated their use are corrected or when market financing can be accomplished. Also, they do not have to be issued until the Treasury's cash balance with the Federal Reserve actually becomes negative. In such a case immediately available funds can be credited to the Treasury very late in the day.

Under the alternative approach provided in H.R. 421, the Federal Reserve would lend securities to the Treasury which the Treasury would sell in the market in order to obtain funds to replenish the Treasury's cash balance. If the Treasury's balance were not adequate when Treasury checks were presented for clearance this would result in nonpayment until such time as the funds could be obtained in the market. If this were late in the day, it may not be possible to obtain funds until the next day. Thus, if H.R. 421 were enacted, there would still be a need to extend the present borrowing authority in order to assure immediately available funds to the Treasury.

The present borrowing authority does not create problems for monetary policy. The Treasury's borrowing can be offset by the Federal Reserve through its open market operations. When such offsetting transactions are undertaken, the current arrangement merely results in a change in the type of securities held in the Federal Reserve's portfolio. The special certificates issued by the Treasury are exchanged for marketable debt securities held by the Federal Reserve which are sold in the market, possibly with a repurchase agreement. Thus, the net effect is essentially the same as if the Treasury had borrowed from the market rather than from the Federal Reserve.

The arrangement provided by H.R. 421 could be disruptive to debt management and potentially damaging to the market. As noted above the Treasury might not be able to sell the securities that the Federal Reserve lends to the Treasury in time to provide the funds necessary to meet the negative cash balance, particularly if such developments occur late in the day. Moreover, the Treasury would have to decide which specific security to borrow and how to sell it in the market. Since the Treasury is not structured to undertake such operations they would presumably be carried out by the Federal Reserve acting as our agent. Any particular security sold would have to be repurchased to meet the requirement in H.R. 421 that the security be returned to the Federal Reserve within six months. To accomplish this, the Treasury would have to purchase the same security in the market, which may not be readily available at the time, and this could result in market disruption and excessive costs to the Treasury. The market disruption problem could be avoided if the Federal Reserve, as agent for the Treasury, were to sell the security with a repurchase agreement, to assure its return to the Federal Reserve. However, the net effect on monetary policy and on the market would be essentially the same as under the present borrowing authority.

In summary, H.R. 421 would not be an effective substitute for the present borrowing authority in meeting the emergency cash needs of the Treasury. Also, since the current borrowing authority is responsive to market forces and does not adversely impact bank reserves or monetary policy, it does not appear that any useful purpose would be served by amending H.R. 421 so that this approach could be used as a supplement to the present borrowing authority.

Accordingly, we recommend that the present borrowing authority be extended for five years, as provided in H.R. 2281, and we recommend against enactment of H.R. 421.

Sincerely yours,



Roger C. Altman
Assistant Secretary

The Honorable
Parren J. Mitchell, Chairman
Subcommittee on Domestic
Monetary Policy
House of Representatives
Washington, D.C. 20515

Chairman MITCHELL. Gentlemen, thank you very much. Please get the debt management testimony as quickly as possible. Obviously, we want to mark this bill up quickly. We want to handle the draw authority early in this session, so we don't have the same problem as we had last year.

Mr. TAYLOR. We will try to have it up by the end of this week.

Chairman MITCHELL. Fine. Thank you very much, gentlemen.

[Whereupon, at 9:30 a.m., the hearing was adjourned, subject to the call of the Chair.]

