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ISSUANCE OF TREASURY BILLS

May 7 (calendar day, May 9), 1929.—Ordered to be printed

Mr. Smoot, from the Committee on Finance, submitted the following

REPORT

[To accompany S. 310]

The Committee on Finance, to whom was referred the bill (S. 310) to amend section 5 of the second Liberty bond act, as amended, having considered the same, report favorably thereon with the recommendation that the bill do pass.

The present method of financing the requirements of the United States Government was developed as a war measure, and not only served admirably in financing war-time expenditures but has continued to function satisfactorily up to the present time. However, in so far as short-term financing is concerned, certain modifications are desirable in the interest of greater economy and of closer adjustment of current borrowings to the immediate needs of the Government.

Generally speaking, short-term financing of the Government is carried on by means of Treasury certificates, with maturities of from 3 to 12 months, issued quarterly on tax-payment dates and maturing on tax-payment dates. These certificates serve a threefold purpose: They maintain a part of the outstanding war debt in the form of short-term securities, which, on the whole, has been advantageous from the standpoint of interest charges; they provide the necessary funds to meet the current obligations of the Government; and since their maturities coincide with the period during which very heavy tax payments are received, they furnish an effective instrument for preventing heavy withdrawal of funds from the market, with a consequent serious disturbance every quarter date.

It is not the purpose to dispense with this system, to which our people have become accustomed and which has functioned smoothly and efficiently, but rather to correct certain defects which have developed and to supplement it in such a way as will decrease the cost of financing and adjust it more closely to the needs of the Government.

The defects may be briefly described as follows:

1. Since the Government borrows only four times a year, the funds are borrowed in advance of the actual requirements, and the interest cost on such borrowings has exceeded the interest received on idle Government deposits. Thus, for instance, the Government borrows on the 15th of March the funds necessary to meet certain definite obligations on the 15th of April and there is necessarily a 30-day interest loss on the funds borrowed. If, however, the Treasury sold bills on the 15th of April rather than certificates on a deposit credit basis on the 15th of March, the saving would be immediate and substantial.

2. While the maturing of securities to-day synchronizes in a general way with the collection of income taxes, in practice the redemption of these securities proceeds more rapidly than income-tax checks can be collected. Consequently at every tax period there is a temporary excess of Treasury disbursements, which necessitates temporary certificates of indebtedness issued to cover overdrafts at the Federal reserve banks, on which interest must be paid, in addition to the interest paid on the newly issued securities.

3. Under the present system where certificates are issued bearing a fixed coupon rate the Treasury is confronted with the difficult task of accurately adjusting the interest rate to current market conditions, and while the department has been successful in doing this with great accuracy, nevertheless it would be more desirable to have the market itself fix the rate by competitive bidding.

The bill, therefore, grants the necessary authority to permit the Treasury to sell short-term bills, with a maturity not greater than a year, on a discount basis. Several important advantages may be expected to follow the adoption of this new form of Treasury obligation:

1. Competitive bidding for these bills should enable the Treasury to get the lowest discount rates consistent with current market conditions.

2. The sale of these securities may be timed to coincide almost exactly with the need for funds, thus saving the interest on money borrowed ahead of requirements.

3. Maturities may be timed to correspond closely to the actual collection of income taxes, rather than on the nominal date of tax payments, as at present.

4. The Treasury will be in a position to take advantage of periods of seasonal ease for the sale of Treasury bills rather than, as sometimes occurs, be compelled to offer a large issue of securities during a period of temporary stringency and high money rates.

5. The banks and the investing public will be furnished with a new instrument for the investing of temporary surplus funds, with frequent and convenient maturities.

The bill also (in subdivision (b)) makes the tax exemptions now applicable to certificates of indebtedness, applicable to Treasury bills, and in addition extends to both an exemption from surtaxes and also provides that gain from the sale of either shall be tax exempt, with the necessary supplementary provision that any loss shall not be recognized. Inasmuch as these are short-term obligations, any advance in price will as a practical matter represent nothing more than interest. In order to make the exemption accorded to interest truly effective, to make unnecessary exceedingly complicated computations, to give the Government the full advantage of the present exemptions, and to place individuals upon the same basis as corporations by removing the discrimination now existing in favor of corporations, your committee believes that the provisions of the bill are proper and desirable.

Subdivision (c) of the amended section makes necessary clarifying amendments to the Federal reserve act, by making the provisions now applicable to bonds, notes, and certificates of indebtedness, applicable also to Treasury bills. For example, under this amendment, notes issued for the purpose of carrying or trading in Treasury bills, or certificates of indebtedness, will be eligible for discount, under the second paragraph of section 13; Treasury bills and certificates of indebtedness will be acceptable security for advances to member banks, under the seventh paragraph of section 13; and they are included among the securities which Federal reserve banks may purchase, under subdivision (b) of section 14.

It is believed that the proposed legislation will afford a necessary flexibility in Government financing, that the advantages should be obtained at the earliest possible time, and that the legislation should be enacted at the present session.

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