Remarks of
Wm. McC. Martin, Jr., Chairman,
Board of Governors of the Federal Reserve System,
for the
American Chamber of Commerce,
Sao Paulo, Brazil

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As you know, the United States authorities are greatly concerned about the long-continued imbalance in our country's international payments. We realize that equilibrium must soon be restored, both in our own interest and, because of the key position occupied by the dollar, in that of the entire free world. The U. S. Government is resolved to take the measures necessary to achieve this objective, but I would be less than candid if I failed to point out certain specific features which hamper our search for policy measures appropriate in the circumstances.

First, the imbalance itself is unique in character, at least among industrialized countries in modern times. We are not suffering from domestic inflation, with a resulting excess of imports over exports, accompanied by a flight from the currency. Instead we have a large and growing surplus on current account. In 1964 our favorable balance on goods and services amounted to $8.2 billion, $2.5 billion higher than in 1963. The problem is that our export surplus--although it amounts to well over one per cent of our gross national product--has not been large enough to effect the transfer in real terms of the official aid and private investment we are making to the rest of the world.

Secondly, the position of the dollar as a reserve currency forecloses the use of certain methods of adjustment frequently employed by other countries. I refer specifically to any policies which would limit the convertibility of the dollar. Such policies, if adopted, would effectively destroy the reserve currency system, which has served so efficiently throughout the postwar period. They would also have an adverse effect upon the world as well as the U. S. economy.

In the third place, the high and rising level of income and output in the United States tends to produce a relatively large volume of savings, with resulting downward pressure on domestic interest rates and an entirely natural desire on the part of the managers of such savings to seek profitable employment for them in foreign countries. Savings in the rest of the world, in the main, are relatively less abundant than in the United States, and the marginal productivity of capital is frequently higher. Thus a large outflow of U. S. capital, private and official, is a perfectly normal phenomenon. An attempt to reduce this outflow substantially by eliminating the differential between interest rates in the United States and rates in other countries is not a feasible alternative in view of our margin of underutilized resources. Accordingly, we are now using the alternative device of the Interest Equalization Tax on long-term lending to foreign industrial countries.

Fourthly, our international transactions are so small in relation to our total economy that if we tried to use only general fiscal and monetary measures to redress our balance of payments there would almost surely be domestic deflationary consequences. Domestic deflation in the U. S. would be not only unacceptable at home but also, in the long run, and perhaps in the not-so-long run at that, inimical to the interests of the rest of the free world. As has been so many times observed, a prosperous and stable economy at home is the greatest contribution that the United States can make to prosperity and stability abroad. I hope that that very elemental truth will be kept in mind by our friends around the world as we attempt to deal with our balance of payments problem.

As all of you know, the President of the United States on February 10 announced a new program for bringing about a rapid and firm improvement in our balance of payments by better aligning our capital outflow with our net exports of goods and services. I assume that you all are reasonably familiar with his proposals, at least in their broad outline, and I shall take time here only to discuss those for which we in the Federal Reserve have primary responsibility, that is the voluntary restraint on foreign lending by U. S. commercial banks and nonbank financial institutions. Let me begin with the banks.

Outstanding credit extended to foreigners by U. S. banks rose by about 25 per cent, or by $2 billion, in 1964, compared with a rise of less than $1 billion in 1963 and with even smaller increases in most earlier years. So rapid a rate of expansion seemed entirely out of proportion to any contribution it was making to international economic growth, and at the same time it seemed clearly to be very important among the factors responsible for our balance of payments deficit. The goal for which we are striving is a very substantial reduction in the $2 billion rate of increase in credits to foreigners which occurred in 1964, and we have set a target for 1965 of holding the further increase this year to 5 per cent of the amount outstanding at the end of 1964.

In shaping our program of restraint, we found that it was necessary to apply the target to all foreign lending by banks. Otherwise there would have been no assurance that we would have been able to achieve any reduction in the rate of expansion. We realized that there were certain types of lending that should be given very high priority, such as credits to finance exports and credits to the less-developed countries. We have asked the banks to give high priority to such credits, and information at hand indicates that they are following our guidelines. Since the whole effort is voluntary, and since the priorities are as much a part of our guidelines as the target itself, there seems to be no reason for believing that the banks will be any less zealous in applying the priorities than in adhering to the target. The fear that this would not be the case is, I believe, unfounded, but if it proves true we may have to make appropriate changes in the guidelines.

The guidelines which we have suggested for nonbank financial institutions--insurance companies, finance companies, pension funds, etc.--are somewhat less restrictive than those applied to banks. In part this is because we did not have sufficient information at the time the guidelines were formulated to be more specific in our suggestions. However, as more data become available, we will undoubtedly be amending these guidelines in order to be sure that the nonbank financial institutions also play an appropriate role in the President's program.

At present, lending by nonbank financial institutions with maturities of more than five years is not subject to any specific limitation under the Voluntary Credit Restraint Program. Issues of securities by borrowers in industrialized countries in this maturity range are subject to the Interest Equalization Tax and have, in fact, been very small in volume since that tax became effective. We do not wish to see long-term borrowing by less-developed countries unduly restricted; indeed, our national policy is to encourage productive investment in such nations. On the other hand, we have suggested that nonbank financial institutions greatly restrict the placing of liquid funds in foreign countries. Their other credits with maturities of less than five years, and loans and advances to their foreign branches and subsidiaries, should be held to an increase of 5 per cent over the amount outstanding at the end of 1964.

I should like now to turn briefly to the results of the program to date. Unfortunately the time elapsed since the program was inaugurated is too short for us to have firm and detailed statistics. However, the preliminary indications are encouraging.

In the first place the over-all balance of payments, for which we have a preliminary measure, changed from a large deficit in January and February to a surplus of around a half billion dollars in March. To some extent this March surplus was due to special factors, including the normal quarterly return of short-term funds from abroad to meet U. S. tax obligations, but even so it is encouraging. We still do not have actual statistical data on the transactions which produced the March surplus but we believe that the restraint on foreign investment played a significant role. It has been indicated to us, for example, that large amounts of U. S. liquid funds were withdrawn from Canadian and other foreign banks and have not been replaced. We also know that commitments by banks to make foreign long-term loans--that is, loans with a maturity of more than one year--fell sharply after the President's program was announced. These commitments, which amounted to $2 billion in 1964 and to $840 million in the six weeks ending February 10, amounted to only $200 million between February 10 and the middle of April. Incidentally, it is highly significant that of the commitments made since February 10, $165 million or 83 per cent were made to less-developed countries, and 50 per cent to Latin America. This compares with a ratio of loans to less-developed countries to total loans of 29 per cent in 1964 and 38 per cent in the first two months of 1965. Thus it appears that, at least as far as loans to less-developed countries are concerned, the banks are making a sincere effort to follow the priorities suggested in our guidelines.

It is being suggested to us that we should have excluded high priority loans from our program completely, i.e., that we should have exempted export credits and credits to less-developed countries and left them outside of our target. In my judgment, to have done so would have been almost the same as not having a program at all. But we will be watching developments very closely and if we encounter problems in the application of our priority system, we shall not hesitate to make any changes in the program that might seem warranted. We are very mindful of our primary responsibility to protect the international value of the dollar, but so long as that responsibility is exercised, we have no desire to inhibit lending for sound purposes in less-developed countries, especially in Latin America. It may be appropriate to point out that U. S. bank lending to Latin America expanded very rapidly in 1964--by $430 million, or one-third of the amount outstanding at the end of 1963. There is some question in my mind whether such a rate of expansion was sustainable, and whether in fact we were not running the risk of saddling the Latin American countries with an increasing burden of relatively short-term debt, thus increasing the problems which many of your countries face in the near future. Happily, there is evidence that some Latin American countries are increasingly able to issue long-term securities in the United States, a form of credit better suited to their needs than bank loans of relatively shorter maturities.

But I would not like to rest our case on this rather negative note. Instead I would like to assure you again that we are interested in seeing that Latin America, as well as the rest of the less-developed world, continues to receive an amount of credit from United States banks sufficient to further its economic development, which is in our own interest as well as that of the countries concerned.