



FEDERAL RESERVE

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Remarks of J. L. Robertson, Member of the Board of  
Governors of the Federal Reserve System, at a Con-  
ference of New Reserve Bank Directors in Washing-  
ton on March 25, 1965

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Purposes and Prospects of Our  
Voluntary Restraint Efforts

The voluntary efforts of our financial community to  
comply with the President's balance-of-payments message of  
February 10 and to restrain credits to foreigners now have  
entered their seventh week.

You are familiar, I am sure, with the broad prin-  
ciples of our efforts. Banks are requested to keep their  
outstanding credits to foreigners to not more than 105 per  
cent of the amount outstanding at the end of 1964. Since  
that amount exceeded \$10 billion, this guideline leaves  
room for an expansion of credit to foreigners by more than  
\$500 million.

Within the over-all limit, banks are requested to  
give absolute priority to bona fide export credits. At  
the end of 1964, export credits accounted for an estimated  
\$2-1/2 - 3 billion. Making the excessively optimistic

assumption of an increase in United States exports this year of 10 per cent, and assuming a corresponding rise in the need for export financing, an amount of \$250-300 million would amply take care of that need. Hence, you will understand that I cannot agree with those who fear that our guidelines do not leave enough room for a sound expansion of export credits.

Among nonexport credits, banks are requested to give priority to credits to less developed countries, and to avoid cutbacks in credits to those developed countries that are either largely dependent on U. S. financing, such as Canada and Japan, or are themselves in payments difficulties, such as Britain.

In so far as cutbacks will be necessary in order to accommodate the expansion of export credits and perhaps of development credits to less developed countries, banks are requested to make these cutbacks in nonexport credits to those developed countries that do not fall within the exceptions just mentioned. In practice, this means the countries of Continental Europe.

This discrimination against nonexport credits to Continental Europe is justified on two grounds.

First, Continental Europe suffers from a persistent payments surplus, just as the United States and Britain have been suffering from persistent payments deficits. Many European governments are less than enthusiastic about the inflow of funds in general, and from the United States in particular, and for years have been urging us to cut that flow. In particular, they maintain - rightly or wrongly - that the inflow of U. S. credit and capital has been the main cause of inflationary pressures on their economies. Hence, a curtailment of bank credits to Continental Europe would conform to the desire of the European as well as of our own authorities.

Second, Europe, like the United States, is naturally an exporter of capital to the rest of the world. While its per-capita national incomes and savings flows are not as large as those of the United States, they are very much larger than those of any other part of the world. Hence, there would seem to be no intrinsic economic reason for a net inflow of capital into Continental Europe, generally speaking. This flow is caused mainly by the imperfections of many European credit and capital markets, which - together with traditional European ideas of monetary and

fiscal policies - tend to raise interest rates and other credit costs. This situation will not be remedied until the Europeans are forced to provide for themselves the liquid funds and credit facilities that their highly developed industrial and commercial enterprises require, instead of relying so heavily on liquid funds and credit facilities of U. S. origin.

In 1965, repayments to U. S. banks on nonexport credits to Continental Europe will probably be in excess of \$500 million. This sum alone is as large as will be any reasonable expansion of export credits and of development credits to less developed nations. Even if we had asked banks to remain at 100 per cent of the 1964 credit level, such a target would thus have permitted the necessary expansion of export and development credits during 1965. As it is, the target leaves ample room not only for those priority types of credit expansion but also for the continued extension of many nonexport credits to Continental European countries that make economic sense, such as the traditional shipbuilding credits to Scandinavian countries, as well as credits permitting the exploitation of natural resources in developed countries outside of Europe, such as Australia and New Zealand.

We have sometimes been asked why we do not exempt from the suggested ceiling all export credits, and perhaps also development credits to less developed countries.

There are two reasons for our decision on export credits. First, virtually every credit granted to a foreigner could be - with a little ingenuity - connected in one way or another with our exports. Second, our exports are so large that if their financing were totally shifted to banks, the amount outstanding at the end of 1965 could easily be larger than the total of all credits to foreigners outstanding at the end of 1964. Obviously, a target with export credits exempted would be meaningless.

Incidentally, it is for these reasons that we have suggested absolute priority only for bona fide export credits, which means credits that do not substitute for cash sales or for credits from nonbank or foreign sources. As long as this definition affects only priorities within the suggested ceiling, its application can safely be left to the banks themselves since the banks would not derive any advantage from unduly expanding the meaning of an "export credit".

The reasons for the decision not to exempt development credits are even simpler. Such credits have not, and ought not to have, the same absolute priority as export credits. An unlimited increase in such credits would be neither in the interests of the United States nor in the interests of the less developed countries. Actually, the main source of the persistent payments surplus of Continental Europe, which is the counterpart of our payments deficit, are not the direct transactions between the United States and Europe - but indirect transactions. Continental Europe has a huge export surplus in relation to the less developed nations, which is being financed largely by the public and private funds that the United States pours into those countries. Hence, a curtailment of the continuous increase in the flow of U. S. funds to less developed countries is needed for a correction both of our own payments deficit and of the Continental European surplus.

Moreover, the less developed nations ought, in their own interest, to increase the proportion of their domestic expenditures financed from local savings and to finance their imports from Europe with credits granted by the exporting countries, instead of relying for both types of funds mainly on U. S. grants and credits.

The main threat to a full success of the voluntary restraint efforts does not come from our treatment of export credits or development credits, nor from the amount or basis of our suggested target figure. It comes rather from the fact that a number of banks, in the last few weeks before the President's message, engaged in a record expansion of credit commitments and disbursements. According to our tentative data, a relatively small number of banks have engaged in that practice but these banks account for perhaps as much as 40 per cent of total outstanding bank credits to foreigners.

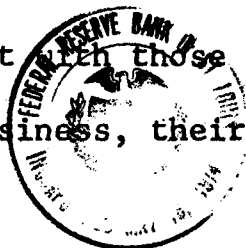
Of course, the actions of these banks were neither illegal nor - at that time - objectionable. It would obviously be out of the question to ask those banks to default on their commitments. On the other hand, it would be unfair to the rest of the banking community to take as a basis not the end of 1964 but the date of the President's message, and then suggest, say, a 100 per cent target on that basis rather than the 105 per cent target on the 1964 basis. A February 1965 basis would validate the credit extensions of a handful of banks, but it would make compliance with the suggested restraint much more difficult

for all the other banks and would raise questions of equity and fairness.

Hence, we have suggested to those few banks that they cut back their credits to foreigners to 105 per cent of their 1964 level if they are now over that ceiling, or will be over the ceiling at any time during this year in consequence of their expanded credit commitments. For a few banks, this will mean a drastic cutback; and in order to avoid serious disruption of their banking business, we expect that those banks will need a reasonable extension of time within which to get back to the suggested 105 per cent ceiling.

The response of the banking community to our guidelines has been magnificent, and permits us to expect full success.

Of course, I hope for similar success in the case of our program for nonbank financial institutions - insurance companies, investment companies, finance companies, pension funds, and the like. But this program is not so far advanced as that for banks. The Federal Reserve hitherto has had little contact with those institutions and knows little about their business, their problems, and their





practices. We are trying as rapidly as possible to remedy that defect, and once we have received the necessary information and acquired the necessary knowledge, we hope to do as well with them as with banks.

Meanwhile, we have suggested the same target for them as for banks in the field of short- and medium-term credits (up to five years maturity), in which competition between banks and other financial institutions is particularly keen. We have suggested a stricter target - no expansion at all - for liquid funds of nonbanks (while in the case of banks these funds are part of the suggested target base). But we have, for the time being, refrained from suggesting a specific target for long-term credits and investments. In this field, we rely provisionally on the Interest Equalization Tax and on the understandings between the U. S. Treasury and the Governments of Canada and Japan. We shall soon see whether more specific suggestions will be needed to assure success in this sector, too.

The wholehearted acceptance of our guidelines by the financial community has made me slightly suspicious about the probable effectiveness of our program: I always remember the Broken Bow proverb that you haven't stuck a

pig unless it squeals. But to my comfort, we had a first loud squeal just a few days ago, when the Federal Reserve was accused of making the banks "sacrificial goats for the government's sins"; of aiming "one of the most severe blows against bank profits"; and of having caused the payments deficit simply by having "inflated the banks' money supplies" so much that they "had to seek higher-income foreign sources to employ the surplus funds". It was suggested that an increase in U. S. money rates by "a further one-half of one per cent" would have been sufficient to avert "at least half the capital outflows which unbalanced our payments position".

Needless to say, in my view these objections are not well-founded. The government has indeed chosen banks as one of its main targets in the drive to reduce our payments deficit - but for a very good reason: it was the excessive expansion of bank credit to foreigners in 1964 that undid the near-balance in our international payments achieved in the wake of the Kennedy program in the second half of 1963 and the first quarter of 1964.

And our action does not aim a severe blow against bank profits. First, bank credits to foreigners are, on

the average, only about 4 per cent of total bank assets - although, obviously, the ratio will be much higher for a few banks. Second, the Federal Reserve has not suggested an over-all cutback but, on the contrary, a further (though limited) expansion of credits to foreigners. Third, most banks that are heavily engaged in international transactions have foreign branches that can expand their business beyond the suggested ceilings so long as they use deposits acquired abroad. Hence, the idea that our actions could cause serious damage to any bank is unwarranted.

But what about the - highly fashionable - contention that we could have avoided even the minor inconvenience and hardship of our voluntary restraint efforts if only the Federal Reserve had not been wedded to an excessively easy monetary policy? If a further rise in money-market rates by one-half of one per cent really could have solved our payments problem, you can rest assured that the Federal Reserve would not have hesitated to seek it. An eminent European central banker suggested in 1963 that a rise by one-half of one per cent would completely eliminate our deficit. Since then, our money-market rates have

risen not by one-half but by more than one per cent - but our payments problem is still with us. The importance of the U. S. money market is such that foreign money-market rates usually follow ours; and a further increase in our money-market rates might simply lead to further "leap-frogging". This is not to say that some increase might not be justified under some conditions: it is justified, for instance, as a defensive measure against foreign action, and especially, of course, if domestic inflationary developments make a lessening of monetary ease desirable or necessary. But in itself it is not, in my view, an efficient or sufficient method of correcting our payments situation.

Of course, it would be possible to stop the outflow of bank credit and thus to make our voluntary restraint efforts unnecessary if the Federal Reserve were so to restrict the availability of credit that banks simply would not have sufficient funds to expand any credit - to domestic and foreign borrowers alike. Apparently, this is what our European critics, and even some of our domestic bankers, want us to do. And if the voluntary effort should fail, this may indeed become necessary. But it obviously

should be a method of last rather than first resort. In contrast to the moderate changes in money-market rates and bank reserves that the Federal Reserve has used as an instrument of monetary policy in recent years, such a meat-ax approach would risk bringing about a domestic recession. Unless such a policy were made inevitable by the failure of all possible alternative steps, it would be irresponsible, for economic, political, and even moral reasons, to incur the risk of aggravating unemployment and thereby rendering ineffective our efforts in the war on poverty, ignorance, and crime that we have recently undertaken. And, incidentally, I hardly think such a policy would be the best method of keeping bank profits at a comfortable level.

Actually, our voluntary restraint efforts mark another experiment in supplementing general credit policies with a more selective method of offsetting differentials between interest and profit levels at home and abroad. At present, we suffer at the same time from an international payments deficit, due to excessive capital outflows, and from domestic underutilization of resources, due to insufficient domestic capital investment. Both

these ills can be simultaneously cured only if we reduce incentives to use capital abroad without reducing incentives to use capital domestically. This has been the justification, under the Kennedy program for the Interest Equalization Tax, and under the Johnson program for the voluntary restraint efforts.

These methods may be too novel and too dependent on individual voluntary acceptance of public responsibility to be workable abroad. But in the United States, businessmen are not averse to new methods, to experimentation, and to voluntary participation in public programs.

They realize the seriousness of our payments problem. They may have different views on the causes of our deficit and on the best ways to correct it. But once the President has decided, as he has, to use the least objectionable alternative method of coping with the problem - an appeal to voluntary restraint - there is no doubt whatsoever about the willingness of the people of this country to cooperate in such a manner as to assure the effectiveness of the program.

The very fact that under our guidelines each individual bank and financial institution is the final judge of its place in the common effort is - in our social system - a source of strength and a guarantee of success.