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LBC

RESERVE REQUIREMENTS AGAINST FOREIGN DEPOSITS IN AMERICAN BANKS

Problem

The problem is (a) to reduce the cost to the Treasury of sterilizing gold inflows and (b) to discourage capital and, hence, gold inflows.

Partial solution

The imposition of higher reserve requirements against deposits held by or on behalf of non-resident aliens would permit the Treasury to transfer part of the burden of sterilizing on to the banks. It would act as a minor deterrent only to the inflow of capital.

Technical problems

1. Authority to vary reserve requirements should be vested in the Board of Governors, should be discretionary, and should be unlimited in scope.

2. Power over reserve requirements should extend to foreign deposits in non-member as well as in member banks. If restricted to foreign deposits in member banks the door would be open to wide evasion. If it were provided that only member banks could accept foreign deposits a good deal of opposition would arise and our legal position would not be as strong as it would be if we can say that any bank may accept foreign deposits provided they carry certain reserves against them.

3. A further problem arises in connection with deposit insurance assessments. If reserves were set at 100 percent member banks would be more apt to impose service charges than non-member banks, inasmuch as they would have to pay the insurance assessments. This would amount to $833 on a million dollar deposit. This discrimination against member banks could be met by exempting foreign deposits from the assessment base.

4. Reserves against foreign deposits should be held in the form of balances with the reserve banks. In connection with the requirement that reserves against foreign deposits in non-member banks should be held with the reserve banks, an initial absorption of excess reserves will occur even before requirements are raised. This will permit an additional small amount of de-sterilization by the Treasury.

5. All foreign central bank and Government deposits should be carried with the reserve banks. It would appear preferable not to enact the same requirement for foreign commercial bank deposits, as this would entail the reserve banks taking over the foreign exchange and foreign correspondent business of commercial banks. This degree of competition would be difficult to justify in view of the existence of the alternative of requiring high reserves against foreign commercial bank deposits with domestic banks.

6. In order to concentrate the administrative problem on the few big banks that carry ninety percent of the foreign deposits exception might be granted to reserve requirements against foreign deposits below, say, $5,000 or $10,000.

7. The discretionary power should apply to time deposits as well as to demand deposits.

8. Domestic balances of branches of American banks abroad should be classified as foreign deposits. Otherwise, evasion could easily occur.

9. In view of the practical administrative difficulties it appears undesirable to attempt to discriminate between foreign ordinary working balances and other balances.

10. Banks should be held responsible for reporting deposits held directly by non-resident aliens. Residents should be held responsible for reporting to banks any deposits held on behalf of non-resident aliens.

Superseded by discussion

11. The mechanics of Treasury de-sterilization.

Something along the following lines appears feasible, although various procedures could be adopted:

(a) The reserve banks could take over from the individual banks concerned, directly or through the dealers, sufficient Treasury obligations at current prices to enable those banks to meet their increased reserve requirements. Alternatively, the reserve banks could notify the dealers that they would bid for a certain volume of securities, although this course might have the undesired effect of creating excess reserves in banks whose requirements are not raised.

(b) The next step would be to allow a short interval to elapse in order to see whether non-resident aliens would withdraw their deposits for the purpose of buying securities. A shift of deposits from non-resident to resident account would automatically result in a reduction of reserve requirements and, hence, the creation of excess reserves. To the extent that such excess reserves come into being, the reserve banks could sell securities.

(c) Since, under existing law, the reserve banks cannot deal directly with the Treasury, the net amount of securities which the reserve banks had bought in connection with the raised reserve requirements could be sold todealers. Simultaneously the

Treasury could utilize its inactive gold account by depositing gold certificates or gold certificate credit with the reserve banks and using the resulting balance to pay off maturing bills and to acquire other securities for its investment accounts. Such purchases and redemptions should equal in amount the securities purchased by the reserve banks in connection with the raised reserve requirements.

(d) After the initial adjustments have been completed, the procedure could be adapted to any future fluctuations in foreign deposits. An increase in foreign deposits accompanied by gold inflow would be prevented from increasing excess reserves partly by increased reserve requirements, partly by additions to the Treasury's inactive gold account as at present. In the case of an increase in foreign deposits not accompanied by gold inflow (arising from sales of securities, for example), the increased reserve requirements could be provided in the first instance by reserve bank purchases of securities which could be indirectly disposed of later to the Treasury under the procedure outlined above.

A decrease in foreign deposits accompanied by gold outflow would result in decreased reserve requirements. If the loss of reserves exceeded the decrease in requirements, the net loss could be made good by further reducing the inactive gold account.

A decrease in foreign deposits unaccompanied by gold outflow would require sales of securities either by the Reserve banks or the Treasury (resulting in an increase in the inactive gold account) to absorb the reserves released in this way.

12. A formula would have to be worked out whereby the Treasury would sterilize any excess reserves resulting from a subsequent shift of deposits from foreign to domestic account and of foreign central bank deposits from the reserve banks to domestic holders in commercial banks.