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Statement of J. L. Robertson, Vice Chairman

Board of Governors of the Federal Reserve System

before the

Subcommittee on International Trade

of the

Committee on Banking and Currency

House of Representatives

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Mr. Chairman, I am pleased to appear before your Committee to discuss with you the views of the Board of Governors on H. R. 8181. The Board has a strong interest in this bill because two of its three titles would directly affect important aspects of our operations. Title I would require the Federal Reserve to grant credit, under certain specified interest rate spreads, to any Federally insured bank seeking funds to finance the production or sale of goods for export from this country. Title II would require the Federal Reserve to exclude from the coverage of its Voluntary Foreign Credit Restraint Guidelines any credit extended by banks or other financial institutions to finance exports of U. S. goods.

Governor Brimmer and I would like to present the Federal Reserve position on these two sections of the bill in two parts. I will comment first on Title I. Although I was responsible for managing the Board's Voluntary Foreign Credit Restraint program in its early years, Governor Brimmer has had responsibility for its administration since mid-1968 -- and I might add that he has done an excellent job of it. It is, therefore, more appropriate for him to comment on that part of the bill.

Another topic of special interest to our Board, which I understand your subcommittee is also considering, is the question whether the Export-Import Bank should be placed outside Federal

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budget totals and ceilings on expenditures and net lending. While Title III of H. R. 8181 contains several amendments broadening the authority of the Export-Import Bank, it leaves the budgetary status of the Bank unchanged. H. R. 5846, on the other hand, -- which I understand is also on your subcommittee's agenda -- would take the Bank out of the budget totals. Near the end of my remarks I would, therefore, like to reiterate briefly the Board's position, already communicated to other Committees of Congress, supporting retention of the Bank in the budget.

How Title I would work

Title I of the proposed bill would, in effect, provide any Federally insured bank automatic access to Federal Reserve credit in amounts limited only by the volume of export paper in the bank's portfolio. Such paper would be discounted by Federal Reserve Banks at the discount rate or 6 per cent, whichever was lower, for short-term paper. For 1-to-5 year paper, the maximum rate would be 5 per cent; and for longer-term paper, 4 per cent. Under this arrangement the spread to the commercial bank (i. e., the difference between the rate charged the customer and the rate at which the loan was discounted by the Reserve Bank) would be allowed to range from 3/4 to 2-1/2 percentage points, depending on the remaining maturity

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of the loan, whether the exports involved were destined for a developed or a developing country, and whether the loan was guaranteed or insured by the Export-Import Bank.

The extent to which U. S. banks would take advantage of such an opportunity to discount their export loans could be expected to vary with domestic interest rate conditions since banks would be limited as to the interest rate they could charge the exporter and still use the Federal Reserve facility. At times when banks were highly liquid and time deposits or other funds to finance their loans could be obtained in the market at rates below the prescribed Federal Reserve minimums, there would be little disposition to take advantage of the facility. But in periods when bank funds were more costly than the maximum 6, 5, and 4 per cent discounting rates specified, banks would be encouraged to use the facility both to make new export loans and to unload their holdings of outstanding export paper on the System.

The opportunity to obtain instant liquidity by unloading export loans on the Federal Reserve would, of course, be quite valuable to a bank in periods when monetary policy was in a posture of anti-inflationary restraint. It should be noted in passing, however, that this advantage would be available only to a relatively small number of institutions. The bulk of U. S. foreign lending is carried on by

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less than 200 banks, and most of the dollar volume of export financing is concentrated in a much smaller number of large city banks.

Where banks did unload outstanding export loans in periods of general monetary restraint, the reserve funds they so acquired would most likely be used to support additional lending to preferred customers for domestic purposes rather than to export customers. However, the combination of low maximum discount rates and fixed spreads would at the same time assure unusually favorable rates on new export loans. In these circumstances foreign customers who might normally finance their imports from the United States in their own countries would be perfectly free to seek and, so long as the bargain rate relationships were maintained, to obtain through their American bankers unlimited credit from the Federal Reserve to finance imports.

It is important to distinguish the basic difference between this proposed discount facility for export loans and the operation of the existing Federal Reserve discount window. As already noted, under the proposed facility a bank would have the right to obtain Federal Reserve credit, at its own option and at guaranteed maximum rates, so long as it possessed or could generate export loan collateral eligible for discounting. Such credit could be used in turn to finance a more or less permanent expansion of domestic lending.

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The purpose of the Federal Reserve discount window, on the other hand, is simply to provide member commercial banks with temporary liquidity, as needed to adjust their reserve positions and help meet weekly average reserve requirements. The window is not designed to provide credit for the purpose of inducing an expansion in bank lending. Consequently, borrowings at the discount window are limited in maturity to 15 days or less. If any particular member bank returns to the discount window too frequently and appears to be becoming "a continuous borrower", its management is brought under surveillance by the regional Federal Reserve Bank and advised to sell sufficient assets to repay the Federal Reserve borrowing. In short, the opportunity to borrow is a privilege provided only so long as a bank uses it to acquire temporary liquidity. If the bank attempts to stretch its use of Federal Reserve credit to finance asset holdings on a more permanent basis, the privilege is withdrawn.

Evaluation of Title I

The preceding sketch of the way in which the proposed Title I facility would work raises serious doubts about the advisability of its enactment. Because the Title I arrangements would provide automatic liquidity to the export loans held by any insured bank,

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they could seriously inhibit general monetary policy at times when the Federal Reserve was seeking to restrain inflation. At such times, banks would be likely to unload their outstanding export loans on the Federal Reserve as a means of continuing to meet the heavy credit demands of their domestic customers.

In addition, banks would very likely continue making new export loans, despite the conditions of general monetary restraint. Foreign customers would be attracted by the bargain rates and U. S. banks could immediately unload any new loans made on the Federal Reserve. Not only would this provision of Federal Reserve credit be automatic, the large banks receiving it would gain a discount interest rate advantage over other banks whenever the maximum discounting rates on export loans were below the regular Federal Reserve discount rate and rates on other short-term sources of bank funds.

When banks transferred export loans to the Federal Reserve, high powered central bank dollars would be released which could serve as the basis for a multiple expansion of bank credit. In such circumstances, if the System's anti-inflation policy was not to be seriously eroded, this release of high powered dollars would have to be offset through other System actions.

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If the offsetting System actions could be made without too much lag, the total volume of bank credit expansion allowed by Federal Reserve policy would be no larger, but the share allocated to foreign lending would be. Thus, the effect of the selective expansion of export financing would be to reduce the amount and raise the costs of the credit supply remaining to finance such domestic needs as housing and State and local government programs.

In short, the Title I arrangements would at times have the inadvertent result of setting a higher priority on financing of export loans than on some domestic needs which might generally be regarded as socially more pressing. This is one of the difficulties of attempting to introduce a program of selective credit allocation within a framework of general monetary control. It also illustrates why the Board of Governors has consistently opposed the use of its discount facility for selective credit allocation purposes.

Budgetary status of Ex-Im Bank

Turning now to the question of the appropriate budgetary status for the Export-Import Bank, the Board continues to recommend against proposals that would exclude the Bank's receipts and disbursements from the totals of the Federal budget and exempt them from any

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limitations on annual expenditures and net lending imposed through the budget. These proposals would make possible an expansion of Export-Import Bank operations by freeing them from budget restraints imposed on other Federal programs. Such restraints are designed to limit the demands of the Government on the real resources of the economy and to enable the Congress and the Administration to establish priorities among Federal programs, so that the maximum benefit is derived from the total outlays of the Government.

If this exclusion from the budget is to have any effect, it will be to allow Export-Import Bank outlays to exceed those that it would make under present restraints. As a result, total Federal outlays will rise without being reflected in the budget totals. In addition, exclusion of the Export-Import Bank from the budget would set a precedent that undoubtedly would be invoked by other government agencies seeking the same privilege. There are a number of agencies with this potential interest, and it would be hard to maintain that the Export-Import Bank is the only institution that merits such treatment.

Promotion of exports

The Board's reservations about the desirability of enacting Title I of H. R. 8181 should not be interpreted as a lack of interest

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in promoting U. S. exports. The Federal Reserve is second to no one in its desire to see an improvement in the U. S. balance of payments. Hence we are very much export minded.

We also fully recognize the importance of providing adequate financing to assist our export sales abroad and believe that the Export-Import Bank plays a positive role in achieving this goal. For this reason we favor the amendments in Title III of H. R. 8181 which would increase the loan, gurantee, and insurance authority of the Ex-Im Bank -- and, among other things, would permit an expansion of the existing discounting facility for medium term export loans. Of course, our support of these expanded financial activities carries with it the proviso that they will be fully coordinated by the U. S. Treasury.

Finally, we believe that there is an important part to be played by such new organizations as the Private Export Funding Corporation. The Board, along with other federal agencies, has helped in the establishment of that corporation. And we expect it to assume important responsibilities in marshalling financial resources in this country and abroad to support major U. S. exports. As a private venture operating with official guarantees and insurance paid for by users of the credits, PEFCO holds promise of providing substantial financial resources on competitive terms.

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This completes my testimony, Mr. Chairman. At this point I would like to have Governor Brimmer testify on the VFCR program, if that meets with your wishes.

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