HIGHER INTEREST RATES ON TIME DEPOSITS OF FOREIGN GOVERNMENTS

REPORT

OF THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES
EIGHTY-SEVENTH CONGRESS
SECOND SESSION

TOGETHER WITH

INDIVIDUAL VIEWS

ON

H.R. 12080

AUGUST 9, 1962.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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87TH CONGRESS 2d Session } HOUSE OF REPRESENTATIVES { REPORT No. 2162

HIGHER INTEREST RATES ON TIME DEPOSITS OF FOREIGN GOVERNMENTS

AUGUST 9, 1962.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. PATMAN, from the Committee on Banking and Currency, submitted the following

REPORT

with

INDIVIDUAL VIEWS

[To accompany H.R. 12080]

The Committee on Banking and Currency, to whom was referred the bill (H.R. 12080) to permit domestic banks to pay interest on time deposits of foreign governments at rates differing from those applicable to domestic depositors, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE OF THE BILL

The bill would exempt from the interest ceilings now imposed by regulation under the Federal Reserve Act and the Federal Deposit Insurance Act, the time deposits of foreign governments, their central banks or other monetary authorities, and international financial institutions of which the United States is a member.

Paragraph 14 of section 19 of the Federal Reserve Act (12 U.S.C. 371b) requires the Board of Governors of the Federal Reserve System to limit the rate of interest paid by member banks on time deposits. Subsection (g) of section 18 of the Federal Deposit Insurance (12 U.S.C. 1828(g)) contains a similar requirement with respect to interest paid by nonmember banks insured by the Federal Deposit Insurance Corporation. Distinctions may be drawn under the foregoing statutes between deposits of varous maturities and types or by reason of the location of the deposit. However, no differentiation in interest rates paid on deposits can be made on the basis of the nature of the depositor, i.e., foreign or domestic, or on the ground of the differences in their geographic location. Consequently, interest ceilings on deposits must be the same on all deposits of the same character, whether made by a foreign or domestic depositor. H.R. 12080 would exempt foreign official time deposits from the application of these statutes.

GENERAL STATEMENT

The bill is designed to implement one of a series of recommendations made by the President in his balance-of-payments message of February 6, 1961. The President's executive communication of March 14, 1961, submitting a draft bill of the legislation now under consideration follows:

THE WHITE HOUSE,
Washington, March 14, 1961.

DEAR MR. SPEAKER: I am transmitting herewith a draft of legislation which would amend existing law by permitting banks in this country to pay different rates of interest on time deposits held here by foreign governments than are paid to domestic depositors. Also transmitted is a memorandum from the Secretary of the Treasury describing the draft bill and its impact in detail.

The draft bill implements a recommendation contained in my message to the Congress dated February 6, 1961, relating to the balance-of-payments problem. It also complements and supports my directive to the Secretary of the Treasury to issue securities at special rates for exclusive holding by foreign central banks or governments.

If commercial banks are permitted to offer foreign governments higher rates of interest in competition with those existing abroad, those governments will be encouraged to maintain dollar accounts in this country rather than require the United States to convert their dollar accounts to gold for withdrawal. In this connection, it is only these foreign governments and their agencies which can directly purchase gold from the reserve stocks of the United States. However, as stated in my message of February 6, the proposed amendment is but one of a series of actions to be taken to alleviate the gold drain. Indeed, the factors which influence any central bank or government to prefer dollar accounts to gold are many and complex. Interest rates are only one. If we pursue policies of stability and growth inspiring world confidence, foreign governments should respond to higher interest rates on time deposits thereby aiding our gold outflow problem.

This inducement to foreign central bank deposits will have practically no impact on domestic market rates of interest. Moreover, any such impact would be confied to the short-term sector of the market and thus be consistent with national policy objectives.

In the interest of orderly procedure, the draft bill also permits similar treatment of deposits of international financial institutions of which the United States is a member.

I will appreciate it if you will lay the draft legislation before the House of Representatives. A similar draft has been transmitted to the President of the Senate. I urge that the Congress act promptly and favorably on the proposal.

Sincerely,

JOHN F. KENNEDY.

OBJECTIVE OF BILL

The objective of the bill is to encourage foreign governments to maintain dollar accounts in this country rather than convert these dollar accounts directly into gold or to transfer the funds to other financial centers, whereupon they could be acquired by official institutions of other countries and be converted into gold. The bill is designed to accomplish this objective by removing the ceiling on rates that commercial banks in the United States may pay for foreign official time deposits, thus permitting those banks to increase those rates within the limits of their own ability.

Testimony received from the Honorable Robert V. Roosa, Under Secretary of Treasury for Monetary Affairs indicated that—

> * * * the flexibility permitted by this bill will be a worthwhile addition to our total effort to achieve a pattern of financial arrangements equal to the task of supporting the position of the dollar—and with it, the whole international monetary system based upon the use of the dollar, side by side with gold, as a reserve currency.

MONETARY RESERVES

The decision of any foreign country to hold dollars instead of gold as a part of its basic international reserves is based upon a complex of interrelated factors. One of these factors is interest rates on time deposits. However, the basic underlying factor in this regard is the willingness and the ability of the United States to buy or sell gold to all responsible foreign monetary authorities and to exchange dollars for gold for legitimate monetary purposes upon demand at the established price of $35 an ounce. This ability, in turn, is based upon the enormous productive capacity of this country and the ability of our industry to compete effectively in world markets. Within this framework, the bill would permit competitive commercial banking in the United States to adapt more effectively to the changing demands upon the dollar and thereby support the international monetary system based upon the use of the dollar.

Confidence in the stability of the dollar, together with the fact that the United States itself accounts for a large portion of world trade and investment, largely explains the unquestioned acceptability of the dollar as the leading means of international payment. The value of the dollar as an international reserve and trading currency is further bulwarked by the efficient facilities provided foreigners by American banking and other financial institutions. These facilities permit speedy transfers of funds between holders and between countries, ready convertibility into other currencies, free access to credit flexibly tailored to meet specific needs as they arise, and all the other varied and specialized services that must be part of an international money market. The United States is the only country now capable of providing these services on the scale needed to sustain the smooth functioning of the monetary system of the free world.

FOREIGN TIME DEPOSITS

The provisions of this bill have a direct bearing on one of the kinds of services which help in maintaining the versatility and universal acceptability of the dollar. It would improve the ability of our financial system to provide a broad range of suitable investment media for official foreign funds, particularly funds for which no immediate disbursement is contemplated but which must be placed in investment media of unquestioned safety and readily available in time of need. Time deposits with our leading commercial banks have traditionally provided to foreigners a desirable short-term investment media of this kind. These deposits provide a direct return in the form of interest, and their maturity and other terms can be flexibly adjusted to the needs of the foreign investors.

Today over $2 billion of the reserve funds of foreign governments and international institutions are held in this form. It would be helpful if such deposits could be increased. However, the ceilings on the rates of interest which can be paid on these deposits have at times caused some problems for U.S. banks in attracting and then holding such deposits. Testimony received by the committee indicated that these ceilings have, on occasion, encouraged a greater conversion of dollars by central banks into gold than might otherwise have occurred had the banks been in a better competitive position.

JUSTIFICATION FOR LEGISLATION

There are certain attributes of the international monetary system, if it is going to work with full effectiveness, which require the special and discriminatory handling of the monetary reserves that underlie the currency. Obviously, to permit the payment of higher interest rates on foreign official time deposits than on other time deposits would be discriminatory. It would not be discriminatory as between private domestic depositors and private foreign depositors, for private depositors, whether domestic or foreign, would continue to be subject to the same ceiling rates of interest on time deposits.

The committee believes, however that in the area covered by the bill, where a foreign central banking function is involved, the payment of a higher rate of interest than is paid to private depositors is justified as being in the public interest. Furthermore, the removal of maximum interest ceilings in the case of official deposits is based in considerable part of the fact that the market in which these funds are handled is quire different and distinct from the domestic market. Consequently the removal of maximum permissible ceilings for time deposits in the case of official foreign time deposits is necessary if flexibility is to be achieved and if there is to be recognition of the practical and fundamental differences between the foreign and domestic markets for time money. As pointed out in the Presidents letter to the Speaker of March 14, 1961, this treatment complements and supports his directive permitting the Secretary of the Treasury to issue securities at special rates for exclusive holding by foreign central banks or governments.

Relatively few banks are engaged in the business of providing deposit facilities for foreign official institutions, and these deposits, while significant in terms of international flows of funds, represent only a relatively small part of their total deposits. They amount to less than 1 percent of total bank deposits. Thus, this exemption from regulation will have no impact on rates paid for funds in our domestic markets, nor will it in any way undermine the safety and stability of the banking system. It should also be noted that the higher rate of interest paid by the banks on such deposits in no way will represent a cost to the Federal Government. The banks will voluntarily pay the higher rates of interest, imposing upon themselves the responsibility of employing these funds on a profitable basis.

We believe the problem and the proposed solution are not unlike those which arise during emergency wartime periods, when it is necessary to deal with basic differences in production costs of a single product. There, too—as in the case of copper production during World War II, for example—the choice had to be made between uniform regulation or specialized action in selected areas. The decision in such instances to follow the latter approach simply reflected the difficulty of attempting across-the-board action when the economic factors themselves were not uniform throughout the market. This, in a fundamental sense, is the same problem which applies today in the case of domestic and foreign time deposits.

In this connection the acting chairman, Hon. Wright Patman, during his interrogation of Mr. Roosa, made the following statement:

> Mr. Roosa, when I first heard of this proposal I didn't like it at all. It is almost repulsive to an American citizen to be asked to pay more interest on balances owned by people outside of the country than to our own people. Yet when I began to analyze it and evaluate it, I had to realize that we have been upping our interest rates largely on account of these foreign balances all over the country in every category, not only New York, but all over the Nation, and it is certainly wrong to require people all over the Nation to pay increased interest in order to take care of foreign balances just in a few banks in New York City so I have thought about it in this light and I am convinced it is a good thing to do.
>
> During the war this committee here, the Banking and Currency Committee, handled OPA, price control, and allocation legislation. We never had any closed rule, incidentally. It came on the floor of the House, bills affecting 8 million prices and wages and every year we did that and we, of course, succeeded in getting it through because we had a lot of good reasons that we thought behind this and we succeeded.
>
> One time the question of copper came up. The large copper companies like Anaconda, Kennecott, and all of them, could produce their maximum at 12 cents a pound. They were satisfied with 12 cents a pound. They could make a good profit and pay good dividends and take care of their workers and take care of all expenses. They were happy with 12 cents a pound.
>
> We needed more copper and we wanted to get it. We could get it by bringing in these marginal mines, but in bringing the marginal mines in, they couldn't afford to operate for any 12 cents a pound. They had to have sometimes 20 and 24 and 30 and 32 and up to 36 cents a pound in order to get the maximum production of copper. So instead of just raising the copper price from 12 cents to say 20 or 30 cents, we left the 12 cents a pound where it was and we got 90 percent of the copper at 12 cents a pound.

Now there was some variation from this but that is substantially true. Now we increased the production of copper by 10 percent, which was a large amount, and we paid high prices, 20 cents and 30 cents a pound subsidy, but in the end for every dollar we paid out in subsidy we got hundreds and thousands of dollars back in savings of what we would have had to pay for the copper if we had increased it clear across the board, so I can see in this the same comparison. It is better for us if sometimes we have to take something bad to keep from taking something worse.

Now maybe it is bad to pay higher interest on these foreign balances to these banks, but it is not as bad as charging the people who have nothing to do with foreign balances, homeowners and people who are in business and people who need personal loans, to make them pay higher interest all over the Nation just to take care of those foreign balances. So I can see in this a good chance to save a lot of money that way for the people and at the same time remedy the situation. Does that seem plausible to you, Mr. Roosa?

Mr. Roosa. Yes, it does.

It should be noted that State banks in a number of States are limited as to the rate of interest they may pay on time deposits, either by State statute or by regulation of State banking authorities. Because of the limitations contained in present law, the bill would not relieve member banks, whether State or National, or insured nonmember banks from interest rate limitations applicable under State law or regulations unless appropriate action is taken by State authorities.

HEARINGS

Hearings were held on the bill by the committee on July 10, 16, 17, and 18, 1962, at which both governmental and public witnesses testified in support of the bill. No witnesses appeared in opposition to the measure.

CONCLUSION

The flexibility permitted by this bill will be a worthwhile addition to our total effort to achieve a pattern of financial arrangements equal to the task of supporting the position of the dollar and with it, the whole international monetary system based upon the use of the dollar, side by side with gold, as a reserve currency. We do not believe that the bill represents any new departure in policy, but rather supplements other measures that have been and are being taken by our Government to provide attractive facilities for the investment of funds of official foreign institutions in the American market.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECTION 19 OF THE FEDERAL RESERVE ACT

BANK RESERVES

SEC. 19. * * *

* * * * * * *

The Board of Governors of the Federal Reserve System shall from time to time limit by regulation the rate of interest which may be paid by member banks on time and savings deposits, and shall prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts. No member bank shall pay any time deposit before its maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the said Board, or waive any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement: *Provided*, That the provisions of this paragraph shall not apply to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia. *The provisions of this paragraph shall not apply to the rate of interest which may be paid by member banks on time deposits of foreign governments, monetary and financial authorities of foreign governments when acting as such, or international financial institutions of which the United States is a member.*

SECTION 18(g) OF THE FEDERAL DEPOSIT INSURANCE ACT

SEC. 18. * * *

* * * * * * *

(g) The Board of Directors shall by regulation prohibit the payment of interest on demand deposits in insured nonmember banks and for such purposes it may define the term "demand deposits"; but such exceptions from this prohibition shall be made as are now or may hereafter be prescribed with respect to deposits payable on demand in member banks by section 19 of the Federal Reserve Act, as amended, or by regulation of the Board of Governors of the Federal Reserve System. The Board of Directors shall from time to time limit by regulation the rates of interest or dividends which may be paid by insured nonmember banks on time and savings deposits, but such regulations shall be consistent with the contractual obligations of such banks to their depositors. For the purpose of fixing such rates of interest or dividends, the Board of Directors shall by regulation prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts. The Board of Directors shall by regulation define what constitutes time and savings deposits in an insured nonmember bank. Such regulations shall prohibit any insured nonmember bank from paying any time deposit before its maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the Board of Directors, and from waiving any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement. For each violation of any provision of this subsection or any lawful provision of such regulations relating to the payment of interest or dividends on deposits or to withdrawal of deposits, the offending bank shall be subject to a penalty of not more than $100, which the Corporation may recover for its use. *The provisions of this subsection shall not apply to the rate of interest which may be paid by insured nonmember banks on time deposits of foreign governments, monetary and financial authorities of foreign governments when acting as such, or international financial institutions of which the United States is a member.*

INDIVIDUAL VIEWS OF HON. CHARLES A. VANIK ON H.R. 12080

Only a few of the larger commercial banks would be affected by this legislation which would eliminate maximum ceilings on interest rates which banks could pay in the United States for dollar time deposits of foreign central banks, official institutions, and international financial organizations. Testimony before the committee indicated at most the legislation probably would not affect more than 100 banks in the country, that at the moment 50 or 60 banks would be a more realistic estimate and that "chiefly it boils down to a half dozen."

The rationale for permitting our banks to pay higher rates of interest on time deposits of foreign governments than is paid on domestic time deposits is that it will permit our banks to compete more effectively for official foreign government funds. A good question is, compete with whom? In my opinion the principal competition will be with the U.S. Treasury rather than with other foreign banks.

Time deposits, of foreign governments and their official monetary institutions and international organizations approximate $2.1 billion. Their holdings of short-term U.S. Treasury securities amount to approximately three times that amount. On their time deposits, because of the restrictions under regulation Q, these institutions cannot be paid more than 1 percent interest on 30- to 90-day time deposits nor more than 2½ percent on 3- to 6-month time deposits. In contrast, 91-day Treasury bills recently have carried yields ranging from 2.75 to 2.97 percent with slightly higher yields on bills in the 3- to 6-month maturity range. If such short-term time deposit interest restrictions are removed and the rate of interest on such time deposits is moved up in the range of U.S. Treasury bill yields, then time deposits on a straight interest return basis would really become competitive with U.S. Treasury bills. This could result in a shift of foreign funds from U.S. Treasury bills to bank time deposits or mean the channeling of any increase in such foreign short-term investment funds into time deposits rather than U.S. Treasury bills.

Interest returns now obtainable by foreign monetary authorities and official international financial institutions on U.S. Treasury bills are quite competitive with net yields obtainable in foreign markets when allowance is made for the cost of eliminating foreign exchange risk. Since a competitive interest return is available on U.S. Treasury bills, it appears questionable to me that moving the short-term time deposit rates up to the range of bill yields will exert any pronounced pull in either attracting new or holding existing foreign government balances in this country.

Proponents of the legislation express the hope that higher interest rates paid on official monetary time deposits will reduce incentives to convert those balances to demands on our gold supply. That might well be true if time deposits were the only medium of short-term investment available for these monetary balances. Certainly there would be less hesitancy for a foreign monetary authority to surrender a 1-percent time deposit for gold than would be the case if the short-term time deposit was earning interest at a rate of 2½ or 3 percent. But if the foreign monetary authority could earn 3 percent on a short-term U.S. Treasury bill investment, the change in the time deposit rate might not have any effect at all. Furthermore, the interest rate factor is only one of the many complex factors entering into a decision of a foreign monetary authority as to what extent it will hold its monetary reserves in nonearning gold or in other forms of interest earning assets. From December 1957 to December 1961, official monetary reserves of foreign countries increased from a total of $33.4 billion to $44.3 billion or a rise of $10.9 billion. Of this increase, 67.9 percent was in the form of gold, 25.7 percent in the form of dollar holdings and 6.4 percent in the form of other country liabilities. On the record, U.S. dollar balances have maintained their relative position in the makeup of total official monetary reserves of foreign countries. As of December 1957, dollar holdings in official monetary reserves of foreign countries amounted to 24.8 percent of such total gold and foreign exchange reserves. As of December 1961, dollar holdings comprised 25 percent of such monetary reserves.

Since this legislation has no substantial effect on the balance-of-payments problem, I seriously question whether this legislation is in the public interest.

Respectfully submitted.

CHARLES A. VANIK.

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