AMEND SECTION 14(b) OF THE FEDERAL RESERVE ACT

HEARING

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY HOUSE OF REPRESENTATIVES

EIGHTY-EIGHTH CONGRESS

SECOND SESSION

ON

H.R. 11499

A BILL TO AMEND SECTION 14(b) OF THE FEDERAL RESERVE ACT, AS AMENDED, TO EXTEND FOR 2 YEARS THE AUTHORITY OF FEDERAL RESERVE BANKS TO PURCHASE UNITED STATES OBLIGATIONS DIRECTLY FROM THE TREASURY

JUNE 11, 1964

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AMEND SECTION 14(b) OF THE FEDERAL RESERVE ACT

THURSDAY, JUNE 11, 1964

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

The committee met, pursuant to notice, at 10 a.m., in room 1301, Longworth House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Reuss, Vanik, Moorhead, Stephens, Gonzalez, Minish, Hanna, Grabowski, White, Kilburn, Widnall, Fino, Mrs. Dwyer, Harvey, Brock, Taft, Talcott, and Clawson.

The Chairman. The committee will please come to order.

We will first take up H.R. 11499, to extend the authority of the Federal Reserve banks to purchase directly obligations of the U.S. Government, and then we will take up in executive session, if it is all right with the committee, House Joint Resolution 1041, introduced by Mr. Rains, to extend certain provisions of the Housing Act for 90 days.

(H.R. 11499 referred to follows:)

[H.R. 11499, 88th Cong., 2d sess.]

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

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 14(b) of the Federal Reserve Act, as amended (12 U.S.C. 355), is amended by striking out "July 1, 1964" and inserting in lieu thereof "July 1, 1966" and by striking out "June 30, 1964" and inserting in lieu thereof "June 30, 1966".

The Chairman. Before we go into this Federal Reserve legislation, I would like to make a statement about the Defense Production Act amendments, and specifically the amendment that drew the opposition of so many members of the committee, concerning the payment of interest. It is my judgment that we should forgo insisting upon that amendment, and secure the passage of the bill next Monday, if we can. I have talked to Mr. Kilburn about it. If we strike out that interest amendment, and pass the bill promptly so it will go to the Senate in time to pass before June 30. In the event the Senate should have other notions about the bill, of course we will have to deal with that when we get to it later on. But we will at least have an opportunity to have the bill considered so as to permit passage before June 30 that way. Unless I hear objections, that is what we will do on that particular bill.

Now, we have with us this morning Mr. Dillon, Secretary of the Treasury, and Mr. Martin, Chairman of the Federal Reserve Board, to testify on the desirability of extending H.R. 11499, to extend the direct purchase authority of the Federal Reserve.

Mr. Martin, since you were here first, you may proceed with your statement, and after that we will hear from Mr. Dillon.

STATEMENT OF HON. WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN OF THE FEDERAL RESERVE BOARD

Mr. MARTIN. The Board of Governors of the Federal Reserve System recommends prompt enactment of H.R. 11499, which would extend for another 2 years the authority of the Federal Reserve System to purchase up to $5 billion of special securities direct from the Treasury.

This direct borrowing authority is an operating convenience which, while seldom used in recent years, has contributed to flexibility in the Treasury's management of the public debt. Its use in the past has avoided needless strains in the banking system immediately preceding taxpayment dates. Even when not used, it has enabled the Treasury to operate with lower cash balances than would otherwise have been feasible, and has provided added leeway in timing new offerings. Furthermore, it is always possible that we may find ourselves in an emergency in which the availability of this sort of "standby" financing would be very important.

Borrowing under this authority has been temporary as well as infrequent. It has been confined to its proper role as a useful tool of debt management and has not been used as a lever to induce financing of Government deficits through unwarranted expansion of Federal Reserve credit.

The statutory provisions which this bill would continue require that the details of all transactions directly with the Treasury be reported in the annual report of the Board of Governors. I should also like to add that such borrowing, when it is outstanding, is reported separately in the weekly statement of condition of Federal Reserve banks.

The CHAIRMAN. Thank you, sir. It is possible we will want to ask you some questions later. Mr. Dillon, we will hear from you now.

STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE TREASURY

Secretary DILLON. Mr. Chairman, and members of the committee, I am happy to appear before you this morning in support of H.R. 11499. This bill would extend until June 30, 1966, 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.

This authority, which would otherwise expire at the end of this month, was first granted in its present form in 1942 for a temporary period. It has been renewed on 10 separate occasions since that time. While used only very sparingly during these past 22 years, and not at all since 1958, I strongly share the conviction of my predecessors that maintenance of this authority is essential to the proper and economical management of the finances of the Government.

The value of the direct purchase authority does not rest on its frequent or extensive use. Rather, it is designed to provide protection against the inevitable uncertainties in estimates of receipts and expenditures and in our borrowing operations and the unforeseen contingencies that can arise from time to time. At no time in our financial planning do we look upon this authority as a substitute for market financing or a cheap source of funds. But its continuing availability as a backstop for all our Treasury cash and debt management operations both permits more economical management of our cash position over the years and 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, year in and year out it provides us with the margin of safety that is necessary if we are to permit our cash balance to fall to exceptionally low levels during periods of seasonally lean revenues. This, in turn, allows the public debt to be kept to a minimum and saves interest costs to the Government.

During the past 6 months, for instance, we have succeeded in holding the Treasury's operating cash balance down to an average of $5.1 billion, or only about half of an average month's cash expenditures. That average has implied, of course, much lower balances during some periods, as we awaited heavy receipts or the proceeds of cash borrowings. With budgetary and trust fund payments running at a rate of over $10 billion per month, these low balances could be maintained, even for brief periods, only because as an emergency support we could count on obtaining funds overnight, if necessary, through the authorization to borrow temporarily from the Federal Reserve banks. As recently as this past April, it appeared possible that use of the authority might be necessary to tide us over a short period before sizable individual tax collections began to flow in. In the end, that did not prove necessary. But without the potential ability to borrow directly from the Federal Reserve, it is clear that prudence would have compelled us to enlarge our cash balance by borrowing additional amounts in the market at a time when market conditions were unfavorable and interest costs had temporarily risen.

In the second place, there is always the possibility that erratic swings in money market conditions and sentiment may produce disturbances of a character that would warrant postponement of a planned Treasury borrowing. In such instances, it is the availability of direct access to Federal Reserve credit that would permit us the flexibility required in such a situation to draw on our cash and to await more propitious market circumstances.

Finally, and perhaps most crucial in an uncertain world, 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, impossible to visualize the kind of situation in which our financial markets would be disrupted and even paralyzed 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. And this is the reason why this authority is required for as much as $5 billion, even though in the past little more than a quarter 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 and that purchases of Treasury obligations by the central bank should normally be made through that same public 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 only rarely and for limited periods. The borrowings are promptly shown on both the weekly Federal Reserve and end-of-month Treasury statements, assuring the widespread publicity that is the best possible deterrent to abuse. In addition, the Federal Reserve must include such information in its annual report to the Congress. And, of course, this borrowing, like any other Treasury borrowing, is subject to the debt limit.

It is a happy circumstance that we have not had to use this authority for more than 6 years. But, as an insurance policy against financial emergency and an essential backstop to our cash management, it must be kept available in case of need.

(The table referred to 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	None			
1945	9	484	2	7
1946	None			
1947	None			
1948	None			
1949	2	220	1	2
1950	2	108	2	1
1951	4	320	2	3
1952	30	811	4	9
1953	29	1,172	2	20
1954	15	424	2	13
1955	None			
1956	None			
1957	None			
1958	2	207	1	2
1959	None			
1960	None			
1961	None			
1962	None			
1963	None			
1964 to date	None			

The CHAIRMAN. Thank you, Mr. Secretary.

This is the 11th time that requests have been made to extend this act, as I understand it.

Secretary DILLON. That is correct.

The CHAIRMAN. And I do not know of any objection from anyone to extending it. If any member desires to ask questions—we have two other matters here this morning—but if any member wants to ask a question, certainly we would not deny that member the privilege of doing so. But if there are no questions——

Mr. REUSS. I have one brief question.

Chairman Martin, if the Congress grants you this authority again, and if a situation would be presented where this country was at full employment, with no more than 3 percent unemployed, and full use of its resources, and the Treasury came around and wanted to borrow under this direct authority $5 billion, would you comply?

Mr. MARTIN. Under those circumstances, we would probably turn it down.

Mr. REUSS. Thank you.

Mr. STEPHENS. Mr. Chairman?

The CHAIRMAN. Mr. Stephens.

Mr. STEPHENS. I would like to know, when was the last time that we acted on this, to extend it?

Secretary DILLON. 1962.

Mr. STEPHENS. And it is a 2-year matter?

Secretary DILLON. It has been extended 2 years at a time for about the last 14 years.

For about the first 7 or 8 years the extensions were rather erratic—some of them were for 18 months or less, one was for more than 3 years. But they got into this 2-year pattern, I think, finally in 1950. So it is the last 14 years.

Mr. KILBURN. Mr. Chairman, I think everybody is agreed this is a good bill, and I cannot imagine anybody opposing it. I think it is an excellent scheme, an excellent way to have the Treasury and the Federal Reserve work together for the good of the country. I hope there won't be any opposition to the bill.

The CHAIRMAN. Mr. White?

Mr. WHITE. Just one question I would like to ask, Mr. Chairman, having not been on the committee before this Congress. Is the rate of interest set by statute?

Secretary DILLON. No, the rate of interest is not set by statute. It is set by agreement with the Federal Reserve—the Open Market Committee, actually. And the agreement that has been in effect for some time has been that the rate of interest would be one-quarter of 1 percent below the current rediscount rate.

Mr. WHITE. Thank you. I have no other questions.

Mr. TALCOTT. Mr. Chairman?

The CHAIRMAN. Mr. Talcott.

Mr. TALCOTT. Mr. Secretary, I take it that the only new reason for needing this bill, other than the reasons that were advanced in previous years, is the possibility of nuclear attack.

Secretary DILLON. Well, I think that has been a reason that has been in the background certainly for the last 4 or 5 or 6 or 8 years, since the Soviet Union has achieved that capability.

Mr. TALCOTT. But it was never mentioned before.

Secretary DILLON. It was mentioned 2 years ago, it certainly was in the background even before that, and it is certainly strongly there now.

Mr. TALCOTT. Would there be much use for money if there were a nuclear attack?

Secretary DILLON. It depends how serious it was. I think there would be a need for money. We do have all sorts of emergency plans to handle that sort of thing, and this is part of it. There would be a period when you had no Congress, and you would have to get them together. This would fill in during that period.

Mr. TALCOTT. Well, I am most pleased to hear this explanation, that we are not fearing complete nuclear holocaust every time we talk about nuclear attack. Thank you very much.

Mr. TAFT. Mr. Chairman?

The CHAIRMAN. Mr. Taft.

Mr. TAFT. Mr. Dillon, in your remarks you state that the purchase authority should not be considered as a means by which the Treasury may independently influence credit conditions by circumventing the authority to engage in open market operations. How could it cut into that? What did you mean by that statement?

Secretary DILLON. When I said that, I just wanted to point out the fact that this is subject to joint agreement with the Federal Reserve System. In other words, we cannot tell the Federal Reserve that they must buy these from us. We can only sell to them if the Federal Reserve agrees with us that they should buy.

Mr. TAFT. So if they continue to engage in public market operations and don't wish to make a purchase they don't have to?

Secretary DILLON. That is correct.

Mr. TAFT. If they did make a purchase, it would cut into their ability to engage in open market operations?

Secretary DILLON. Not necessarily.

Mr. TAFT. That is what I don't understand.

Secretary DILLON. This is the opposite side of the coin of the question Mr. Reuss asked. We in the Treasury cannot tell the Federal Reserve to buy very substantial amounts of direct purchase securities. They can only be sold to them at such times as the Open Market Committee agrees. That is what the law says. I just wanted to point that out.

Mr. TAFT. Thank you.

The CHAIRMAN. Any other questions? Mr. Fino?

Mr. FINO. I would just like to make an observation. With the Secretary of Treasury here, I have the temptation to make one observation.

I cannot resist that temptation this morning—to again remind the Secretary of the Treasury that needed funds—and this is always a problem in the Government—needed funds could very voluntarily and easily be furnished through a Government-run lottery, which could pump into the Treasury of the United States at least $10 billion a year.

Now, that is a sizable sum of money you fellows could play around with, if we had one. Isn't that so?

Secretary DILLON. That is a lot of money; that is correct. I will have to agree with that.

The CHAIRMAN. Any other questions? Thank you, gentlemen, very much. We certainly appreciate your testimony.

Mr. MOORHEAD. Mr. Chairman, is it contemplated that we will take action today on H.R. 11499?

The CHAIRMAN. Yes, we would like to take action now on this bill if it is all right.

Mr. KILBURN. I move we adopt it, and that the chairman take such action to bring it before the House.

The CHAIRMAN. Are you ready for the question?

As many as favor the motion by Mr. Kilburn let it be known by saying aye.

[Chorus of "Aye."]

The CHAIRMAN. All opposed, no.

(No response.)

The CHAIRMAN. The ayes have it unanimously. We will take such action as deemed necessary to get it on the calendar. We will now go into executive session.

Now, the next is a resolution by Mr. Rains, House Joint Resolution 1041. The Senior Citizens Housing Act of 1962 established a new program under the Farmers Home Administration for the insurance of private loans for rental housing for the elderly in small towns, 2,500 population or less, and rural areas. These loans are limited to $100,000 each, carry a term of up to 40 years, and currently bear interest at the rate of 5¾ percent. Existing law includes a termination date of June 30, 1964. This resolution would extend the authority of this program for an additional 90 days to September 30, 1964.

This interim extension is needed to allow the program to continue operations until the Congress has time to act on general housing legislation, including the administration recommendation for the continuation of this program. It seems to be a very reasonable request. Mr. Rains made the request. We all have great respect for Mr. Rains. We want to honor any request that he makes, especially on housing, since he is chairman of the Housing Subcommittee, and he believes this is necessary and desirable. Any comments or any suggestions?

Mr. BARRETT. I move it be reported out favorably.

Mr. KILBURN. Mr. Chairman—just before that—of course this is under Mr. Rain's subcommittee. I just wanted to ask this. In the past I have seen some housing reports come out on the floor that I thought were terrible. Now, supposing a bill like that comes out before September 30 and it is licked. What happens to his resolution?

The CHAIRMAN. Of course it runs out in 90 days. There would have to be another extension, or it would die.

Mr. CLAWSON. Mr. Chairman, are there applications for this kind of housing now?

The CHAIRMAN. I don't know the score on that. We just granted the 90 days so they could continue normal operations. Mr. Barrett made a motion.

Mr. WIDNALL. Mr Chairman, Mr. Rains spoke to me about this. I don't see any objection to this at all. It just continues the authority for 90 days. It does not provide additional authorization. I think it should be supported.

Mr. STEPHENS. Mr. Chairman, may I ask this: Isn't it true that there are a number of pending applications that could not be acted upon if we don't do this?

Mr. TALCOTT. Is that true?

The CHAIRMAN. Mr. Barrett makes a motion that the resolution be reported favorably and that the chairman take such action as may be necessary to get early action and passage. Are you ready for the question? As many as favor the motion, let it be known by saying aye.

[Chorus of "Aye."]

The CHAIRMAN. All opposed, no.

(No response.)

The CHAIRMAN. The ayes have it. The resolution is unanimously adopted.

Without objection, we will stand in recess subject to call of the Chair.

(Whereupon, at 10:30 a.m., the committee recessed, subject to the call of the Chair.)