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Statement of Wm. McC. Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

on H. R. 8729 and H.R. 9143

before the

House Committee on Banking and Currency

May 26, 1954

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I am glad to have this opportunity to testify on behalf of the Board of Governors of the Federal Reserve System relative to the proposed legislation which you have before you. The Board of Governors endorses both of these proposed bills.

H.R. 8729 would extend for another two years the authority (continuously provided since 1942) of the Federal Reserve to purchase up to 5 billion dollars of United States securities directly from the Treasury. Without this authority the Treasury and the Federal Reserve on occasions would be unable to prevent the disturbing effects on the money market of the sudden drains that occur at tax payment periods. The use of this authority prior to tax payment dates avoids creating unnecessary financial strains that would otherwise occur if the Treasury had to draw heavily on its accounts. Temporary Treasury borrowing through this means followed by prompt repayment from the proceeds of tax payments provides a smooth operating mechanism, without the abrupt money market fluctuations that would otherwise occur, and thus is helpful in the conduct of Federal Reserve policy. Use of this procedure as required by law is reported each year in detail in the Board's Annual Report. We believe that this authority, under existing safeguards, should remain available.

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H.R. 9143 would repeal the provisions of Section 16 of the Federal Reserve Act which prohibit a Federal Reserve Bank from paying out notes of another Federal Reserve Bank. Under present law it is necessary for each Federal Reserve Bank to sort all of the millions of Federal Reserve notes fit for further circulation which are received by it from member banks, according to the Reserve Bank by which each note was originally issued. In addition, it is necessary for the Reserve Bank to return such notes to the Reserve Banks that originally issued them.

Such sorting and crisscross shipping of currency are expensive. It is estimated that the annual cost of these operations, which would not be necessary except for the statutory restriction, is in excess of $750,000 annually. The pending legislation would remove a provision of law which was thought to be important in the early days of the System but which in practice has not proved to be so.

Experience over the years definitely establishes that the requirement for the return of fit Federal Reserve notes to the Federal Reserve Banks of issue has no important economic effect on the amount of Federal Reserve notes in circulation. The notes that are returned to the Federal Reserve Banks of issue, in accordance with the requirements of the law, are again placed in circulation as demand for currency appears. Outstanding currency which is not needed by the economy is returned to the Reserve Banks for credit to the reserve accounts of the member

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banks. In other words, the amount of currency in circulation rises and falls in accordance with changes in the demand for currency on the part of the public, and is in no way affected by the return of fit notes to the Bank of issue. Accordingly no useful purpose is served by retaining the restriction upon a Federal Reserve Bank's paying out of currency issued by other Federal Reserve Banks. This matter has been thoroughly studied by the Presidents of the Federal Reserve Banks and has their approval.

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