



FEDERAL RESERVE

press release

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Remarks of J. L. Robertson, Member of the Board of
Governors of the Federal Reserve System, to repre-
sentatives of banks and other financial institutions
with respect to the President's Balance of Payments
Program

Let me discuss more closely what the President's
program means for banks and other financial institutions -
bearing in mind, of course, that what is asked of them is
only part of the over-all attack on the balance of payments
problem.

Given the urgent need for a decisive cutback in
capital outflows this year, what is an appropriate and
realistic target for the banking community? After a great
deal of thought, the Federal Reserve has concluded that
any expansion of bank lending abroad in 1965 should not
be greater - and preferably should be less - than the
rate of growth of domestic lending. Last year, in con-
trast, foreign bank lending rose three times as rapidly
as domestic loans and investments.

More dollars are needed abroad day by day, month
by month, to finance trade throughout the free world -

but not as many dollars as we have been providing. Hence the need for voluntary restraint on dollar outflows - the need for a curtailment of the rate of expansion of the outflow. Here is a situation in which we can make progress by standing still awhile - as the need for dollars abroad increases.

Therefore, we have asked all banks to restrict credits to foreigners that are not clearly and directly for the purpose of financing exports of United States goods and services. While all exports must be financed, we seek to have outstanding credits to foreigners (including export credits) held during 1965 to a level not over 5 per cent above the amount outstanding on December 31, 1964. In most instances, individual banks should do better - especially the larger ones - to offset the fact that some bona fide export credits to foreigners may be granted by banks that had no outstanding foreign credits at all last year.

This target must apply to all foreign credits - loans and investments, acceptances and deposits. And the target must be aimed at by all banks. The institutions represented in this room account for most of the outstanding U. S. bank credit to foreigners, but of course we

expect the smaller banks also to participate in this program.

This target will take care of any possible increase in bona fide export credits. The National Foreign Trade Council has estimated that U. S. exports in 1965 will be about 5 per cent higher than the rate for the fourth quarter of 1964. Hence, an increase in export credits by 5 per cent of the amount outstanding at the year end should cover the requirements of export expansion, assuming no change in the proportion of exports financed by credit. Thus, even if all credits granted by banks to foreigners were export credits, the 5 per cent target would still be realistic.

Actually, as you know, only a fraction of bank credits to foreigners are used to finance exports of U. S. goods and services. In the case of long-term credits, we know that this fraction is only around 15 per cent. In the case of acceptances, it is about 40 per cent. In the case of other short-term credits, it may well be less than in acceptances, but assuming for argument's sake that the fraction were equally high, this would mean that altogether only \$3 billion of the total of \$10 billion of bank credits to foreigners outstanding on December 31, 1964, was for the purpose of financing exports of U. S.

goods and services. An increase of \$500 million in such credits would thus finance an export expansion, not by 5 per cent, but by more than 15 per cent - an expansion that, unfortunately, is highly improbable.

And in fact, this calculation is still too conservative. All of your short-term credits and a substantial part of your long-term credits will be repaid in 1955. Assuming - quite conservatively - that only half of your total nonexport credits outstanding will fall due this year, an additional \$3-1/2 billion would become available this year to expand your export credits. Although it is unrealistic to expect that extensions or renewals of non-export credits could be cut back to zero, in theory you could (within the Federal Reserve target) increase your export credits outstanding from \$3 billion to \$7 billion - enough to finance an export expansion of 133 per cent:

You will understand, therefore, that I do not intend to lose any sleep about the possibility that our target might prove to be too restrictive to permit the granting of all bona fide export credits. You will have plenty of opportunity to cut down your nonexport credits, if that should prove necessary in order to make room for

any imaginable expansion of export credits. We recognize that in some cases this adjustment cannot be made overnight, especially if the credits granted or committed during the first six weeks of this year have already taken you over the target. But you should be able to get within the limit in a reasonably short period of time. In fact, you will probably be able to maintain your nonexport credits to foreigners at a level which will not impose a serious burden either on you or on your domestic or foreign customers, since the target level will be one-third higher than your outstanding credits were at the end of 1963.

Within the limits set, we must avoid creating more problems than we solve. Hence, it is assumed that while abiding by the target, you will exercise discretion in allocating loans. Since it would be in your own best interest, undoubtedly you will concentrate on credits that are exempt from the Interest Equalization Tax. This would mean that in the medium and long-term field you will give preference to the less developed nations. Moreover, again in your own interest as well as in that of the U. S. economy at large, you will presumably avoid any cutback that would inflict a serious burden on less developed countries, whose

economic growth is especially in our national interest, or on such developed countries as Canada or Japan (both of which are heavily dependent on U. S. finance) and the United Kingdom (which, as we all know, is going through a difficult period in its own balance of payments). But again, I am sure this problem will hardly arise in practice since you will be able to stay within the target limit and still meet the real needs of these countries.

The 5 per cent target is simple and straightforward. It requires a minimum of interference with your operations and no elaborate machinery or detailed supervision. With the understanding that bona fide export financing is to be given priority and met adequately, and that serious cutbacks in other credits may need to be avoided for certain countries, within this 5 per cent target each bank would be free - subject only to any guidelines that may be developed - to use its resources as it thinks best.

We will need some informational reporting, mainly of a kind already supplied to the Treasury. Without adequate information, we could not spot points at which threats to the effectiveness of the program or problems of its equitable execution might arise; we could not gauge

the success of the program and hence the possibility of relaxation; and we could not become aware that an unco-operative institution was taking advantage of the voluntary character of the program to compete unfairly with other banks. But let me emphasize that we have no desire to burden you with unnecessary reporting.

We are aware that a number of difficult problems are likely to arise in carrying out the program. For instance, relationships with your foreign branches will certainly pose complicated questions. Another major problem will be domestic credits which would affect the U. S. payments balance as much as credits to foreigners. I am thinking, for example, of credits to domestic borrowers that the borrower is going to use for financing operations abroad other than those directly connected with exports. Or some of your customers may be eager to increase the amount of their borrowings for export financing so as to free their own funds for uses inconsistent with our program. These are areas in which we will be working closely with you, and with the Department of Commerce in its efforts to limit foreign credits and investments of nonfinancial corporations.

In the case of the so-called Edge Act and Agreement corporations, the guiding principle, of course, is that banks with such subsidiaries be neither favored nor penalized in comparison with other banks. The most equitable solution, as a rule, seems to be to combine the parent bank and its subsidiaries for the purpose of calculating the 5 per cent target. Equity investments abroad, which are not available to banks without Edge Act subsidiaries, may require special treatment, but we are in a position to deal with that problem.

In connection with these investments and with banks' holdings of foreign securities or other foreign assets, problems may arise with respect to the disposition of those assets. It would obviously undermine the program if banks were to sell such assets domestically so as to free more of their own funds for investment abroad.

Transactions of banks for account of their customers and fiduciary accounts will also require attention.

I am sure that you will avoid encouraging customers to extend any credit to foreigners that you could not extend yourself within the target limits, and that you will avoid acting as brokers or intermediaries by diverting to

them credits that you would normally finance out of your own funds in the usual course of business.

We will endeavor to develop, very soon, appropriate guidelines to deal with these and other problems. In doing so, we may request representatives of the banking community to serve on a small technical advisory committee to assist us. In any event - whether or not we issue guidelines or have an advisory committee - officers of our Reserve Banks will be in touch with you on an individual basis to assist in working out problems that you encounter.

As you know, this is not the only group that is being asked to make a strenuous voluntary effort to implement the President's program. You were joined at the White House today by representatives of leading business corporations that are being asked to make similar efforts. But the contribution that the banking system itself can make is crucial. And your economic interest in the success of the whole program and in the consequent continuing strength of the dollar is particularly strong.

The place of nonbank financial institutions in the President's program is somewhat different. To the best of my knowledge - which is admittedly imperfect

in this field - most of these institutions have played a minor role in the recent expansion of credits to foreigners, although some of them have purchased large amounts of IET exempt foreign bonds and also have placed part of their liquid funds abroad. What we must ask from them, at this time, is that their foreign credits and investments in 1965 also be kept within limits comparable to those we are suggesting for the banking community, and that no additional liquid funds be placed abroad.

Obviously, any potential foreign borrower whose credit application must be rejected by a commercial bank on account of the voluntary restraint program will be tempted to tap other credit sources. The pressure on investment houses, finance companies, insurance companies, and pension funds to extend foreign credits not subject to the IET - perhaps even credits that are - will no doubt increase considerably. Many if not most of these potential borrowers will be excellent risks and will offer excellent terms. It is asking a great deal when we request these institutions to resist the temptation. But, of course, we must do so. If such credits were granted, restraint by the banking system would be in vain. From the point

of view of our payments balance, it makes no difference at all whether a credit to a foreigner is extended by a bank or by some other lender.

One problem involved in charting a course for non-bank financial institutions is the relative lack of data regarding their foreign lending. Only a few of them have undertaken transactions that are reportable on Treasury foreign exchange forms. We shall certainly have to request additional reports from these institutions.

Moreover, in the case of some nonbank institutions the problem of customer accounts will probably be even more troublesome than in the case of banks. And in the case of insurance companies, obvious exceptions must be made for foreign investments connected with foreign coverage requirements - exceptions that will have to be analogous to those made for the same reason in the IET legislation. But there is no denying that the Federal Reserve is far less conversant with the practices and problems of non-bank lenders than with those of banks. Hence, discussion of doubtful points with us in the System by the representatives of these financial institutions will be particularly important.

As you see, the success of this entire sector of the President's program depends on your acceptance, your dedication, and your unremitting effort to achieve its purpose. Given the present circumstances of our nation's economy - and the desire of all of us to avoid rigid controls - the Government believes that, in this area, it would be in the best interest of all to rely on voluntary restraint - rather than on laws and regulations - to reduce the outflow of dollars on capital account. With your cooperation, the country's balance of payments in 1965 can be leveled in the direction of full equilibrium. Your actions could have a decisive effect, and world confidence in the dollar would reflect it.