illiam McChesney Martin, Jr., Papers

ox 26/Folder 4

Series V, Subseries D

Hearings, January-July 1962 (cont.)

(55)

House Banking and Currency Committee

Brent Spence (Ky) Chairman
Wright Patman (TEX)
Albert Rains (Ala)
Abraham J. Multer (NY)
Hugh J. Addonizio (NJ)
William A. Barrett (Pa)
Lenor Kretzer (Mrs. John B.)
Sullivan (Mo)
Henry S. Reuss (Wis)
Thomas L. Ashley (Ohio)
Charles A. Vanik (Ohio)
William S. Moorhead (PA)
Clem Miller (Calif)
Edward R. Finnegan (Ill)
Robert G. Stephens, Jr. (Ga)
Fernand J. St. Germain (R.I)

Hugh L. Carey (NY)
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Clarence E. Kilburn (NY)
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William B. Widnall (NJ)
Eugene Siler (Ky)
Paul A. Fino (NY)
Florence P. Dwyer (NJ)
Edward J. Derwinski (Ill)
Seymour Halpern (NY)
James Harvey (Mich)
Tom V. Moorehead (Ohio)
John H. Rousselot (Calif)
William W. Scranton (Pa)

For release on delivery

Statement of

William McChesney Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking and Currency

House of Representatives

On H.R. 10162

February 28, 1962.

It is a pleasure to be here today at the invitation of Chairman Spence, to discuss why the Federal Reserve supports H. R. 10162, and how the proposed special IMF borrowing arrangements contemplated under H. R. 10162 would fit in with other actions the Federal Reserve is taking to help preserve the strength of the dollar in the international payments system.

If we are to maintain vigorous, growing economies in the free world, we must have a system of international payments that permits countries to finance the goods and services they exchange with a minimum of risk and cost, whether payment is made in cash or on credit. We have come a long way since World War II toward the achievement of this goal. Western Europe has made a remarkable recovery. It has restored convertibility of its principal currencies, eliminated most of its trade controls, and reduced its tariff barriers.

These favorable developments have, however, brought with them new problems, as well as new opportunities. As it became easier to exchange one currency for another, flows of short-term funds between countries have increased. Holders of liquid funds have become increasingly aware of opportunities to benefit from interest-rate differentials and exchange-rate arbitrage.

International flows of funds in response to profit opportunities are useful features of a free world economy, and an increase in such flows should not, as a general matter, give rise to any concern. In recent years, however, the continuing deficits in this country's international payments and the persisting surpluses of some European countries have created recurrent uneasiness in foreign-exchange markets and have added an element of destabilizing speculation to the profit considerations that ordinarily influence international flows of short-term funds.

H. R. 10162 would put the United States in a better position to deal with some of the problems arising out of this development. With this same object in view, the Federal Reserve has recently decided to re-enter the field of foreign-exchange transactions. The Federal Reserve, therefore, is particularly interested in the enactment of this legislation.

In order to bring both H. R. 10162 and the recent decision of the Federal Reserve into proper focus, we must remember that neither action will correct the underlying difficulty, which is our international payments deficit. Regardless of the methods chosen to deal with problems of international flows of short-term funds, the United States must achieve a balance between the amounts we spend, lend and invest abroad and the amounts foreigners spend, lend and invest here.

Until equilibrium is achieved in our payments accounts, there will be a risk that the flow of dollars into the hands of foreigners might become larger than they would be willing to hold. This state of affairs could lead to recurrent drains on our gold stock. And even if the dollars are not presented by foreign central banks to our Treasury for redemption in gold, the feeling of the financial community that the dollar balances of foreigners may be excessive could affect dollar rates adversely in foreign-exchange markets.

We must, therefore, work steadily to reduce and finally eliminate the deficit in our international payments. Among other things, we must seize every opportunity, major or minor, to build an even larger export surplus. And, as other countries grow and prosper, we should expect them to take a greater share of the necessary costs of mutual defense and aid to underdeveloped areas. Your Committee has recognized these needs in its consideration of recent legislation, such as the International Development Association Act and last year's authorization for an expanded export guarantee program.

Obviously, the present proposal to supplement the resources of the IMF will not reduce our payments deficit. But it will be of important help in maintaining orderly exchange markets during the period of adjustment and avoiding speculative forays against the dollar pending correction of our deficit. It will make possible an increase in international liquidity that would be available for meeting extraordinary movements of funds due to temporary factors.

The borrowing arrangements contemplated by the bill H. R. 10162 will help to achieve this purpose in two ways. First, the knowledge of the existence of a mechanism that can mobilize, in addition to present IMF resources, about $4 billion in major foreign convertible currencies in support of the dollar will in itself restrain speculation against the dollar. Second, if any adverse developments should nevertheless occur, resulting in offers to sell more dollars than the normal dealings in the market would absorb, these facilities, together with our other resources could be called upon to deal with any consequent disruption of exchange markets.

In case of established need, the IMF would sell to the United States for dollars the major foreign convertible currencies that the IMF would borrow from the other participating countries. The United States could then use these currencies to buy up dollars offered in the market by private holders, and to redeem dollars acquired by foreign central banks in excess of the amounts they are willing to hold. This would tend to prevent dollar holdings of foreign central banks from becoming a drain on our monetary gold stock.

The dollars acquired by the IMF in the course of these transactions would be kept by the IMF for three to five years, unless in the meantime our reserve position, as we might hope, had so improved that we would no longer need to continue the arrangement.

The contemplated Federal Reserve operations in convertible foreign currencies would complement the proposed IMF arrangements in two ways. The Federal Reserve would help to deal with minor pressures before they reach a scale commensurate with IMF action. And it could take prompt action in more serious circumstances while IMF arrangements are being worked out.

In accordance with established reserve banking practice, however, the System would not enter into long-term foreign exchange commitments. That is to say, it would not make arrangements under which the United States would acquire foreign exchange for a period of three to five years, as under IMF procedures.

Federal Reserve foreign-exchange transactions and the proposed IMF arrangement would, therefore, complement each other. Both would play important roles in maintaining an efficient international payments system.

While reserve banks in other countries customarily engage in foreign-exchange operations, the Federal Reserve has not done so for its own account for many years. Until recently, the U. S. dollar has been the only fully convertible currency widely used in international transactions. Accordingly, the United States has been settling its international accounts exclusively by transfers of dollars and by sales and purchases of gold. The Federal Reserve Bank of New York has, however, continued to deal in foreign exchange for accounts of its foreign correspondents and as fiscal agents for United States government agencies. For the last year or so, it has also been operating for the account of the Treasury Stabilization Fund.

The Federal Reserve has recently acquired small amounts of several convertible currencies widely used in international transactions from the Treasury Stabilization Fund and has opened accounts with several European reserve banks. We plan to acquire further amounts through open-market purchases of cable transfers or bills of exchange at home or abroad, when conditions on foreign-exchange markets are favorable, and also through reciprocal transactions with foreign reserve banks.

While in time it may be desirable to recommend amendment of the Federal Reserve Act to provide greater flexibility than we now have under the Act in carrying out these operations, it would be impractical to request such legislation before operating experience under existing authority has provided a clear guide as to the need for it.

The System will, of course, coordinate its foreign exchange operations with those of the Treasury Stabilization Fund. The relatively modest resources of the Stabilization Fund have been used recently to counteract speculative pressures in the exchange markets. The System operations will be conducted not only with broader resources than those of the Stabilization Fund, but also with an additional purpose.

Necessarily, operations of either the Fund or the System in foreign exchange will influence exchange rates in some degree. Indeed, one of the purposes of these operations will be to correct or avoid disorderly movements of exchange rates, which might otherwise spark disruptive flows of funds internationally.

But the System will also have this additional purpose: to improve the international payments system by cooperative arrangements with foreign central reserve banks that would permit the financing of sudden large movements of volatile funds without impairing the role of the dollar as a medium for international transactions. In the case of an outflow from the United States, these arrangements would permit us to moderate its impact on our gold stock; in the case of an outflow from other countries to the United States, they would permit those countries to moderate its impact on their gold and dollar reserves. This would be one way in which the System would carry out its responsibilities for providing the U. S. economy with a sound dollar.

If we want cooperation from others, we must be prepared to cooperate with them. This principle is applicable also to the present proposal to strengthen the resources of the IMF. If we want foreign countries to lend additional support to the IMF, so that it will be better able to offset possible adverse pressures on the dollar, we must be prepared to lend dollars to the IMF, so that it will be better able to offset adverse pressures on other major convertible currencies.

In conclusion, we can look to these new arrangements in the international payments system to give us time to correct our balance-of-payments position. But we must clearly understand that they will not be substitutes for a basic cure.

March 13, 1962

The Honorable Brent Spence,
Chairman, Committee on Banking
and Currency,
House of Representatives,
Washington 25, D. C.

Dear Mr. Chairman:

You have asked for my comments on a "Suggested Wording for Banking and Currency Committee Report on H. R. 10162," dated March 7, 1962. Feeling that this draft either reflects, or would lead to, misunderstandings about our operations and our relations with the Congress and the Treasury, I submit the following comments:

First, the Federal Reserve intends to make information concerning its foreign exchange operations available to the public to the fullest extent consistent with accomplishing their purpose. Federal Reserve holdings of foreign currencies will be included under "other assets" in the statement of condition of the Federal Reserve Banks published weekly, and will be separately stated in the Federal Reserve Bulletin, published monthly. Breakdowns of holdings by currencies will be made public with only such time lag as appears necessary to forestall use of the information by speculators. As to market operations, certain information necessarily will have to be kept confidential. It would be self-defeating to reveal market operations before or in the midst of their execution, or to reveal the amounts involved in planned or pending operations. As to reciprocal balance arrangements with reserve banks in other countries, we expect to release information promptly, as we did in the case of the first such arrangement, with the Bank of France. Of course if the foreign reserve bank concerned should insist that certain details not be made public, we would have no choice but to comply with their wishes or to forego an arrangement that might be important for defense of the dollar.

Second, any "arrangements" between the Federal Reserve and reserve banks in other countries will be confined to normal banking transactions incidental to the establishment and use of reciprocal balances and will in no wise involve matters normally negotiated through Executive Agreements.

Third, we have worked closely and in complete harmony with the Secretary of the Treasury at every stage in shaping and establishing this program. We will continue to do so. However, we must recognize that Congress has given the System responsibility for exercising its own judgment in monetary matters, free from control by any Executive Department. Therefore, if the occasion should ever arise that the Secretary of the Treasury should ask the Federal Reserve to engage in foreign exchange operations which in our judgment were financially unsound, we would have to refuse. On the other hand, the Federal Reserve obviously must operate within the framework of the established foreign financial policy of the United States. Therefore, even if the Federal Reserve believed that certain operations in foreign exchange were desirable to protect the dollar, we would refrain from engaging in them if the Secretary of the Treasury or the National Advisory Council on International Monetary and Financial Problems advised us that the operations would conflict with United States foreign financial policy. Admittedly, in the large area between these extremes close cooperation will be called for to avoid duplication of effort or even conflict between our operations and those of the Treasury Stabilization Fund. This cooperation is facilitated by the fact that operations for both the Treasury and the System are carried out through the Federal Reserve Bank of New York. In addition, there is daily consultation between the Treasury and the Federal Reserve on foreign exchange developments and operations. Further experience with these operations will provide clearer guidelines than we now have for achieving maximum efficiency in meshing the two operations. We are fully aware of the need to work closely with the Treasury to this end.

Finally, these operations are being undertaken only after the most careful consideration of the question of whether Congress had authorized them. Our general counsel concluded, after thoroughly studying the question, that Congress has granted this authority. This opinion was concurred in by the general counsel of the Treasury and the Attorney General. It is true that the Federal Reserve has not used this authority for many years. Under present world conditions, however, this authority should be used. If we are to live up to the responsibilities Congress has assigned to the Federal Reserve, we must contribute all we reasonably can to the defense of the dollar while solutions are being worked out to the basic problem of the U. S. balance of payments.

Sincerely yours,

(SIGNED) WM. McC. MARTIN, Jr.

Wm. McC. Martin, Jr.

RLC/JHF/CM:ac
cc: Mr. Molony
Mr. Furth
Mr. Young
Miss Muehlhaus
Mr. Cardon

ABRAHAM J. MULTER
13TH DISTRICT, NEW YORK

COMMITTEES
BANKING AND CURRENCY
DISTRICT OF COLUMBIA
SMALL BUSINESS
JOINT COMMITTEE ON DEFENSE PRODUCTION

DEMOCRATIC WHIP, ZONE 2

Congress of the United States
House of Representatives
Washington, D. C.

March 15, 1962

Honorable William McC. Martin, Jr.
Chairman, Board of Governors of the
Federal Reserve System
Washington 25, D. C.

Dear Mr. Chairman:

Many thanks for yours of March 13, together with the enclosures, supplying the data which I requested during your testimony on February 28.

You are always most helpful.

With kindest regards, I am,

Sincerely,

Abe

Abraham J. Multer

AJM:lg

C. Ch. Martin

March 13, 1962.

Honorable Abraham J. Multer,
House of Representatives,
Washington 25, D. C.

Dear Mr. Multer:

During my testimony on February 28, you asked if we could tell how much of the increase in time and thrift accounts after the first of the year was from foreign countries or foreign central banks, and how much was for one year and how much for less. We now have some data which enable us to answer part of your question.

The figures in the attached tabulation indicate that time deposits of foreign central banks, official institutions, etc., rose, but only slightly, after the first of the year. The bulk of the increase was in domestic accounts, as is normally the case. Savings deposits of individuals increased sharply. The rise in time deposits was also unusually large; in fact, it was larger than the increase in savings deposits. In addition to personal accounts, time deposits include accounts of businesses, state and local governments, and foreign central banks and official institutions.

With regard to the length of time the funds will remain on deposit, it appears that the substantial increase in negotiable time certificates of deposits at 9 large New York City banks was concentrated in those maturing in from 6 to 9 months. We have no information on how much of time and savings deposits are or can be expected to be for one year or more. In the case of regular savings deposits, which constitute the bulk of time and savings accounts, there is no requirement that the depositor declare his intention at the time he makes the deposit, so we will not get definitive information on this point.

Sincerely yours,

Wm. McC. Martin, Jr.

SHA/GEN/crc

Time Deposits at All Commercial Banks
(Amounts outstanding, in millions of dollars)

	Total time and savings deposits at all commercial banks.	Time deposits of foreign institutions, central banks, international institutions, ect. 1/
1961 -- Nov. 29	81,960	2,194
Dec. 27	82,450	2,243
1962 -- Jan. 31	84,960	2,262
Feb. 14	85,600	2,248
Feb. 21	n.a.	2,247
Change Dec. 27-Feb. 14	+ 3,410	+ 5

n.a. Not available.
1/ Data for all commercial banks are not available; figures are foreign holdings at weekly reporting member banks, which hold nearly all of these deposits.

Time Deposits at Weekly Reporting Member Banks in Leading Cities
(Amounts outstanding, in millions of dollars)

	Total time and savings deposits	Savings deposits	Other time deposits of individuals, partnerships and corporations	Time deposits of State and local Govts.	Time deposits of foreign official institutions, central banks, etc.
1961 -- Nov. 29	41,188	29,771	6,190	2,721	2,194
Dec. 27	41,472	30,082	5,969	2,851	2,243
1962 -- Jan. 31	42,863	30,640	6,553	3,068	2,262
Feb. 14	43,359	30,899	6,764	3,108	2,248
Feb. 21	43,640	30,996	6,943	3,112	2,247
Change Dec. 27-Feb. 21	+ 2,168	+ 914	+ 974	+ 261	+ 4

Negotiable Time Certificates of Deposit
(Amounts outstanding in millions of dollars)

	9 large N. Y. C. banks
1961 -- Nov. 29	1,166.6
Dec. 27	1,004.3
1962 -- Jan. 31	1,101.9
Feb. 21	1,141.3
Change Dec. 27-Feb. 21	+ 137.0

Delivered by Mr. Cardon 3/1/62 March 1, 1962.

The Honorable Brent Spence,
Chairman, Committee on Banking and Currency,
House of Representatives,
Washington 25, D.C.

Dear Mr. Chairman:

In response to requests made by Representative Patman and Representative Reuss, I enclose for inclusion in the record of the hearings on H. R. 10162 five documents relating to foreign exchange operations by the Federal Reserve System.

The first document is a memorandum from our General Counsel, Howard Hackley, dated November 22, 1961, in which he expresses the opinion that such operations are authorized by the Federal Reserve Act.

The second is a summary opinion to the same effect by Mr. Hackley.

The third is a letter from the General Counsel of the Treasury Department, Robert H. Knight, to Mr. Hackley, expressing his concurrence and that of the Attorney General in Mr. Hackley's opinion, and enclosing a memorandum he had submitted to the Secretary of the Treasury to the same effect.

The fourth is a copy of a letter I sent on February 16, 1962, to the Secretary of the Treasury as chairman of the National Advisory Council on International Monetary and Financial Problems, in compliance with section 4(c) of the Bretton Woods Agreements Act, informing the Secretary of the action of the Federal Open Market Committee, taken on February 13, 1962, authorizing such operations, to which is attached a copy of the authorization.

The fifth item is a copy of an action by the National Advisory Council, dated February 28, confirming the understanding I expressed at yesterday's hearing that the National Advisory Council was in accord with the System's decision to undertake foreign currency operations.

Copies of this letter and the enclosures are being xent to Representatives Patman and Reuss.

delivered by Mr. Cardon 3/1

Sincerely yours,

(SIGNED) WM. McC. MARTIN, JR.

Wm. McC. Martin, Jr.

Enclosures

cc: Mr. Cardon, Mr. Young, Mr. Molony, Mr. Hackley, Miss Muehlhaus
RLC:mnm

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

March 1, 1962

The Honorable Robert S. Kerr,
United States Senate,
Washington 25, D. C.

Dear Senator Kerr:

In your letter of February 17, 1962 you asked six questions in connection with the proposed foreign exchange operations of the Federal Reserve System.

The answers to these questions are given as follows:

Q.1. Has this proposal been implemented or is it about to be implemented?

(a) If the answer is "yes," then to what extent in terms of dollars would be invested in foreign currencies?

(b) For what period of time is it contemplated that this new program will continue?

A.1. The Federal Reserve has recently acquired small amounts of several convertible currencies widely used in international transactions from the Treasury Stabilization Fund and has opened accounts with several European reserve banks. We expect to acquire further amounts through open market purchases of cable transfers or bills of exchange, at home or abroad, when conditions on foreign exchange markets are favorable. From time to time, we may also acquire holdings of foreign currencies through reciprocal transactions with foreign reserve banks. One such transaction with the Bank of France was announced today. (See attached press release.)

The amount of dollars to be invested in foreign currencies will depend upon the needs encountered in specific situations. The Federal Reserve will publish its aggregate holdings of foreign currencies monthly in the Federal Reserve Bulletin. The Federal Reserve will not, of course, be in a position to reveal foreign currency operations before or pending their execution nor the amounts involved in planned or pending operations.

The period for which the program will continue also will depend upon need and experience. If a need is demonstrated and the program proves useful, it may be continued indefinitely. Otherwise, it will be abandoned.

Q.2. Would the dollars used in the purchasing of the foreign currencies contemplated become additional claims against our gold reserve?

A.2. There is indeed a risk that additional dollars put into the hands of foreigners through our foreign exchange purchases might, at least in theory, become a claim against our gold reserve. In practice, however, the likelihood of this risk materializing would be small, even remote.

We could always resell the foreign currency acquired and thus remove the dollars sold to foreigners from their holdings, in this way eliminating them as potential claims against our gold.

We shall endeavor to administer our operations in such a way that we take dollars away from foreigners whenever and wherever the risk is high of their conversion into gold. Similarly, we shall be willing to put dollars into the hands of foreigners only when the likelihood is small of a conversion into gold.

Dollars held by foreigners become potential claims on our gold reserve only if the foreigners sell them to a foreign central bank.

For this reason, we shall purchase foreign currencies in the open market only if the market situation is favorable, i.e., when dollars are on balance demanded rather than offered. In such a market situation, the other party would probably prefer to hold the dollar proceeds or to use them for its own account, rather than to sell them to a foreign central bank.

If the market situation were unfavorable, the possibility of adding to potential claims on our gold stock would indeed seriously limit our operations in the open market. In such a situation, we shall try to acquire foreign currencies directly for foreign reserve banks by means of a reciprocal transaction. In such direct transactions, we shall be able to minimize the risk that the foreign reserve banks involved would convert their dollar balances into gold.

Q.3. Would the foreign currencies purchased be redeemable on demand in gold by the countries issuing them?

A.3. The Federal Reserve will deal only in currencies that are fully convertible. Under the Articles of Agreement of the International Monetary Fund (Article VIII, Section 4), these currencies must in general be redeemed upon the request of the Federal Reserve by the central banks of the country of issue either in dollars or in gold.

Redemption in dollars rather than in gold would itself serve to reduce potential claims on our gold stock.

Q.4. It is noted that the primary purpose of this program operating in conjunction with the Stabilization Fund would be to help safeguard the dollar against speculative flows of funds How will those persons charged with the responsibility of operating this program be able to differentiate between purchases and sales by speculators as against non-speculators and even your own purchases and sales?

A.4. For the purposes of these operations, it would be not necessary for us to attempt to differentiate between purchases and sales of individual speculators and non-speculators. But we shall have the task of differentiating between flows of funds consistent with the underlying economic situation and those representing temporary speculative deviations from that situation.

Admittedly, this task is difficult and subject to errors, but it is not unusual. For example, the manager of the System Open Market Account confronts a similar task from time to time in domestic open market operations.

Experience with foreign exchange operations for account of the Stabilization Fund, which have been conducted by the same officers of the Federal Reserve Bank of New York who will conduct System operations, indicates that it is possible to identify with reasonable accuracy speculative elements influencing the movements of short-term funds and the exchange market.

Moreover, the manager of the System foreign currency account will be helped by the continuous review of the world economic situation conducted by the staffs of the Board of Governors and the Federal Reserve

Bank of New York, by his close contacts with the New York money and exchange markets, and by continuous consultation with major foreign central banks.

> Q.5. What assurances do you have that the net effect of the operation of this program will not in fact be a stabilizing factor for some of the foreign currencies using our dollars instead of trying to stabilize the dollar by using various foreign currencies?

A.5. Any stabilization of the dollar in terms of major foreign currencies will indeed have the incidental effect of stabilizing these currencies in terms of the dollar. This incidental effect, far from being unwelcome, would in itself diminish incentives for speculative activities that might have repercussions adverse to the dollar.

We would not, however, let the operations be used to stabilize a particular foreign currency, the value of which was being undermined by basic financial or economic faults.

> Q.6. Please furnish me a chart covering the last ten years showing the relative value of the various foreign currencies purchased or to be purchased in their respective relationship to the value of the dollar.

A.6. I enclose charts showing monthly figures of exchange rates for the six most important European currencies (pound sterling, French franc, Swiss franc, Netherlands guilder, Italian lira and German mark) from 1953 through January 1962. The selections of these charts should not be interpreted, however, as implying that the Federal Reserve intends to operate in all of these currencies or in no others.

Sincerely yours,

Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

FEDERAL RESERVE

press release

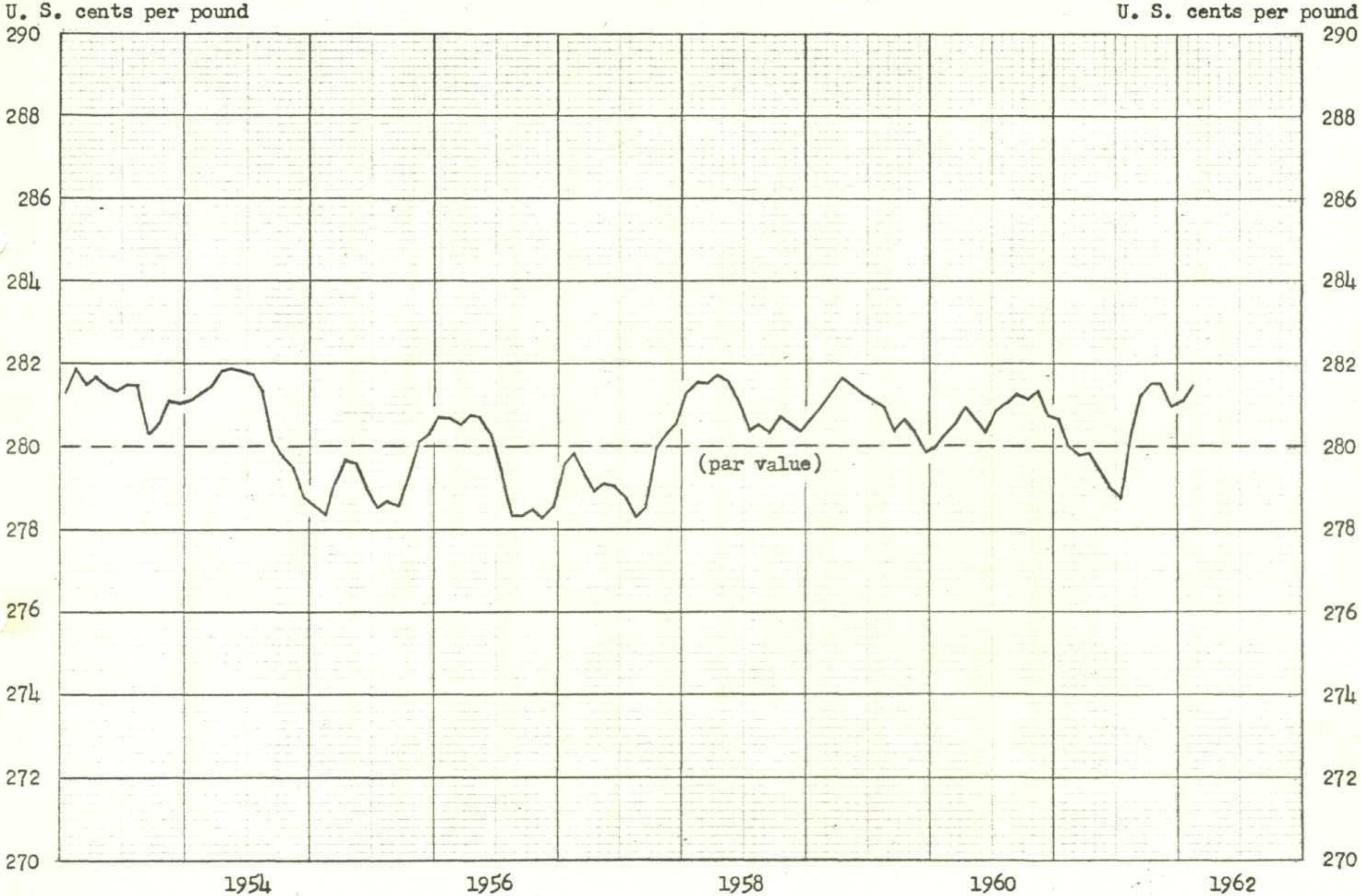
For immediate release March 1, 1962

The Bank of France and the Federal Reserve Bank of New York today agreed on a reciprocal arrangement under which the Federal Reserve Bank of New York will pay to the dollar account of the Bank of France $50 million against a corresponding payment of approximately 245 million francs to the account of the Federal Reserve Bank of New York with the Bank of France. This arrangement, under which forward cover is provided to both parties, will facilitate official intervention in the foreign exchange market in the event that such intervention may become advisable.

The arrangement, although similar to transactions between the U. S. Treasury and monetary authorities of other European countries, is the first of its kind undertaken since the War by the Federal Reserve System in its own name. The New York Reserve Bank is acting on behalf of the twelve Federal Reserve Banks under the direction of the Federal Open Market Committee.

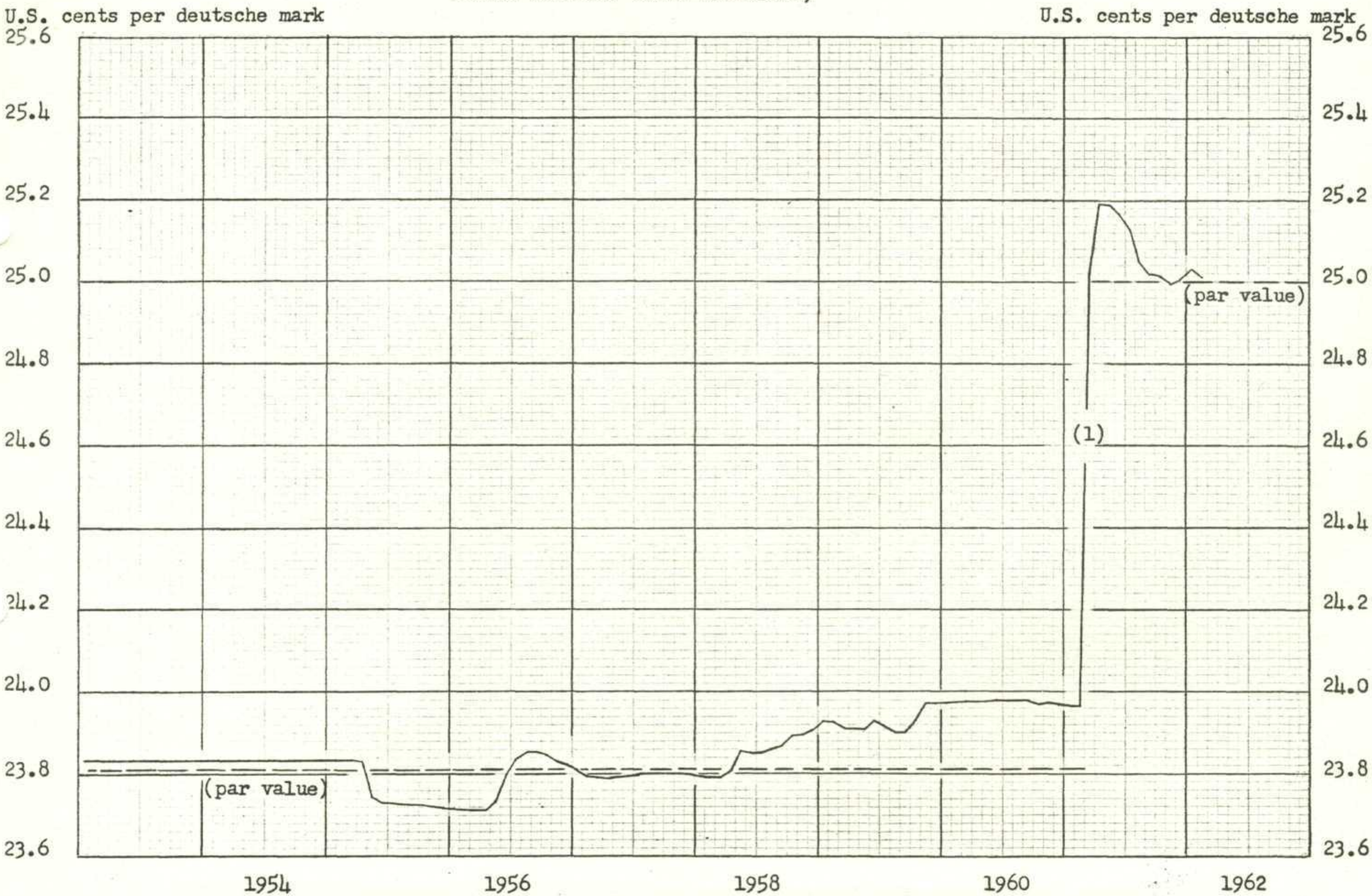
(Note: The foregoing announcement has also been issued by the Federal Reserve Bank of New York.)

FOREIGN EXCHANGE RATES: UNITED KINGDOM (monthly averages of certified noon buying rates in New York for cable transfers)



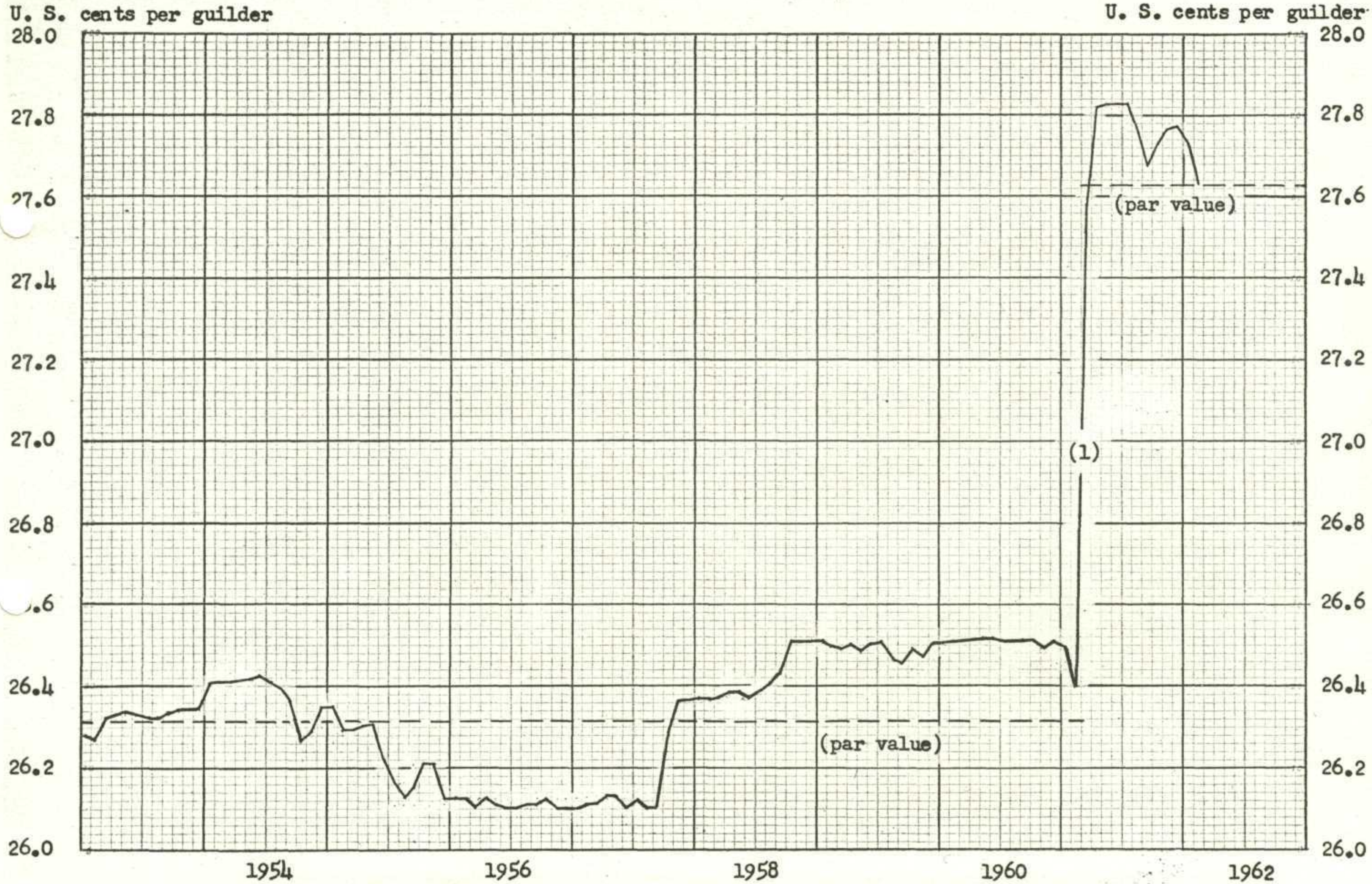
FOREIGN EXCHANGE RATES: SWITZERLAND (monthly averages of certified noon buying rates in New York for cable transfers)

FOREIGN EXCHANGE RATES: GERMANY (monthly averages of certified noon buying rates in New York for cable transfers)



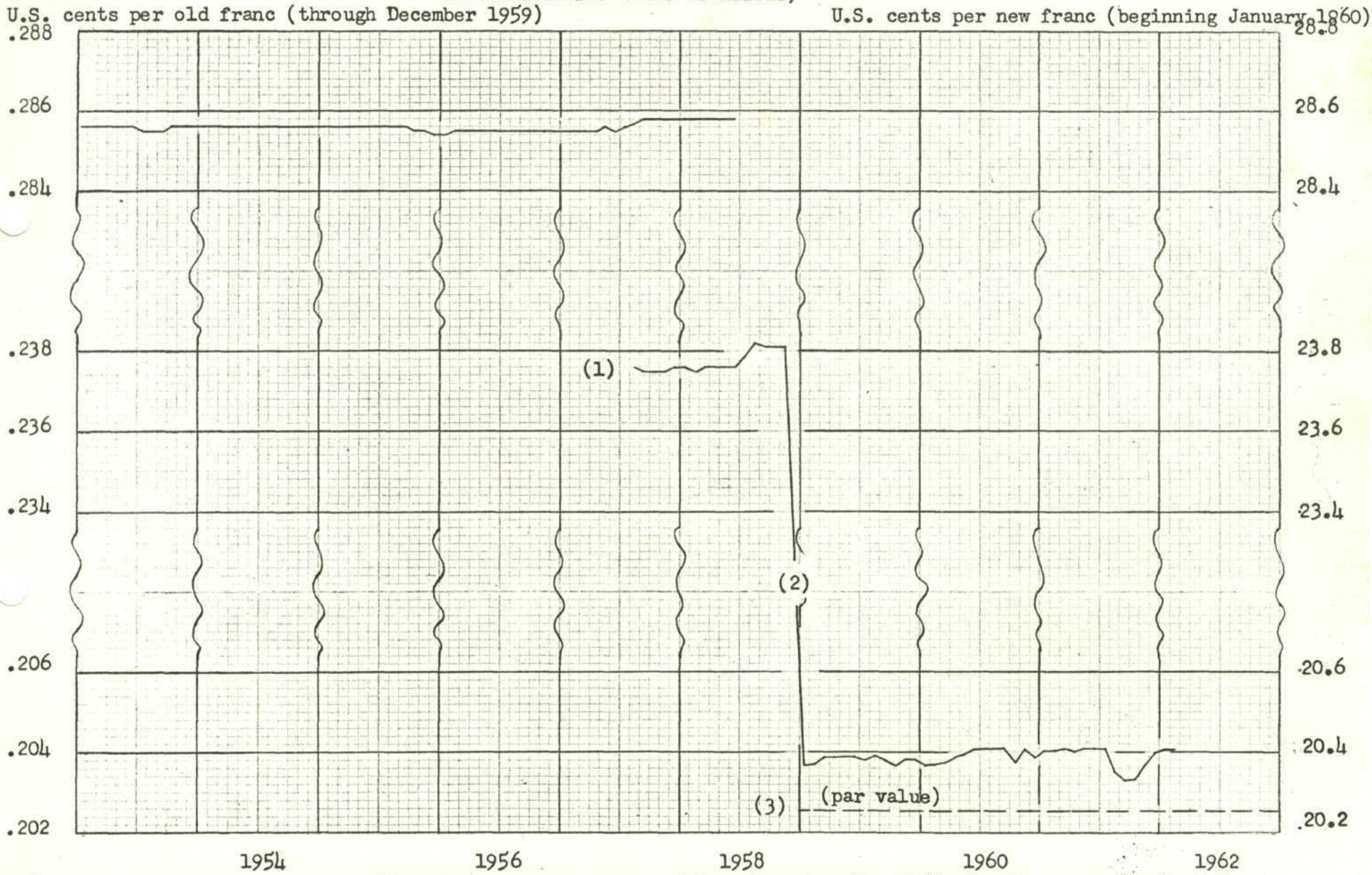
(1) Effective March 5, 1961, par value of the deutsche mark was changed from 23.8095 to 25.0000 U.S. cents.

FOREIGN EXCHANGE RATES: NETHERLANDS (monthly averages of certified noon buying rates in New York for cable transfers)



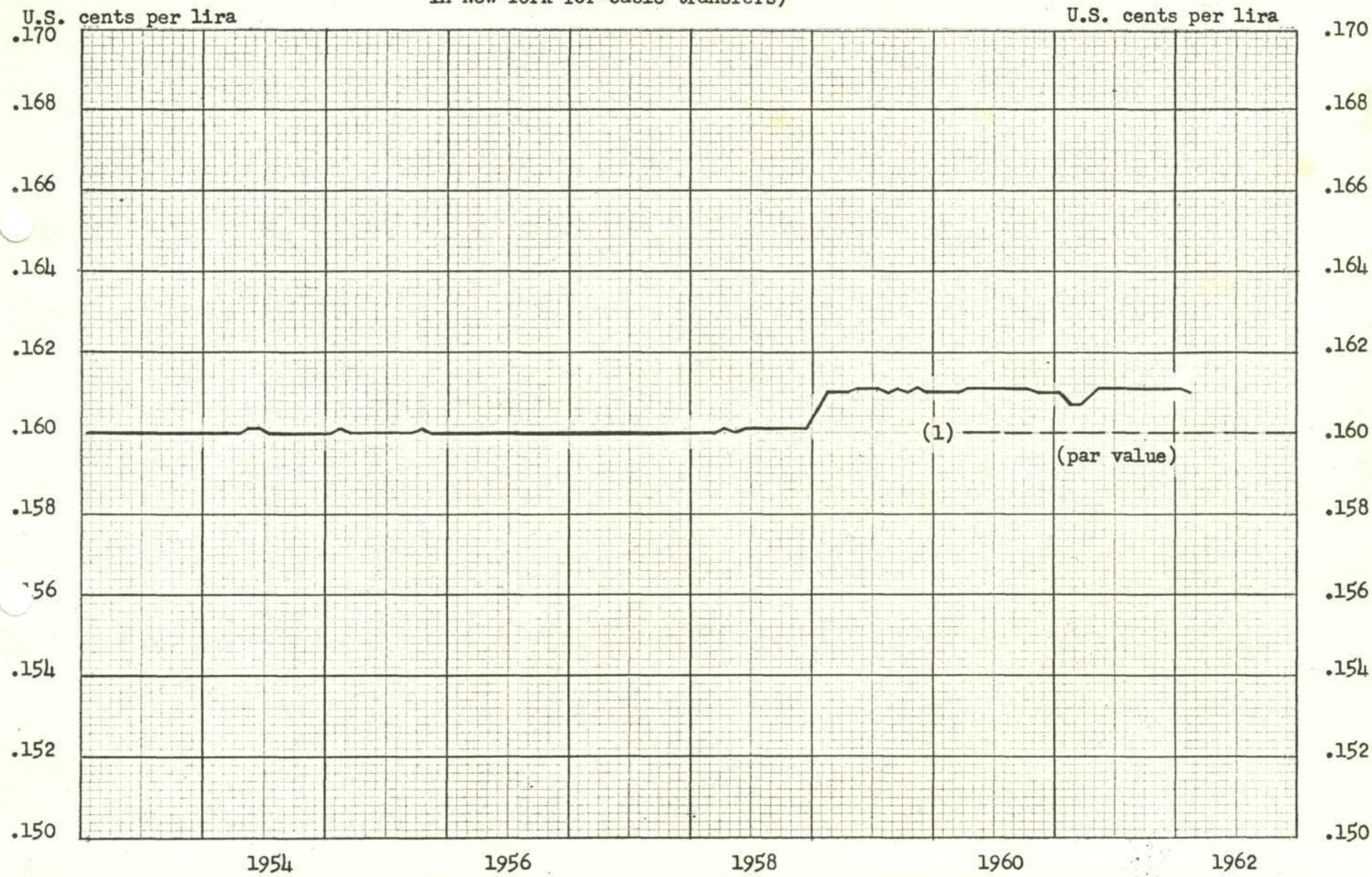
(1) Effective March 7, 1961, the par value of the guilder was changed from 26.3158 to 27.6243.

FOREIGN EXCHANGE RATES: FRANCE (monthly averages of certified noon buying rates in New York for cable transfers)



(1) From August 1957 to June 1958, there were two rates. (2) On December 29, 1958, the franc was devalued from .238095 to .202550 U.S. cents. (3) Before December 29, 1958, no par value was agreed with the I.M.F.

FOREIGN EXCHANGE RATES: ITALY (monthly averages of the certified noon buying rates in New York for cable transfers)



(1) Before March 30, 1960, no par value was agreed with the I.M.F.

UNITED STATES SENATE

Washington, D. C.

February 17, 1962.

Honorable William McChesney Martin, Jr.
Chairman, Board of Governors
The Federal Reserve System
Washington, D. C.

My dear Mr. Chairman:

On Tuesday, January 30, 1962, you made a statement before the Joint Economic Committee which included the following:

> "As one step in such cooperation, the System is now prepared in principle and in accordance with its present statutory authority to consider holding for its own account varying amounts of foreign convertible currencies. Towards this end, we are now exploring, in consultation with the Secretary of the Treasury, methods of conducting foreign exchange operations in convertible currencies with due and full regard for the foreign financial policy of the United States."

In connection with this proposed new undertaking of the Federal Reserve System, I respectfully ask for answers to the following questions:

1. Has this proposal been implemented or is it about to be implemented?

   (a) If the answer is "yes", then to what extent in terms of dollars would be invested in foreign currencies?

   (b) For what period of time is it contemplated that this new program will continue?

2. Would the dollars used in the purchasing of the foreign currencies contemplated become additional claims against our gold reserve?

3. Would the foreign currencies purchased be redeemable on demand in gold by the countries issuing them?

4. It is noted that the primary purpose of this program operating in conjunction with the Stabilization Fund would be to help safeguard the dollar against speculative flows of funds. How will those persons charged with the responsibility of operating this program be able to differentiate between purchases and sales by speculators as against nonspeculators and even your own purchases and sales?

5. What assurances do you have that the net effect of the operation of this program will not in fact be a stabilizing factor for some of the foreign currencies using our dollars instead of trying to stabilize the dollar by using various foreign currencies?

6. Please furnish me a chart covering the last ten years showing the relative value of the various foreign currencies purchased or to be purchased in their respective relationship to the value of the dollar.

The program that you allude to in your statement before the Joint Economic Committee appears to me to be a bold one and will probably require the wisdom of a Solomon. If it will in fact help stabilize the dollar I am of course for it. As my questions indicate, I have serious doubts about the program, and, therefore, I need to have more information.

Sincerely,

(signed) Robt S. Kerr

Rob't S. Kerr.

Article Title: Currency Plan Assailed

Journal Title: Dow Jones News Wire

Date: February 28, 1962

This article is protected by copyright and has been removed.

Article Title: Monetary: The Federal Reserve Chairman Told Congress Today the "Fed" is Making Cooperative Arrangements with Foreign Reserve Banks to Help Keep the Dollar Stable

Journal Title: Associated Press News Wire

Date: February 28, 1962

TREASURY DEPARTMENT
Washington

FOR RELEASE UPON DELIVERY

Statement of the Honorable Douglas Dillon
Secretary of the Treasury
before the
Committee on Banking and Currency
House of Representatives
on
SPECIAL BORROWING ARRANGEMENTS
OF THE INTERNATIONAL MONETARY FUND
Tuesday, February 27, 1962, 10:00 A.M., EST

Mister Chairman and Committee Members:

I am glad to appear before the Committee this morning in support of H. R. 10162. This legislation will enable the United States, in cooperation with nine other industrial countries of the free world, to take a major step in support of a strong international monetary system. An amendment to the Bretton Woods Agreements Act authorizing the United States to lend up to $2 billion to the International Monetary Fund is a prerequisite for United States participation in proposed arrangements which will make $6 billion of additional resources available to the Fund.

Five members of the European Common Market are participating in the special arrangements with an aggregate lending commitment of $2.45 billion. Germany's commitment is $1.0 billion; France and Italy have agreed to lend up to $550 million each; while the Netherlands is participating with $200 million, and Belgium with $150 million. The United Kingdom is to lend up to $1.0 billion. Other participants are Japan, which is to lend up to $250 million, Canada, participating with $200 million, and Sweden, with $100 million. In all, the nine participating countries other than the United States will stand ready to lend their currencies to the Fund up to a total of $4 billion.

These additional resources have potentially great importance for the United States. The Fund has on hand today only a limited supply of currencies that could be used if the need for a drawing by the United States should ever arise. The lending commitments of the major countries other than the United States and the United Kingdom -- which amount to $3 billion -- are approximately twice as large as the Fund's current holdings of their currencies.

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These supplementary resources would greatly enhance the Fund's ability to assist us should it ever become necessary.

As you know, the International Monetary Fund was established in 1945, at the same time as the World Bank. United States membership in the Fund was authorized by the Bretton Woods Agreements Act. The Fund's purpose is to promote exchange and monetary stability among its 75 member nations. It does so principally by providing short-term assistance to deal with temporary balance-of-payments difficulties, pending the results of longer-range corrective measures.

With the growth of world trade and the increase in the size of monetary reserves, the resources of the Fund have been called upon to a greater and greater extent. To keep pace with these requirements, the quotas of the Fund's members, including the United States, were increased in 1959.

Since that time new problems have arisen, largely as a result of the recent heavy strains placed upon the two principal world reserve currencies -- the dollar and the pound sterling. The proposed legislation, which would authorize United States participating in the new Fund borrowing arrangements, is designed to help deal with these problems, which arose partly as a result of the restoration of currency convertibility among the industrialized countries. With the advent of full economic recovery in Europe, these countries have improved their trade and payments positions and have accumulated large monetary reserves. In the four-year period from the end of 1957 through the end of 1961, the reserves in gold and foreign exchange (mostly dollars) of the major industrial countries other than the United States and the United Kingdom increased from $12.1 billion to about $20.1 billion.

As a result of the improvements in the payments positions of other industrial countries, chiefly in Western Europe, they were able to make their currencies freely convertible, with the consequence that movements of short-term capital from country to country were greatly increased. Wider investment opportunities, the attraction of interest rate differentials and, to some extent, speculation, all contributed to these movements of capital.

Increases in foreign monetary reserves were largely the counterpart of over-all deficits in the balance of payments of the United States. Our deficits totalled approximately $13.5 billion during the four-year period 1958-1961 and were financed by a gold outflow of $5.5 billion and an increase in United States dollar liabilities of $8 billion.

The basic part of our deficit has been made up of trade transactions, long-term investment and expenditure for military and economic aid programs. But since the middle of 1960 a large part has also resulted from movements of short-term capital. In 1958, 1959, 1960 and 1961, our basic deficit (which is the net of all of our international transactions except short-term capital movements and unrecorded transactions) was \$3.6, \$4.3, \$1.9 and \$0.6 billion, respectively, while we incurred total deficits, including short-term capital movements and unrecorded transactions, of \$3.5, \$3.7, \$3.9 and about \$2.4 billion, respectively.

The stability of the dollar is essential not only to the economy of the United States but to that of the entire free world. The dollar is the major reserve currency of the free world. Much of world trade and other transactions is carried out in dollars, and settlements of payments surpluses or deficits between foreign countries to a large extent are made in dollars. It is for these reasons that other nations have a vital interest in these new Fund arrangements which will be so important as an added resource to deal with stresses in the international payments system.

In his Message of February 6, 1961, President Kennedy referred to the drawing rights of the United States on the International Monetary Fund as a secondary line of reserves which we could call upon to maintain the strength of the dollar, in addition to our own holdings of gold and foreign currencies.

The United States quota in the Fund is \$4,125 million, one-quarter of which the United States has paid to the Fund in gold and three-quarters in dollars. A member country is normally entitled to draw currencies freely from the Fund up to the amount of its gold payment, plus an amount equal to the outstanding amounts of the member's currency which have been drawn by other countries. As of December 31, 1961, these virtually automatic drawing rights of the United States amounted to \$1.7 billion. In addition, the Fund treats liberally requests for additional drawings up to 25 percent of a member's quota, if the member itself is making reasonable efforts to solve its balance-of-payments problems. In the case of the United States, this would be the equivalent of another \$1 billion. Larger drawings are permitted by the Fund if a member is undertaking programs of monetary stabilization and measures for rectifying balance-of-payments deficits.

The total amount, therefore, that the United States would have the right to draw from the Fund almost automatically would be \$1.7 billion; another \$1.0 billion could be drawn with relative ease; and additional amounts could be drawn depending upon the seriousness of the situation and the measures which the United States was taking to cope with it.

However, the resources of the Fund to meet a United States request for a large drawing are not at present adequate. On December 31, 1961, the Fund had available to it \$2.1 billion in gold and \$11.5 billion in member currencies. But a large part of these currencies consisted of currencies of the less developed countries which for the time being are not suitable for use by the Fund. The Fund's holdings of the currencies of the major industrial countries amounted on that date to the equivalent of about \$6.6 billion; however, of this amount \$4.9 billion was in dollars and sterling and only \$1.6 billion was in currencies of the other industrial countries. The currencies of the member countries of the European Economic Community accounted for only \$890 million of this \$1.6 billion. On the same date, the Fund's outstanding commitments under existing stand-by arrangements with the United Kingdom and other members, amounted to the equivalent of \$1.4 billion.

It is clear, therefore, that the Fund now lacks the resources in gold and the currencies of industrial countries other than dollars and sterling which would be needed to meet a large drawing such as the United States would be entitled to request.

At their Vienna meeting last September, there was general agreement among Fund Governors that ways should be found to increase the resources available to the Fund. The arrangements finally worked out are embodied in the Fund Decision of January 5, 1962, and in the exchange of letters initiated in Paris in December 1961 at the conclusion of discussions among the ten governments concerned. The Fund Decision and the related Paris arrangements are reproduced in the Report of the National Advisory Council which is now before you.

The proposed new arrangements can be described very simply. The ten participating countries would lend stated amounts of their currencies to the Fund if required to permit drawings from the Fund by any one of the participant countries in order to "forestall or cope with an impairment of the international monetary system." These commitments to lend would be invoked only if and when the Fund needs the additional resources.

The proposed arrangement is intended to remedy the shortage of the Fund's current holdings of currencies of industrial countries, especially those of countries having surpluses in their balance of payments and increasing reserves. The participating European Common Market countries -- Belgium, France, Germany, Italy, and the Netherlands -- would commit an amount of their currencies almost equal to their present quotas in the Fund, while the commitments of the United States and the United Kingdom would be only about half of their present quotas. The effect of the new arrangement would be to increase by about 275 percent the present availability to the Fund of the currencies of the surplus countries of the European Economic Community.

The proposed arrangement is designed so that countries which are in a surplus position and which are gaining reserves may lend their own currencies to the Fund which in turn can supply them to other participating countries which might need additional resources. Thus, if the United States were to draw on the Fund, the Fund would be able to obtain the currencies which we could use. On the other hand, a country which itself faces serious balance-of-payments problems and whose reserves are declining would not be expected to lend to the Fund. This would mean that the United States, for example, would not be expected to lend dollars to the Fund under present circumstances. In any event, since the Fund still has available in dollars almost \$2-1/2 billion from the regular United States quota, it is highly unlikely that a need for borrowing from the United States will arise.

The agreement set forth in the Paris letters establishes the international machinery necessary for the ten participating countries to meet and act upon requests for loans to the Fund.

If one of the ten participating countries wishes to draw from the Fund, or to enter into a stand-by arrangement with it, in order to forestall or cope with a situation that might lead to impairment of the international monetary system, that country would consult with the managing Director and with the other participants.

The Managing Director would then propose to the participants the total amount which he believes the Fund should borrow, and the amounts which should be supplied by each participant in its own currency. The participants would try to reach unanimous agreement on their response to the Managing Director's proposal. If they could not reach unanimous agreement, the question of lending to the Fund would be decided by a vote of the participants. The country proposing to draw would not vote. A decision would require a two-thirds majority of the other voting participants and a three-fifths majority of their weighted votes.

Since the countries concerned are in constant close communication regarding their balance-of-payments positions not only in the Fund, but also through the Organization for Economic Cooperation and Development and bilaterally, a decision can be reached very rapidly. The procedure established balances the right of each country to safeguard its own interests with the collective judgment of the group as to the needs of the international monetary system. Such safeguards are appropriate and necessary since it is impossible to foresee what the situation of any particular country may be at an unspecified date in the future when a borrowing may be needed.

Loans to the Fund by participating countries would carry a transfer charge of 1/2 of 1 percent, plus annual interest of 1-1/2 percent. Loans to the Fund would mature in five years, but would be repaid sooner if the drawing country repaid the Fund sooner. Also, if a lending country should itself encounter balance-of-payments difficulties, it may obtain prompt repayment from the Fund.

Drawings of the additional resources from the Fund would conform to the Fund's normal procedures: that is to say, the drawing member would purchase from the Fund currencies of other participating countries with its own currency, and would pay a service charge of 1/2 of 1 percent on the amount of the drawing, plus interest. The rate of interest would vary with the size of the drawing and the period for which it would be outstanding. The drawing member would usually have to repay the Fund by repurchasing its currency within three to five years, but would be expected to repay earlier if its payments situation improved.

The whole arrangement would be effective for an initial period of four years, subject to renewal by the Fund, but it could not be modified within that period except with the consent of all the participants.

I wish to emphasize the great advantage to the United States of these borrowing arrangements. It may be that the Fund will never need to borrow. We hope this will be the case. But the commitments will stand as a reserve to be used if and when necessary, and they will provide the Fund with the currencies which would be needed by the United States if it were ever to draw on the Fund. Thus the very existence of this large supplementary pool of usable resources should act as a strong deterrent to speculation against the dollar or other currencies, since it will be well known that there are ample resources available to counteract serious disturbances of the international monetary system. The arrangements will benefit not only the participating countries, but all countries of the free world. The stability of the dollar and of the other major currencies are of vital importance to the smooth functioning of the international trade and payments system.

The legislation which is before you would amend the Bretton Woods Agreements Act, which now prohibits any loan by the United States to the Fund without the specific approval of Congress, and grant the authority to lend up to $2 billion. The legislation would also authorize an appropriation of $2 billion, to remain available until expended, for the purpose of making loans to the International Monetary Fund. As I have pointed out, we will not be called upon to make a loan to the Fund under present conditions and, in any event, the question of a loan would not arise until the Fund's resources in dollars -- currently about $2-1/2 billion -- had been exhausted. This is to be a stand-by commitment to the Fund. There will not be an expenditure of the funds authorized until such time as we might actually make a loan to the Fund. In considering any request to lend under the commitment, we would of course take into consideration our balance-of-payments position at the time and the level of our reserves, as well as the special circumstances which led to the request to lend.

I should like to emphasize that the amount of the appropriation must be in the full amount of $2 billion, in order to bring into effect our agreement with the other nine participants. The entire arrangement is contingent upon the participating countries having authority to take action promptly. The amount of each country's commitment is part of the arrangement, and any change in this amount would require a renegotiation. It is thus necessary to have the full authority to provide the necessary financing if we should be called upon, even though in practice we do not expect to have to use this authority in the foreseeable future.

A section of the legislation before you includes a technical amendment designed to clarify existing legislative authority, so as to permit the use of non-interest-bearing notes -- and thus save us interest costs -- in an amount of any United States drawings on the Fund. If the United States were to draw on the Fund, it would have to do so by purchasing foreign currencies from the Fund with dollars. The Fund's Articles of Agreement, however, permit these dollars to be paid to the Fund in the form of non-interest-bearing notes, without any use of cash from current receipts or any debt operations which would involve the United States in an interest cost. The Bretton Woods Agreements Act authorized the issuance of such non-interest-bearing notes to the Fund up to the amount of our quota subscription, which is $4.1 billion. As of December 31, 1961, notes outstanding under this authority amounted to $2.4 billion. If the United States were now to make a drawing from the Fund in excess of the $1.7 billion balance of this authority, it is not clear, under existing legislation, that we could issue non-interest-bearing notes in the amount of this excess. The proposed legislation would make entirely clear the Treasury's authority on this matter.

In conclusion, Mr. Chairman, I should like to say that the present proposal before the Committee is one which is in the best interests of the United States and of the free world as a whole. It is essential to us and to other countries that the dollar be maintained as a sound and reliable currency at its present parity. If necessary to defend the dollar, as President Kennedy said in his Balance-of-Payments Message, we will use our drawing rights in the International Monetary Fund as a supplementary form of reserves. The bill before you will enable the United States to participate in arrangements which will provide the International Monetary Fund with an adequate supply of the currencies which we ourselves might some day need. It will provide significant assistance to the United States in dealing with the balance-of-payments problem.

The arrangement can be used by the Fund to assist any other participating countries as well. The other nine countries also have a stake in the maintenance of a stable international monetary structure in the free world, and this is why they are all now cooperating in this new arrangement. We should join with them in strengthening the International Monetary Fund by giving it authority to borrow, if needed, the currencies which are most essential to cope with an impairment of the monetary system of the free world.

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February 23

Bob,

This is a tentative draft. I haven't had a good chance to go over it but any suggestions you have would be appreciated.

WMM

Attachment (Revised draft, 2/23, on IMF bill testimony)

Chairman Martin

February 12, 1962

To Board of Governors

From Robert L. Cardon

Subject: Bills to authorize U.S. participation in loans to International Monetary Fund.

Legislation to implement the special loan arrangement recently worked out to strengthen the International Monetary Fund has been introduced in the Senate by Senator Sparkman (S. 2824) and in the House by Chairman Spence of the House Banking and Currency Committee (H.R. 10162). Both bills authorize the Secretary of the Treasury to make loans to the IMF up to a limit of $2 billion outstanding at any one time.

S. 2824 is identical with the draft bill on which the Board commented favorably in its letter of January 25 to the Budget Bureau.

H.R. 10162 differs from S. 2824 in its provisions on financing any loans made to the IMF under the bill. S. 2824 would authorize the Secretary of the Treasury to obtain funds for this purpose through a public debt transaction; H.R. 10162 provides that funds for this purpose must come from appropriations. H.R. 10162 reflects the present position of the Administration. It eliminates what may well have been the most controversial feature of the bill as far as the House is concerned.

Chairman Spence has indicated that he would like Chairman Martin to testify on this legislation in the near future, but, presumably, the hearings will not take place until after February 22.

RLC:ac

cc: Each Board Member and to
Messrs. Young, Thomas, Molony, Fauver, Knipe, Sherman, and Hackley

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Subcommittee on Economic Stabilization, Automation, and
Energy Resources of the Joint Economic Committee

Henry S. Reuss, Wisconsin, Acting Chairman
Wright Patman, Texas, Chairman

Martha W. Griffiths, Michigan
Clarence E. Kilburn, New York (R.)
William B. Widnall, New Jersey (R.)
William Proxmire, Wisconsin
Claiborne Pell, Rhode Island
John Marshall Butler, Maryland (R.)

Mr. Chairman and Members of the Subcommittee:

In its continuing assessment of the business situation, the Federal Reserve pays close attention to changes in inventory investment -- and to the circumstances which give rise to those changes. It is important for all of us to know as much as we can about these matters and I am sure that our analyses will benefit from the valuable background studies which have been prepared for this Committee and from the further impetus that these hearings have given to research in this field.

My own view is that inventory fluctuation is symptomatic of rather than fundamental to the cyclical behavior of the economy. From the evidence, inventory fluctuations would appear to be a major factor in intensifying cyclical swings once they get under way. But whether inventory changes are a major factor in triggering cycles is more questionable. In retrospective analyses of cyclical movements, the association between changes in inventory and in gross national product may seem impressive, yet it may well be that swings in business sales expectations, placements of orders and Federal expenditures exerted a more determinative influence. It is possible, at least in theory, for an economy to have stable investment in both plant and equipment and in inventories and yet to experience cycles in output because of fluctuations in these other factors.

In this connection it is important to recognize that inventory changes result not only from conscious management decisions but also from causes outside management control. And there is no present means of determining the relative importance of the voluntary and involuntary changes. For these reasons, we must go behind the published statistics, indispensable as they are, to assess the underlying inventory and production decisions which help determine the strength of consumption and investment demands. Therefore, further research into the relation of inventories to cyclical fluctuations should be directed not only to improving data on inventory holdings but also toward shedding some light on the decision-making processes themselves.

From your Committee's invitation, I understand my major assignment today to be to comment on the influences of the cost and availability of credit on inventory investment. Necessarily, much of this discussion must be imprecise, for, despite earnest efforts--which include the studies commissioned by this Committee--relatively little is known about the effects of specific financial conditions on inventory policy.

While the cost and availability of credit is one influence on the level of inventories which businessmen desire to hold, it seems obvious that this is not the predominant influence. Unless the availability of credit is extremely limited, businessmen will give more weight in decision-making to expected sales trends, the volume of incoming orders, backlogs of unfilled orders, the level of production, the presence or absence of materials shortages and expected price changes. If inventories are insufficient, the result may be expensive interruptions in production and loss of customers. The resulting costs usually would be larger than the cost of funds borrowed to carry larger inventory. Moreover, interest is only a small part of over-all inventory expense. The total cost of carrying inventories has been estimated at between 10 and 25 per cent per year, while interest rates applicable to this type of credit generally fluctuate below 6 per cent.

Businesses ordinarily finance their inventories in a wide variety of ways. Besides bank or other short- or intermediate-term borrowing, they may do so by retaining earnings, issuing securities, incurring greater trade debts to suppliers, and by drawing down cash and other liquid assets. Even the reduction or postponement of plant and equipment outlays or the holding down of accounts receivable may provide inventory finance. In recent years, trade debt has become a prime vehicle with which financially strong businesses help finance the inventories of customers who are unwilling or unable to resort to bank or other market borrowing. In the 12 months ending with March 1962, for example, corporations increased their aggregate trade debt by more than $7 billion. The growth in corporate short-term indebtedness to banks, however this is measured, was far smaller.

Also, commercial banks usually exert considerable effort to insure that their business customers obtain the credit they need for purposes such as inventory investment. Banks often elect to provide for such needs by reducing portfolios of liquid and even long-term securities and, on occasion, by limiting mortgage, security and other nonbusiness lending. Business loans are the bread and butter business of many banks, and it is evident to them that a dissatisfied business customer can be lost forever to competing lenders. Additionally, bankers have traditionally regarded inventory needs as one of the most legitimate reasons for borrowing and they consider the meeting of such needs as one of the most appropriate forms of bank lending.

Yet after all these considerations have been taken into account, it seems to me that credit conditions do at times significantly influence inventory policies. Moreover, I think it reasonable to believe that the potential influence of these conditions is greater now than in earlier postwar years, because interests costs are a larger proportion of total inventory costs and because business firms generally have become less liquid and therefore more dependent on credit.

While much of the financing of inventory positions normally comes from internal and nonbank sources, the bank component can be strategic at some times and for some borrowers. Inventories have several characteristics that make them more susceptible to changing credit conditions than are plant and equipment outlays. The possible range of inventory mix and level is wide, while fixed capital investment often requires all-or-nothing decisions; some portion of inventories can be liquidated in case of need, while fixed capital requires long pay-off periods; inventory levels can be raised or lowered rather quickly, while fixed capital installations can require up to two or three years of lead-time and are not halted
they are started
easily once begun. Thus, the initial impact of a change in credit

policy on business investment outlays may fall on inventories even though inventory financing requires only a small share of all funds raised.

The potential impact of monetary policy has probably been strengthened by the decline of internal corporate liquidity since the early and mid-1950's and by the currently spreading belief that price increases of the earlier postwar character are not apt to recur in the near future. By whatever yardstick corporate liquidity is measured--liquid assets taken as percentages of current liabilities, total liabilities, or transactions--the ratios are now significantly lower than in comparable stages of other postwar business recoveries. For example, liquid assets of manufacturing corporations were 58 per cent of their current liabilities in March 1959 but only 45 per cent of their current liabilities in March this year. Thus, manufacturing liquidity fell by 23 per cent between about the same stages of the 1958-59 and the current business recovery. Furthermore, the abatement of inflationary expectations among businessmen means that the interest cost of borrowing is no longer offset by the anticipation of higher prices.

Monetary policy also has indirect effects on business demand for inventories, as can be illustrated briefly. Through its effect on plant and equipment outlays, monetary policy may indirectly influence new orders for producers equipment and building materials and hence inventory investment in the industries producing these goods. Similar influences spread out from changes in the availability of loanable funds for the financing of houses, autos and other consumer durable goods.

To sum up, demand and supply effects in credit markets undoubtedly influence inventory investment contra-cyclically. On balance, the magnitude of these effects would seem to be significant and pervasive although moderate. The gradual narrowing of the spread between profits and interest rates, the fall in corporate liquidity and the higher level of interest rates in recent years suggest that in future periods of credit restraint, monetary policy may exert somewhat more restraint on inventory accumulation than during most of the postwar period.

My invitation to appear today specifically requested comments regarding the feasibility of introducing some form of direct control over bank lending for inventory purposes. On the basis of the Board's experience with selective controls in the security, mortgage and consumer credit areas, I am very skeptical of the desirability or the practicality of credit controls directed specifically towards inventory investment. One characteristic of credit--even of the most specialized type--stands out from our experience: that is, it is impossible to trace, except by the business decision maker. Who is to say whether borrowing to finance plant and equipment "really" finances that or a concomitant rise in inventories?

Aside from these general defects, a specific problem in any effort to exercise direct control over inventory lending would arise out of loans secured by or financing expansion of the borrowers' accounts receivable. Since the accounts receivable of a firm often finance the inventories of its customers, much inventory financing actually appears in balance sheets as accounts payable and accounts receivable. Accounts receivable of nonfinancial corporations now stand at a higher level than inventories themselves, in terms of book value. Thus, financially strong businesses could obtain large amounts of new bank credit secured by their existing receivables, which then could be used to expand their receivables and thus to finance inventory expansion by their customers. And to the extent that other borrowers are denied bank credit by selective controls on inventory credit, the ultimate effect might well be to force additional financing along the accounts receivable route. Such a development does not seem desirable from the standpoint of maintaining and extending the competitiveness of the economy and curbing market power of dominant suppliers.

In short, there would be serious, and probably insurmountable problems in any attempt to ration one specific use of credit by business. It would also be very difficult to avoid discrimination against those growing businesses which must rely on bank credit to a greater extent than established firms.

I realize that this discussion of direct, selective controls on inventory credit has not included any suggestions on how the difficulties mentioned might be overcome. But I seriously doubt that there is anything constructive to offer with respect to administrative controls of this type. The problem remains, of course, of inventory fluctuations and their effects on the business cycle. Effective use of available tools of monetary policy can assist in moderating these swings, as can appropriate fiscal and Federal procurement policies. Also helpful is the continuing development of accurate, detailed and prompt statistics on inventories and related factors. These will enable individual businessmen to assess more accurately the output and inventory investment decisions of their customers and suppliers and hence help diminish destabilizing movements in their own output and inventories. The effort of your associated subcommittee on economic statistics has contributed importantly to this objective.

But by far the most important influence on inventory investment is the character of the economy and business expectations regarding the future course of events. Basically, our attention should be focused on means for shaping that character and these expectations in ways that encourage vigorous, stable and sustainable patterns of economic growth. Continuing progress toward this objective should do much to moderate cyclical swings in anticipations and hence in inventory investment.

Chairman Martin

July 10, 1962

To Board of Governors

From Robert L. Cardon

Subject: Hearings on inventory fluctuations and economic stability.

Hearings on inventory fluctuations and economic stability opened yesterday morning before the Joint Economic Committee's Subcommittee on Economic Stabilization, Automation, and Energy Resources. Although Representative Reuss has been named Acting Chairman of the Subcommittee to conduct these hearings, he was "unavoidably detained" yesterday morning, and Chairman Patman presided. Representatives Patman and Widnall and Senators Proxmire and Pell attended. To a noneconomist, the purpose of the hearings seems obscure. As I get it, the general idea is that businessmen tend to build up inventories during a boom, with increasing enthusiasm, leading to unsustainable levels of production, followed by panicky cutting back when it finally dawns on them that the bubble has burst. The Subcommittee wants to study ways of measuring the effect of inventory decisions on economic activity, and then consider possible means of cancelling out the perverse effects of these decisions on business cycles. This seems to me to be rather a technical subject for Congressmen, but it may be it is a part of the effort of some Members of Congress to suggest alternatives to a tax cut as a means of stimulating the economy. The hearings are now scheduled to run through this week, with Chairman Martin appearing on Friday, July 13.

The witnesses yesterday morning were:

Professor James S. Duesenberry, Harvard University
Mr. Vincent J. Graham, General Merchandising Controller, Sears Roebuck and Company
Dr. Thomas M. Stanback, Jr., National Bureau of Economic Research
Mrs. Ruth P. Mack, National Bureau of Economic Research

They disagreed as to the advisability of trying to moderate the impact of inventory decisions, but they all agreed that general monetary policy could not be used for this purpose. None of the four Committee Members present betrayed enthusiasm for Government controls or incentives designed to influence inventories. The lead-off witness, Professor Duesenberry, said that "fluctuations in inventory investment have made a major contribution to the instability of our economy", but, when Senator Pell asked him whether the Government should seek to influence these decisions directly, he indicated that to do so would be to "reach pretty far down in the economic machinery, and you might get your hand ground off in the process." He preferred, if I understood him correctly, to attempt to influence demand rather than inventory decisions. Senator Proxmire also indicated skepticism about the efficacy of stimulating the economy through encouraging build-up of inventories. He likened it to efforts to spark recovery by speeding up defense spending, which he said have not worked effectively in the past.

Unquestionably Chairman Martin will be asked whether selective controls over lending to finance inventory purchases would be desirable. Mr. Stanback yesterday indicated doubt about this, in response to a question by Senator Pell. Although the Senator asked whether this might not involve too much control over the economy, Mr. Stanback based his doubts on grounds of "efficiency, not philosophy."

Despite some indications to the contrary in the May 31 press release announcing the hearings, there was no sign yesterday that the hearings would focus on the recent drop in stock market prices.

cc: Each Board Member
Mr. Molony
Mr. Fauver
Mr. Young
Mr. Sherman
Mr. Noyes
Mr. Partee

Darling - 5171

FOR A.M. RELEASE
WEDNESDAY, July 11, 1962

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

SUBCOMMITTEE ON ECONOMIC STABILIZATION,
AUTOMATION, AND ENERGY RESOURCES

Investigation of Business Inventories

Rep. Henry S. Reuss (D., Wis.) today announced the witnesses to be heard on business inventory fluctuations during the remainder of the week.

On Thursday morning the Subcommittee will hear Hon. Charles J. Hitch, Assistant Secretary of Defense, and Mr. Murray Weidenbaum, Economist for the Boeing Company, both on the subject of the effects of changes in defense orders on business inventories and business activity.

On Thursday afternoon a panel of Government and university economic experts will testify on the availability and reliability of inventory statistics.

On Friday morning Hon. William McChesney Martin, Jr., Chairman of the Board of Governors, Federal Reserve System, will testify on the subject of general and selective monetary controls with reference to inventory fluctuations.

A complete list of witnesses is attached.

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JOINT ECONOMIC COMMITTEE

SUBCOMMITTEE ON ECONOMIC STABILIZATION,
AUTOMATION, AND ENERGY RESOURCES

Schedule of Hearings
(July 12 and 13)

Thursday morning, July 12, 1962, 10:00 o'clock, ROOM 304, Old House Office Building - Government Inventories and Their Relation to General Business Activity.

Witnesses:

Hon. Charles J. Hitch, Assistant Secretary of Defense
Mr. Murray Weidenbaum, The Boeing Company

Thursday afternoon, July 12, 1962, 2:00 o'clock, ROOM 304, Old House Office Building - Availability and Reliability of Inventory Statistics.

Witnesses:

Mr. Carey P. Modlin, Jr., Office of Statistical Standards, Bureau of the Budget
Mr. George Jaszi, Assistant Director, Office of Business Economics, Department of Commerce
Professor Gary Fromm, United Research Services and Harvard University
Professor Elmer C. Bratt, Lehigh University

Friday morning, July 13, 1962, 10:00 o'clock, ROOM 4200 New Senate Office Building - Stabilization Policy.

Witness:

Hon. William McChesney Martin, Jr., Chairman, Board of Governors, Federal Reserve System

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Mr. Martin

This is the hearing at which you are scheduled to testify--on Friday morning, July 13.

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FOR A.M. RELEASE
THURSDAY, July 5, 1962

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

SUBCOMMITTEE ON ECONOMIC STABILIZATION,
AUTOMATION, AND ENERGY RESOURCES

Investigation of Business Inventories

Rep. Henry S. Reuss (D., Wis.), Chairman of the Subcommittee on Economic Stabilization, Automation and Energy Resources, announced today that the Subcommittee will hold hearings on July 9, 10, 11, 12 and 13, on the effects of inventory fluctuations on business recessions, prosperity and growth in the United States.

Six sessions are planned for the five-day period. Lead-off witness at the first session set for Monday morning, July 9, at 10:00 o'clock, will be James S. Duesenberry, Professor of Economics at Harvard University. He will be joined in a panel by Vincent J. Graham, General Merchandising Controller of Sears Roebuck and Company; Dr. Thomas M. Stanback, Jr., of the National Bureau of Economic Research, and Mrs. Ruth P. Mack of the National Bureau of Economic Research.

A list of the witnesses scheduled to appear at the first three sessions is attached. Witnesses for the final three sessions, scheduled for Thursday morning and afternoon, July 12, and Friday morning, July 13, will be announced later.

(MORE)

JOINT ECONOMIC COMMITTEE

SUBCOMMITTEE ON ECONOMIC STABILIZATION,
AUTOMATION, AND ENERGY RESOURCES

Schedule of Hearings
(July 9,10 and 11)

(All Sessions in Public Works Committee Hearing Room, 4200 New Senate Office Building)

Monday morning, July 9, 1962, 10:00 o'clock - The Role of Inventory Changes During Expansion and Contraction.

Witnesses:

Professor James S. Duesenberry, Harvard University
Mr. Vincent J. Graham, General Merchandising Controller, Sears Roebuck and Company
Dr. Thomas M. Stanback, Jr., National Bureau of Economic Research
Mrs. Ruth P. Mack, National Bureau of Economic Research

Tuesday morning, July 10, 1962, 10:00 o'clock - The Role of Inventories in Cyclical Reversals.

Witnesses:

Professor John P. Lewis, Indiana University
Mr. Martin R. Gainsbrugh, National Industrial Conference Board
Professor Michael C. Lovell, Yale University
Mr. Nat Weinberg, United Auto Workers Union, AFL-CIO
Mr. Louis J. Paradiso, Department of Commerce

Wednesday morning, July 11, 1962, 10:00 o'clock - The Relation of Inventory Fluctuations to Price Level Changes and Rate of Utilization of Productive Capacity.

Witnesses:

Professor Franco Modigliani, Massachusetts Institute of Technology
Mr. Fred H. Holt, General Manager, Household Refrigerator Dept., General Electric Company
Mr. Norman Robertson, First National City Bank, New York City
Professor Charles C. Holt, University of Wisconsin

END

Miss Muehlhaus

June 25, 1962

The Honorable Henry S. Reuss,
Acting Chairman, Subcommittee on
Economic Stabilization, Automation,
and Energy Resources, of the
Joint Economic Committee,
Washington 25, D. C.

Dear Mr. Chairman:

This is in response to your request that I appear before your Subcommittee on July 13 in connection with the study of inventory fluctuations. I have previous commitments that require my leaving the city on the afternoon of July 13, but, since presumably my appearance could be completed that morning, I am planning to appear at that time, as you request.

Sincerely yours,

(SIGNED) WM. McC. MARTIN, Jr.

Wm. McC. Martin, Jr.

P30 on 10.2

WRIGHT PATMAN, TEX., CHAIRMAN
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EXECUTIVE DIRECTOR

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(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)

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June 20, 1962

Honorable William McChesney Martin, Jr.
Chairman, Board of Governors
Federal Reserve System
Washington, D. C.

Dear Mr. Chairman:

As you may know, the Joint Economic Committee has long had in process technical studies looking into inventory fluctuations, their role in business expansion and contraction, as well as into causative factors influencing these fluctuations.

During the week beginning July 9 the Subcommittee I am heading will hold hearings on this matter, at which time we hope to hear several expert witnesses on "fact finding" aspects of the subject. However, at the end of the session we would also like to go beyond the fact finding stage and hear testimony on some of the policy implications. Accordingly, we would deeply appreciate it if you could testify at that time.

Naturally we would like to have your particular comments and judgments on the role or influence of money and credit policies on inventory holdings by business firms. Thus we would like to know what roles inventories - and shifts in inventories - play both in the Federal Reserve's periodic assessment of the current business situation, and in its policy decisions. Also, I wonder what your experience with selective credit controls such as margin requirements for stock purchases, might suggest for new policies for discouraging unwarranted fluctuations in inventories. In addition, however, we would wish you to introduce any other considerations which you feel to be relevant to our study.

I believe that the most appropriate time for the Subcommittee to hear you would be at the concluding session of the hearings on Friday morning, July 13. If this is not a convenient date for you, however, we would of course be glad to fit you into our schedule on some other day. Please let me know whether or not you can testify either on the date suggested or at another time during the week of our hearings. Needless to say we will appreciate any information and judgment you may give us on our subject.

I am

Sincerely yours,

Henry S. Reuss
Acting Chairman
Subcommittee on Economic Stabilization,
Automation, and Energy Resources

(57)

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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

U.S. GOVERNMENT PRINTING OFFICE

85006 WASHINGTON : 1962

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87TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { 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.

Statement of
Wm. McC. Martin, Jr., Chairman,
Board of Governors of the Federal Reserve System,
before the
House Committee on Banking and Currency,
on H. R. 12080
July 17, 1962

H. R. 12080 would exempt foreign official time deposits from the interest ceilings now imposed under the Federal Reserve Act and the Federal Deposit Insurance Act, in order to give U. S. commercial banks greater freedom to compete with banks in other countries for such deposits. As indicated by Mr. Roosa in his opening testimony in support of the bill, it is a limited step toward reducing the pressures we have experienced on our gold reserves until more basic measures can bring our international payments accounts into balance. It will not, of course, reduce the balance of payments deficit that underlies these pressures. It can be tried without jeopardizing sound management of the relatively few banks that are in a position to compete for these deposits.

Foreign central banks hold their international reserves partly in gold and partly in reserve currencies. In general, they do not decide on the distribution of their reserves as between gold and currencies on the basis of interest rates. But they may let international interest-rate differentials influence their decision on the distribution of their currency reserves as between the dollar and other currencies. Therefore, the bill may add to the amount of reserves held by foreign central banks in dollars, and correspondingly reduce requests for redemption of dollar holdings in gold.

Under the present law the Board is not authorized to fix different interest-rate ceilings for foreign official deposits than for other similar deposits, foreign or domestic. Within this framework, it is not feasible, in my judgment, to set ceilings which achieve the objectives of the underlying law with respect to deposits of domestic origin and, at the same time, permit active competition by American banks for foreign accounts.

It seems preferable to waive restrictions completely for these foreign official deposits, rather than to authorize the Board to fix higher ceilings applicable only to them. The number of banks involved is small, and only a small percentage of the deposits of these banks will be in the form of foreign official time deposits. I see no danger, therefore, in letting these banks determine for themselves the rates that they can prudently offer.

One additional point should be mentioned. In a number of States, including New York, State banks are limited as to the rate of interest they may pay on time deposits, either by State statute or by regulations of the State banking authorities. Section 24 of the Federal Reserve Act prohibits any national bank from paying interest on time or savings deposits at a rate in excess of that authorized by State law to be paid upon such deposits by State banks in the State in which the national bank is located. Consequently, enactment of H. R. 12080 would not relieve member banks (either State or national) or insured nonmember banks from interest rate limitations applicable under State law or regulations unless appropriate action is taken by the State authorities.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Thursday, July 26, 1962.

Copies of answers to questions asked of Chairman Martin when he testified on H. R. 12080 before the House Banking and Currency Committee, the originals of which have this afternoon been sent to the Committee for insertion at proper places in the printed record.

1. Open
2. Frustrated
3.

Question (page 172 of hearing transcript)

What is the volume of loans which U.S. banks are now making abroad? Would you have an estimate of that on an annual basis, just as estimate?

Answer

Outstanding dollar claims on foreigners by U.S. banks (including loans, acceptance credits, and collection items) totaled \$6.4 billion at the end of May, 1962. Over the first five months of this year, the outstanding amount of dollar claims rose by \$275 million compared to an increase of almost \$500 million in the same period of 1961. Thus, the net increase in bank credits to foreigners this year appears to be running on the order of half the rate of last year, when the rise for the year was slightly more than \$1 billion. A large part of the increment thus far in 1962 resulted from bank credits to Japan in the first quarter; further net outflows to Japan in the immediate future, if they occur at all, are expected to be small.

Question (page 172 of hearing transcript)

How many United States banks are now engaged in making loans abroad?

Answer

Banking organizations in the United States (including agencies and branches of foreign banks) reporting claims on foreigners on Treasury foreign exchange forms currently number 119. However, about a dozen U.S. banks account for the great bulk of the bank lending to foreigners. In the Second (New York) Federal Reserve District, for example, eight U.S. commercial banks account for from 65 to 97 per cent of total Second District credits in various individual categories of bank credits to foreigners.

Question (page 172 of hearing transcript)

What interest rates are United States banks charging on prime loans to Western Europe? Is it higher than United States prime rate, or what is the rate?

Answer

A canvas of a small number of large U.S. banks known to be important in international business indicates that prevailing rates charged prime foreign corporate borrowers on short-term loans (July 1962) range from 4-3/4 to 5 per cent, or about 1/4 to 1/2 per cent higher than rates charged U.S. companies of prime credit standing.

On term loans prime European borrowers are charged 5-1/4 to 6 per cent, or about 1/2 to 1 per cent above rates charged U.S. companies.

Compensating balances required under foreign loans appear to be similar to those on loans to comparable domestic corporations.

Question

Could you name any reliable barometer or barometers that I could look at to learn just what degree of tightness or ease the Federal Reserve is following?

Answer

There is no single barometer or even small group of barometers to indicate just what degree of tightness or ease the Federal Reserve is following that can be relied upon at all times and under all economic conditions.

The only specific economic or financial variable over which the Federal Reserve has anything approaching full or direct control is the total of commercial bank reserves. Through this control the System exercises its influence on bank lending and investing, and on the growth of bank deposits and the money supply. At any given moment, therefore, the choice for monetary policy lies among the various degrees of restraint upon or encouragement to expansion of bank credit and money through altered reserve availability.

The figure of "free reserves" or its negative counterpart, "net borrowed reserves," provides one convenient and significant working measure of the posture of monetary policy. This figure is the difference between the reserves member banks hold in excess of their legal requirements and their borrowings from the Federal Reserve Banks. This figure is closely related to the firmness or ease that exists in the money market although it is not always a good indicator in the short-run. Other indicators of money market conditions that have to be taken into account along with free reserves are the level of short-term rates of interest, including those on Federal funds, Treasury bills and loans to dealers in Government securities by the large New York City banks; and the relationships among these rates and the Federal Reserve rediscount rate. These statistics, taken as a group, are reasonably accurate barometers of the current degree of firmness or ease or restraint in the money market, in which the Federal Reserve is an important, but by no means the determining participant.

The degree of ease or restraint of monetary policy indicated by a given level of free reserves varies from time to time depending on the differences that exist in the underlying economic situation. Moreover, the figures for free reserves must be considered in the context of changes in the total reserve position of the member banks. To maintain free reserves at some particular level might, under circumstances of vigorous demands for bank credit, mean the continuing provision of reserves to meet all such demands. Under conditions of slack demand for credit on the other hand, maintenance of this same level of free reserves might mean an actual reduction in the amount of outstanding reserves with tendencies in the direction of credit liquidation rather than expansion.

Thus, more significant guides than free reserves are provided by the consequences of the existing degree of reserve availability on the growth of bank credit and the money supply. The Federal Reserve always has to judge what growth and availability of bank credit and what expansion in the money supply is most appropriate at any given time. The decision as to appropriate bank credit and monetary growth rests ultimately, of course, on one's judgment as to the effects of changes in money and credit on the fundamental objectives of fostering high level employment and sustained economic growth, and of maintaining a sound dollar both at home and abroad.

Finally, as for interest rates as guides to monetary policy, these rates are determined by the interplay of borrowing demands of all kinds upon the available supply of loanable funds. Bank credit is only a portion of this supply, and it is through its influence on bank credit that the Federal Reserve exerts its main influence on interest rates.

Thus, most of the time fluctuations in interest rates reflect changes in the intensity of various market forces rather than changes in monetary policy. When significant changes in policy do occur, however, they are reflected in interest rate movements. Indeed, it is through interest rate changes that monetary policy exerts a significant part of its influence on saving, spending, and investment decisions. These reflections are strongest in the short-term area of the credit market where banks are relatively more important as compared to nonbank lenders, although they are also apparent to a damped degree in the longer areas of the market, where savings are a more important supply factor than bank credit.

Question

I believe you have indicated on previous occasions at the end of the war there was too much liquidity relative to the amount of goods available and that helped cause inflation.

(a) Liquidity has been greatly reduced, has it not, as in relationship to the amount of goods now available?

(b) As you see the picture now, is the ratio of the liquidity to our gross national product still too high or do you think it may be a little too low or is it about right in your view?

Answer

Liquidity is a difficult concept about which to generalize. For one thing, there is neither complete agreement among economists as to the content of the concept nor how it is to be measured. Also, liquidity measures for the economy as a whole may conceal important differences among the major sectors of the economy and among the economic units comprising each sector. In evaluating liquidity at any point in time, therefore, it is necessary to look, as far as one can with existing data, at the parts as well as the whole.

One summary measure of liquidity for the economy as a whole is a comparison of the gross national product with the total liquid assets held by the nonbank public, i.e., the total of cash and assets easily converted into cash at relatively fixed values. In such a calculation, liquid assets are often defined to include currency, demand deposits, time and savings deposits at commercial banks, mutual savings banks and the postal savings system, savings and loan association shares, U.S. savings bonds, and U.S. Government securities maturing within a year. The total amount of these assets owned by the nonbank public increased greatly during World War II, and the amount outstanding was one-fifth greater than the gross national product in 1945. With the end of wartime financing, the liquid asset total increased more slowly while the dollar value of output rose rapidly, reflecting both increases in output and increases in prices. By 1955 the ratio between liquid assets and GNP was reduced to about 80 per cent.

Over the past seven years, trends in liquid asset holdings and in GNP have been roughly parallel. Liquid asset holdings have grown fairly steadily, showing much smaller cyclical fluctuations than in total economic activity. Fluctuations in the liquidity ratio, therefore, have reflected mainly cyclical swings in output. In the second quarter of this year, the ratio is estimated at 79.4 per cent, up some from late 1961 and not much less than at the trough of the recession in early 1961.

The two main sectors of the nonbank public, consumers and business, have had substantially different liquidity patterns. Consumer liquidity has generally been maintained, while business liquidity has tended to decline over the past decade. Consumer holdings of liquid assets usually rise relative to income in recessions and decline relatively in recoveries and expansions. The ratio of liquid assets to disposable incomes rose from mid-1960 to early 1961, but has remained at relatively high levels throughout the recovery in 1961 and early 1962. Consumer debt burdens--payments of interest and principal on debts as a proportion of disposable incomes--have been fairly constant over the past four or five years.

Corporate liquidity, whether measured by the ratio of liquid assets to current liabilities or liquid assets to sales, has declined since 1955. This has been a continuation of the trend over the whole postwar period of corporations' putting surplus funds to work principally in extending credit to customers and suppliers and, in certain phases of the cycle, in adding to inventories. At the end of the first quarter of 1962, liquid asset holdings of corporations were about as low as at any time in the postwar period, but with the decline in inventory investment that has taken place in recent months corporate liquidity ratios at midyear were probably up a bit from the first quarter lows.

Liquidity of the banking system is affected by variations in the public's demand for bank credit and changes in reserves made available by the Federal Reserve. One measure of bank liquidity, indicating the extent to which bank resources have already been used to meet loan demands, is the ratio of outstanding loans to total deposits. This ratio rose rapidly to postwar highs in mid-1960, declined somewhat during the recession, and has risen somewhat this year. At midyear, however, the ratio was still below its previous peak. Another measure of bank liquidity, indicating the capacity to expand loans even without additional deposit growth, is the ratio of secondary reserves to demand deposits. For this purpose, secondary reserves are defined as bank holdings of U.S. Government securities maturing within a year plus free reserves. This ratio increased sharply from early 1959 to the summer of 1961, and is still relatively high.

The differences in ~~liquidy~~ liquidity position among these major economic sectors indicate how hard it is to generalize about the liquidity state of the economy. If one were required to reach some over-all conclusion, it could be said that consumers in the aggregate are fairly liquid, corporations in the aggregate have the lowest liquidity ratios of postwar years but may be increasing liquidity as inventories are not being increased in relation to cash inflows, and commercial banks are quite liquid and capable of meeting substantial increases in loan demands.

Question

During the past two months (mid-May to mid-July, 1962) has it been the policy of the Federal Open Market Committee to bring about increased interest rates? Did the Federal Open Market Committee expect that one of the consequences of its policy would be an increase in interest rates, or have the recent increases in interest rates come as a surprise to you?

Answer

During the past two months, it has been the policy of the Federal Open Market Committee to provide reserves for further expansion of bank credit and of the money supply, taking into account the adverse balance of payments and the role of capital flows in that balance. More specifically, concern for the balance of payments has motivated the Committee not to press reserve expansion to a point which would encourage capital outflows directly, or create sustained downward pressure on short-term rates. The Committee's judgment has been that this can be accomplished without interfering with the basic objective of supplying adequate reserves so that credit is readily available to meet the needs of the domestic economy. While, as usual, different points of view have continued to be represented at its meetings, the Committee has felt that the situation was not one which called for restraint and neither the Committee's policy nor its implementation has been restrictive.

Within this framework there have been moderate shifts of emphasis from time to time in the last eighteen months. It would be inappropriate to discuss very recent or current actions of the Committee in detail, but it can be said that there was some concern as to the international repercussions of downward pressures on short-term rates that developed in June, and that as a result somewhat greater emphasis was placed on limiting any contribution to those pressures from open market operations.

It would be misleading to say that recent changes in interest rates have come as a "surprise" to the Federal Open Market Committee, but it would be equally misleading to say that the specific rate movements that occurred were expected "as a consequence of its policy."

At each meeting the Committee receives a detailed briefing on recent and prospective market developments. This certainly does not preclude the possibility of unexpected short-term market developments, but it does assure that the Committee is alert to more likely possibilities. In the case in point, the Committee was aware of the fact that the Treasury had been increasing its weekly offerings of Treasury bills and that this action in and of itself would tend to exert some upward pressure on bill rates. It was also aware that the market had passed the peak of the normal seasonal demand for bills, which tends to depress bill rates at that time of the year. In the light of these facts, other economic information, and the policy of the Committee itself, it is fair to say that some firming in the short-term rate was anticipated. On the other hand, the amount of the change was not specifically anticipated, nor was any specific change in rates the objective of policy.

<u>Question</u> (page ~~189~~ 191 of hearing transcript)

> Mr. Martin, during the first six months of this year, has the United States had a net outflow of short-term funds? How about the last six months of 1961? Did we have a net outflow of short-term funds?
>
> How much of the net outflow of funds was by reason of higher interest rates abroad than here?
>
> To which countries principally did we have a net export of short-term funds?

<u>Answer</u>

The following answer to these questions is based on recorded data on short-term movements of U.S. capital. However, it is assumed that the net shift on unrecorded transactions from a large inflow in 1959 to outflows of $0.6 billion in both 1960 and 1961 reflected in good part short-term capital transactions. Among these capital transactions there may have been sizeable short-term movements, including shifts in terms of payment for commercial transactions.

The recorded net outflow of U.S. short-term funds in the first five months of 1962 is estimated on the basis of incomplete data at about $400 million; in the last half of 1961 the recorded outflow was about $650 million. A large part of the outflow of short-term funds in both periods has been to Japan and represented bank loans and acceptance credits, in part undoubtedly connected with the financing of U.S. exports to that country. In the last half of 1961 there were also sizeable outflows of short-term bank credit to Latin America.

Outflows to Japan and Latin America appear to be related primarily to (a) the large credit demands of these countries for financing of trade and for balance-of-payments assistance, (b) the availability of funds in the U.S. market, and (c) the long-standing banking relationships between official and banking institutions in these countries and banks in the United States. Interest rates in these countries are in most, if not all, instances considerably higher than those in the United States, but this has generally been the case independently of cyclical variations in U.S. interest rates. Changes in the volume of funds moving to these countries, therefore, may be considered to be generally independent of variations in interest rate differentials, although the flows reflecting commercial demands would, of course, be unlikely to occur if interest rates were not higher than in the U.S.

The answer to the third part of this question is given in the response to another question on page 191 of the hearing transcript.

Question (p. ~~189~~ 191 of hearing transcript)

> Would you mind submitting for the record a list of the countries to which the net outflow of short-term funds went principally to the last half of last year?
>
> You need not list those involving only minor amounts and if you can, can you do the same thing for the first six months of this year?
>
> If you will also show the interest rate differential and the foreign (i.e., forward) exchange rate?

Answer

Recorded net outflows of short-term funds in the last half of 1961 and for the first half of 1962 to all countries for which the net outflow in either period was $20 million or more are listed in the table below.

Countries Receiving a Significant Net Flow of Short-term U.S. Capital Second Half, 1961, and First Five Months, 1962, 1/

(Millions of dollars)

	July-Dec. 1962	Jan.-May 1962
Canada	73	-9
Argentina	45	12
Colombia	34	38
Germany	27	-26
Japan	196	233
Mexico	91	4
Norway	20	-4
Panama	8	27
Philippines	91	-7
Switzerland	43	-37

1/ Countries shown are those for which net flow from the U.S. in either period exceeded $20 million. Minus sign indicates net return flow to the U.S.

NOTE: Data for Canada from U.S. balance of payments except for April, May 1962.
Data for other countries are reported by banks and (for 1961) as reported by non-financial concerns, as published in the Federal Reserve Bulletin.

Variations in interest rate differentials are likely to influence capital flows only between major money markets. Treasury bill or deposit rates for most important international money markets are shown in Chart 1.

The chart brings out that interest rate differentials on prime money market in investments vary frequently and erratically, depending upon changes in relative credit conditions in the various markets. Lenders in a position to choose between markets will necessarily take these differentials into consideration in placing funds. Interest rates available to commercial and industrial borrowers on negotiated loans are generally less variable than money market rates, but differentials on these rates tend to change with some lag in the same direction as interest rate differentials on prime market investments.

Capital movements free of exchange risk are possible only between markets having active forward exchange facilities. Of the countries listed in the table, such facilities are likely to have a significant influence on capital movements only in the case of Canada, Germany and Switzerland. For the period in question, the actual forward exchange rates probably influenced flows of funds only to Canada, and perhaps Germany.

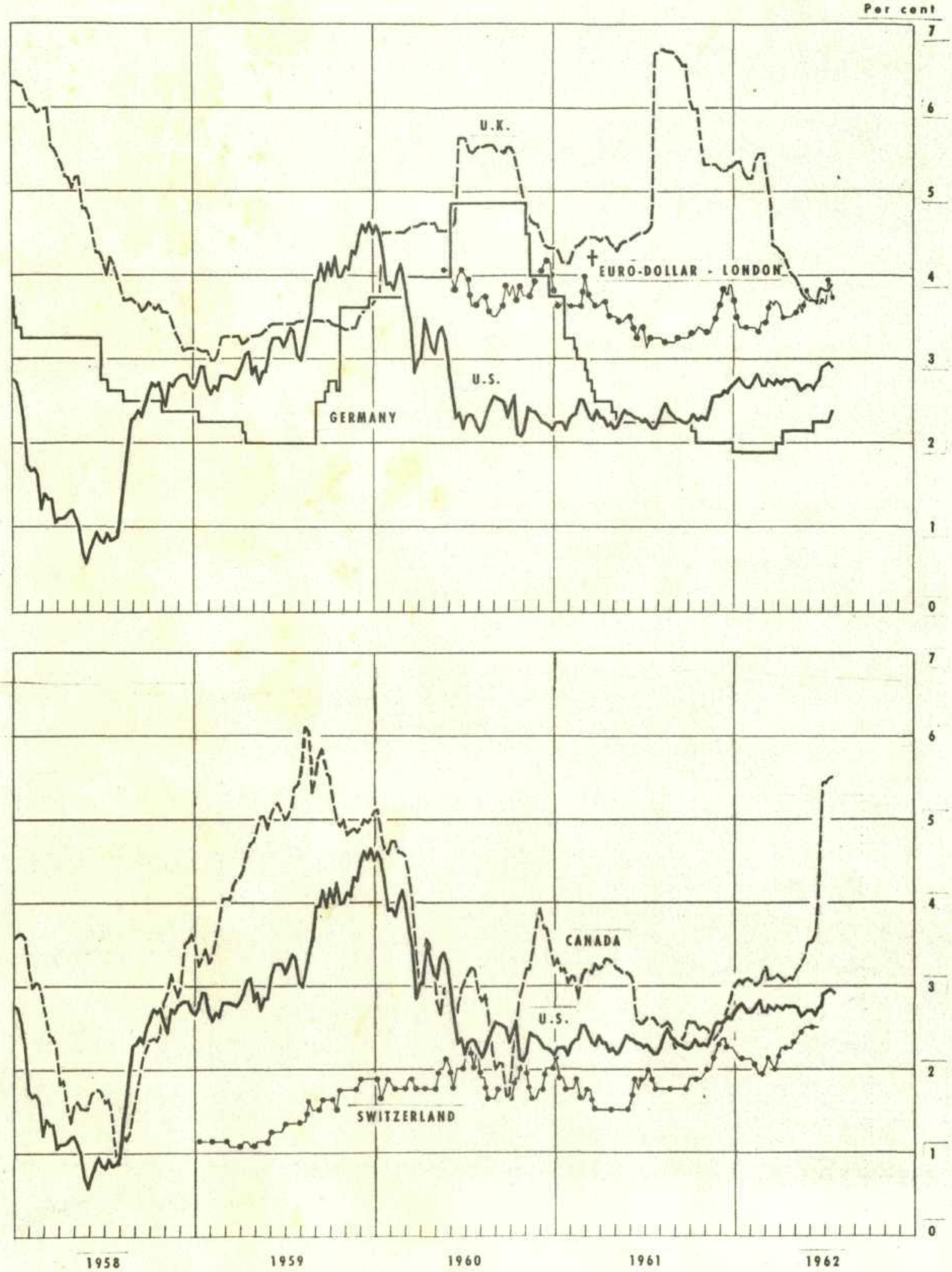
As shown in Chart 2, there was a small net covered yield in favor of investments in Canadian dollars at times in the last half of 1961, and in early 1962, and some part of the outflow may have represented short-term investments in Canada through interest rate arbitrage.

In the case of Germany, the outflow shown in the table reflected extensions of U.S. bank credit to German borrowers. During the last half of 1961, there was generally a premium of more than 1 per cent on the forward German mark, which made it more advantageous to German borrowers to resort to borrowing with U.S. Presumably, some German commercial borrowing was affected by this additional incentive, but in this period there was also the influence of covering German export sales payable in dollars with an equivalent borrowing of dollars.

The outflow to Switzerland in late 1961 is reported to have reflected a window-dressing operation over the year-end, and apparently did not involve either interest rate or exchange rate market considerations. The outflow was reversed at the beginning of 1962.

CHART I

SHORT-TERM INTEREST RATES,* UNITED STATES AND LEADING INDUSTRIAL COUNTRIES

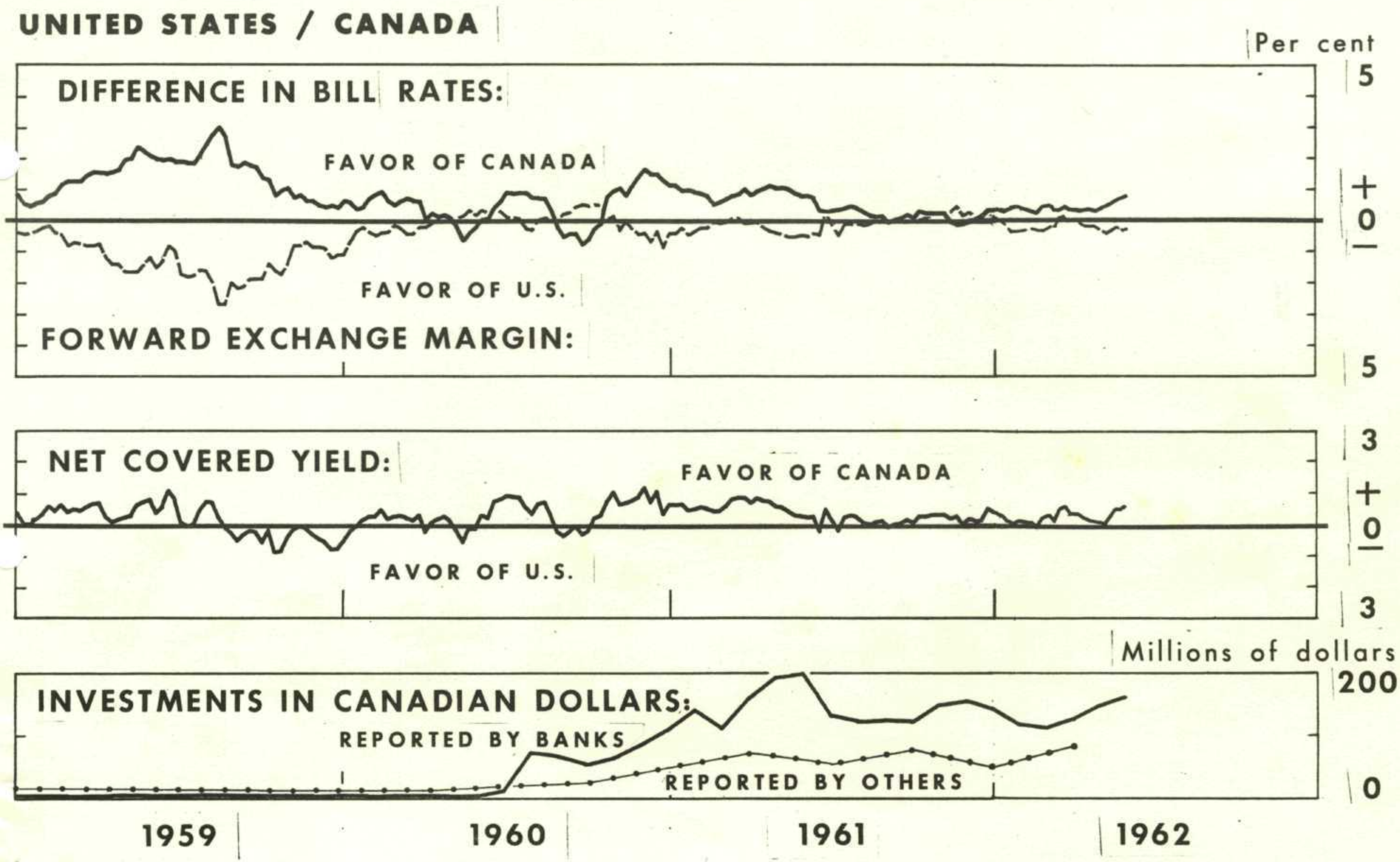


* 3-month treasury bill rates for all countries except Switzerland (3-month deposit rate)

† 3-month rate for U. S. dollar deposits in London.

CHART II

INTEREST ARBITRAGE AND MONEY MARKET INVESTMENTS



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Insert on page 214

MAXIMUM INTEREST RATES ON TIME DEPOSITS IN INSURED COMMERCIAL BANKS
PRESCRIBED BY STATE LAWS OR STATE BANKING AUTHORITIES

STATE	FIXED BY STATUTE	FIXED BY STATE BANKING AUTHORITIES SUBJECT TO CHANGE
Arkansas	4%	-
Colorado	-	4%
Indiana	-	3%
Iowa	4%1/	-
Louisiana	5%1/	-
Michigan	-	$2\frac{1}{2}$%4/
Minnesota	4%	-
Mississippi	-	Same as Regulation Q
Nebraska	4%	-
Nevada	-	3%
New York	-	Same as Regulation Q
North Dakota	4%3/	-
Oklahoma	-	Same as Regulation Q
Pennsylvania	-	Comparable to Regulation Q
South Dakota	-	Same as Regulation Q
Tennessee	4%	-
Utah	-	$3\frac{1}{4}$%5/
Virginia	4%2/	-

1/ In Iowa and Louisiana bank deposits bearing interest at a rate over the indicated limit must be classified as borrowed money although this does not apply to deposits of public funds in Louisiana.

2/ In Virginia the maximum rate of interest permitted on time deposits is 4 per cent per annum provided, however, that such rate of interest may not exceed rate set by the Federal Reserve Board for member banks.

3/ In North Dakota the State Banking Board may authorize a higher rate of interest not to exceed 6 per cent.

4/ Applies only where rate is not subject to Federal regulation.

5/ In Utah the State Depository Board has authority to fix maximum rate of interest, but it has not done so except for inactive public funds.

Note: Those States which have not been listed have no statutes nor regulations setting a maximum rate of interest, except for a few States where the limits apply only to certain types of public funds.

Question (page ~~233~~ 234 of Hearing Transcript)

What would be the effect on our balance of payments deficit of a tax of, say, two per cent per annum [on interest earned] on loans made to foreign governments and nations in the industrialized countries--say those countries of western Europe--which currently need no assistance from the United States?

Would such a tax equalize interest rate differentials, and free the hands of the Federal Reserve to follow whatever kind of money and interest rate policy it feels is most appropriate to the domestic economy, particularly to encourage an expansion of private economic activity and put the unemployed back to work?

Answer

To the extent that such a tax reduced U.S. lending to industrially developed countries, it might appear to reduce our balance-of-payments deficit by an equivalent amount. However, (1) the actual reduction in direct lending to such countries might be substantially less than expected; and (2) secondary movements of funds consequent on the measure might offset or even more than offset all of the reductions in lending that did occur.

Less-than-expected reductions in direct lending. Actual reductions in direct lending to industrialized countries could be disappointing if on the one hand the banks and other lenders decided to accept a cut in their margin in order to keep valued foreign accounts, or if, on the other hand, lending rates in leading foreign financial centers rose in response to the increase in New York lending rates. If the tax were raised more than two percentage points in order to try to plug the first of these loopholes, this would reinforce a tendency for the second one to result.

The actual reduction in direct lending might also be less than expected to the extent that foreign borrowing in New York is a function of market organization and of availability of funds rather than of interest rates charged.

Secondary movements of funds. Various repercussions of adopting the proposed tax would offset its effects in reducing the balance-of-payments deficit.

First, a measure of this kind would be difficult to enforce. In some cases at least, funds loaned to borrowers in underdeveloped countries could be used for purposes not directly connected with these countries. Moreover, it would not be easy to disentangle transactions between U.S. parent companies and their foreign subsidiaries or affiliates (including U.S. banks and their foreign branches), or transactions between U.S. branches of foreign corporations and their home offices.

Second, much short-term lending is trade-connected, especially with U.S. exports. While no comprehensive data on the purposes of bank accommodations to foreigners are available, statistics on bankers' acceptances--which are close substitutes for ordinary bank credit--show that out of a total of $2.7 billion outstanding at the end of 1961, $1.0 billion was for the purpose of financing U.S. exports and $0.5 billion for the financing of U.S. imports. Making trade credit more expensive could easily jeopardize some part of our export surplus, and would be in direct conflict with present efforts to promote exports through easier export financing.

Third, there is fequently a direct relation between bank deposits held by foreigners and loans made to foreigners. Foreign banks frequently keep deposits with U.S. commercial banks primarily in order to insure access to U.S. credit markets for their customers. If credit to those customers were cut off or made materially more expensive, the deposits themselves might be withdrawn, with the result that the U.S. monetary reserve position would be improved little if at all and might be adversely affected.

Fourth, curtailment of foreign borrowing in the United States would encourage the expansion of the so-called Euro-dollar market. Such a curtailment, by stimulating the demand for dollar funds in foreign centers, would push up the rates paid there for such funds. As a result, foreigners would increasingly keep deposits denominated in U.S. dollars with banks outside of the United States, and these dollars would be used to finance dollar transactions abroad. If the increased Euro-dollar market deposit rates attracted U.S. bank funds and deposits by U.S. residents, the outflow of capital from the United States might be increased rather than reduced. To a small extent the current-account balance of the U.S. balance of payments would also be adversely affected by diverting to foreign banks earnings otherwise accruing to U.S. commercial banks.

Finally, the offsets could swamp any balance-of-payments benefits stemming from such a tax if its enactment were construed as the first step in restricting the outflow of credit and capital. In other words, capital flight might be activated. Such a construction would be within the range of possibilities.

Sheltering the domestic economy. As for the second part of the question, it is doubtful whether, under present conditions, a tax to equalize interest differentials between the United States and foreign industrial countries would shelter the domestic economy from the influence of international credit and capital flows. The foregoing analysis of the proposed tax would indicate that such a tax would be more likely to change the composition and direction of international credit flows than to reduce the country's balance-of-payments deficit. Moreover, the analysis makes evident that the changes possible would risk aggravating seriously the problem of domestic and international monetary equilibrium with which the Federal Reserve System must constantly deal.

P234-235

Question (~~p. 233~~ of hearing transcript)

The possibility, and your objections to the possibility, of requiring an additional reserve to be deposited with the Federal Reserve Banks equal to a certain percentage of future loans made by member banks of the Federal Reserve System to foreign governments and foreign nations of the industrialized countries?

What percentage of reserve requirements would be necessary to remove the drawing power of a differential of two per cent in interest rates?

How many U. S. banks would be affected?

Does the Federal Reserve have authority under existing law to make such reserve requirements against foreign loans or would new legislation be necessary?

Answer

This question assumes that a member bank of the Federal Reserve System could make a loan to a borrower in an industrialized foreign country at, for example, a 7 per cent interest rate, which would involve no more risk to the lender than a domestic loan which would carry a rate of 5 per cent. In this situation, the relative attractiveness of the two types of loans to a lending bank could be equalized by requiring the bank to deposit with the Federal Reserve Bank an additional reserve equal to 40 per cent of the amount of the foreign loan.

The figures leading to this percentage are as follows: A foreign loan of $1 million at 7 per cent would call for annual interest of $70,000. To produce an equal amount of interest would require $1.4 million of 5 per cent loans. If a bank, making a $1 million loan at 7 per cent, were required also to place $400,000, or 40 per cent, in a noninterest-bearing reserve account, then its earnings on the entire $1.4 million would be the same as if the entire amount were invested in 5 per cent loans.

One important objection to an additional reserve requirement of this kind would be based on its effect in placing U. S. banks at a disadvantage in relation to other lenders such as foreign banks and nonbank U. S. lenders. Assuming that a rate differential exists between foreign and domestic loans in which the risks are approximately equal, the reserve requirement would then divert foreign lending business away from U. S. banks to no purpose of value to the United States.

Another objection to this special type of selective reserve requirement is that it would impose a differential burden on member banks as compared with nonmember banks. Avoidance of this inequity would make it necessary that both member and nonmember banks be treated alike under any such requirement.

Finally, if foreign branches of U. S. banks were covered by this requirement and it applied to substantially their entire loan portfolios, they might find it virtually impossible to compete with foreign banks. On the other hand, if the foreign branches were free of the requirement, it would place banks with foreign branches at a great advantage over other domestic banks.

Aside from these matters, there would also be the onerous administrative problems of determining from time to time the countries to be subject to the requirement, the size of the interest rate differential needed to justify administrative action, the percentage of reserve that should be required, and the periods when foreign lending by member banks should or should not be under restraint of this kind.

From an international point of view, a further important question of principle is whether this kind of reserve requirement would seem a step toward either a mechanism of exchange control or a system of multiple exchange rates. This implication would arise because the requirement would make interest earnings from a domestic source worth more than earnings at the same interest rate from a foreign source.

From available data, it is not possible to say how many banks would be affected by a selective reserve requirement against increases in foreign loans. The information supplied in the answer to the question raised on page 172 of the hearing transcript would suggest that the number would be small, i.e., a few dozen institutions.

Under existing law, the Federal Reserve does not appear to have authority to impose an additional reserve requirement against foreign loans. Accordingly, new legislation would need to be enacted if such a requirement were to be utilized.

Question (p. 235 of hearing transcript)

And, . . . I would like to know the aggregate volume of U. S. bank loans made last year for:

(a) Use in Western Europe by foreigners and by U. S. companies doing business in Western Europe and,

(b) Made to foreigners exclusive of loans made by U. S. companies doing business in Western Europe.

Answer

Data on bank credit to foreigners are based on reports by banks in the United States; the reports by banks do not provide for a distinction between loans to foreign affiliates of U. S. firms and foreign-owned firms.

Dollar claims by banks (both short- and long-term) on Western European countries rose $183 million in 1961. In addition, some U. S. firms may have used their domestic credit lines to obtain financing for business done in Europe, but so long as the loan was made to a domestic concern, the bank would not report the credit on the foreign exchange forms.

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Author: Juan Cameron

Article Title: Martin, Patman Debate Tax Bill

Journal Title: American Banker

Date: July 18, 1962

Article Title: Interest Rates Hearing

Journal Title: Dow Jones News Wire

Date: July 17, 1962

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 16, 1962.

To Chairman Martin

Subject:

From J. Herbert Furth

The breakdown of foreign official short-term dollar holdings between deposits, Treasury bills and certificates, and other assets, and the Board's staff estimates of foreign official holdings of Treasury bonds and notes have never been published. Moreover, the total for May will not be published until the end of the month.

However, Mr. Holmes has assured me that the Treasury does not object to your giving the Table to the Committee if you think it advisable.

The totals differ from those ordinarily used and published because they exclude non-negotiable, non-interest-bearing Treasury notes held by international organizations (which obviously remain unaffected by interest-rate considerations) but include rough estimates of official holdings of Treasury bonds and notes.

JHF

Attachment.

Foreign Official Dollar Holdings 1/

(In millions of dollars)

End of Period	Deposits		Treasury bills and certificates 2/	Treasury bonds and notes 3/	Other (Short-term) 4/	Total 3/
	F. R. Banks	Commercial banks				
1957	399	2,739	4,936	1,025	614	9,713
1958	316	3,438	4,935	1,075	762	10,526
1959	419	2,552	6,687	1,625	589	11,872
1960	334	3,024	7,415	1,750	982	13,505
1961	341	3,454	7,320	2,250	1,089	14,454
1962-May	320	3,248	7,646	1,775	995	13,984

1/ Includes holdings of international organizations, except as indicated by note 2.

2/ Does not include nonnegotiable, non-interest-bearing special U.S. notes held by international organizations.

3/ Estimated.

4/ Represents principally bankers' acceptances and commercial paper.

July 13,1962.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 16, 1962.

To Chairman Martin

From J. Herbert Furth

Subject:

You may be interested in the following deposit rates for Euro-dollars (July 13, 1962, latest date available).

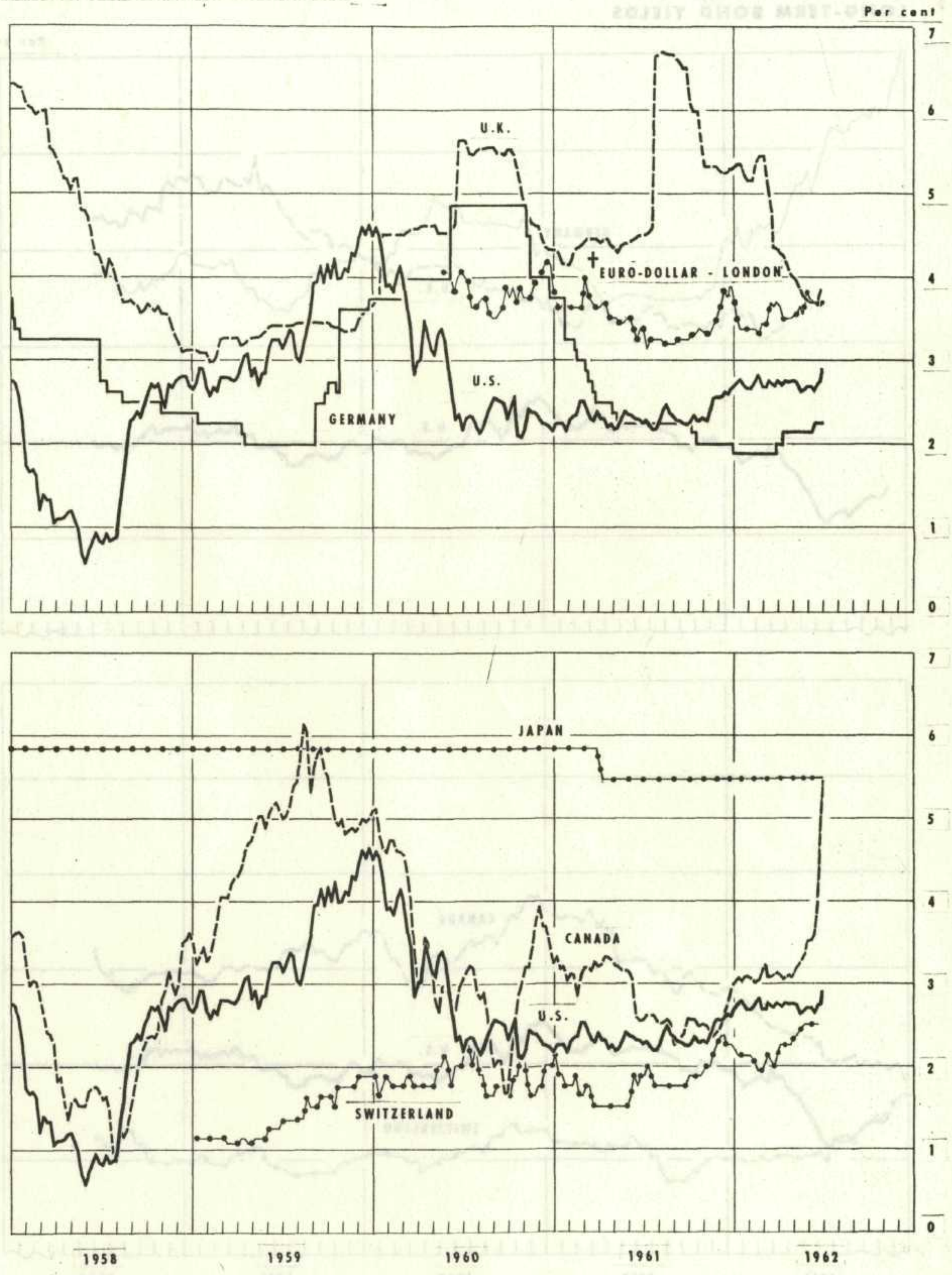
Call deposits	3-3/8 per cent
7-day deposits	3-3/8 per cent
30-day deposits	3-5/8 per cent
90-day deposits	3-13/16 per cent
180-day deposits	4.0

The attached table shows developments in short-term interest rates (including Euro-dollar rates) in leading financial centers since 1958.

JHF

Chart 5

SHORT-TERM INTEREST RATES *

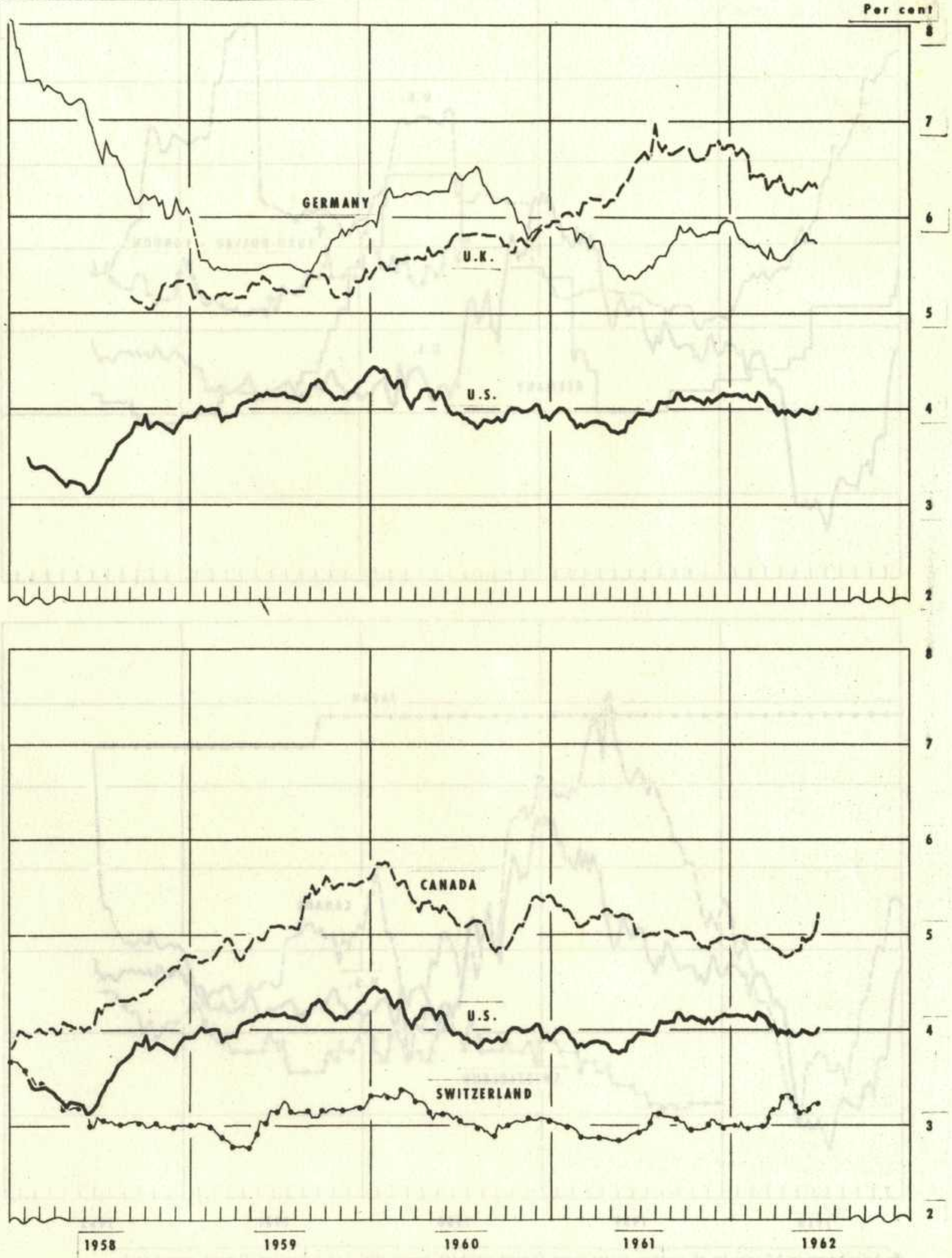


* 3-month treasury bill rates for all countries except Japan (3-month interbank deposit rate) and Switzerland (3-month deposit rate)

† 3-month rate for U. S. dollar deposits in London

Chart 6

LONG-TERM BOND YIELDS



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Author: Edward T. O'Toole

Article Title: Tax Move Seen as Deficit Check: Representative Patman May Propose Measure to Deter Investments Abroad

Journal Title: New York Times

Date: July 14, 1962

Chairman Martin

July 10, 1962

To Board of Governors

From Robert L. Cardon

Subject: Hearings on H. R. 12080, to permit domestic banks to pay higher interest rates on time deposits of foreign governments and central banks.

The full House Banking and Currency Committee, with Mr. Patman as Acting Chairman, opened hearings this morning on H. R. 12080, a bill to exempt foreign official deposits from the interest rate ceilings on time and savings deposits. Mr. Roosa was the only witness this morning. About half of the Committee Members attended.

Monetary policy was discussed only twice. Mr. Patman argued that it is better to pay higher interest rates on the comparatively small amount of time deposits held by foreign governments than to raise interest rates across the board. When he asked Mr. Roosa if this was a "plausible" argument, Mr. Roosa agreed, although his formal statement specifically stated that passage of the legislation would not pave the way for a monetary policy designed to keep domestic interest rates low. Later, Mr. Patman asked Mr. Roosa whether the Treasury is borrowing more than it needs in order to peg short-term interest rates. Mr. Roosa answered that the Treasury is not borrowing more than it needs but, in determining methods and timing of borrowing, is considering effect on short-term rates. In fact, in what seemed to me an impressive bit of candor, he told Mr. Patman "We've tried to increase the bill rate." Mr. Patman contented himself with the observation that this policy is wrong and devoted less than a minute to outlining his reasons for that conclusion.

As to the reasons for recommending favorable action on the bill, Mr. Roosa emphasized that the bill would have no direct effect on the balance of payments deficit and, indeed, represented a small step in a big package of measures needed to deal with the balance of payments deficit and the outflow of gold which has resulted from it. Several Republican Members criticized the proposal as discriminating against U. S. citizens and two or three of the Democrats revealed sensitivity to criticism on this point and sought some assurance from Mr. Roosa that the legislation is really needed. He indicated that foreign central banks now hold $2 billion in time deposits in U. S. commercial banks, that the legislation would do away with Government restrictions which now handicap the efforts of commercial banks to compete with foreign banks for these deposits, and that perhaps the legislation would permit banks to double these deposits in two years.

Mr. Widnall asked whether the problem could not be solved by an amendment to Regulation Q raising the ceiling on time deposits of less than six months maturity. He indicated that a rate of 3-1/4 per cent on 30 to 90-day deposits should permit U. S. banks to compete effectively, inasmuch as they have other advantages to offer to overcome some discrepancy in interest rates. Mr. Roosa replied that as much as 4-1/8 per cent is now being paid on Euro-dollar deposits.

Mr. Multer stated that when the full Committee goes into executive session on the bill, he will offer his bill H. R. 6900, introduced last year, as a substitute. H. R. 6900 contains the same provisions as H. R. 12080 concerning foreign official deposits but, in addition, repeals the 25 per cent gold cover requirement. Mr. Roosa recommended against such a move at this time purely on psychological grounds. He said it would be interpreted by many as "a sign of weakness", not so much in our international policies as in our domestic policies. In other words, it would be cited as proof of fiscal irresponsibility on the part of the Administration.

Mr. Moorhead of Pennsylvania asked whether it would not be more prudent to allow the Board and the FDIC to fix higher ceiling rates on official time deposits than on domestic deposits rather than waiving these ceilings completely, as the bill does. Mr. Roosa replied that this question had been carefully considered and it had been decided that it would be better to leave interest rates on these deposits to be set completely by market judgments. He said he had become personally convinced that this was the right approach when the Euro-dollar market developed. His point, as I got it, was that this market would never have developed in the form it did if the Board had acted more promptly to amend Regulation Q to raise interest ceilings. He concluded, therefore, that "regulation is sometimes perhaps an impediment in this particular area."

Mr. Roosa indicated that we are "doing much better than we'd dared to hope in the second quarter" in reducing our balance of payments deficit; in fact, he indicated the figures will be so encouraging that they may lead to an unwarranted relaxation of our efforts. He predicted a deficit of $1 to $1-1/2 billion in 1962 (I assume he meant in the basic balance) and expressed hope that the deficit in the basic balance would be eliminated in 1963.

cc: Each Board Member
Mr. Molony
Mr. Fauver
Mr. Young
Mr. Sherman
Mr. Noyes
Mr. Partee
Mr. Farrell
Mr. Hackley

STATEMENT BY THE HONORABLE ROBERT V. ROOSA
UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS
BEFORE THE HOUSE COMMITTEE ON BANKING AND CURRENCY
ON H. R. 12080
TUESDAY, JULY 10, 1962 -- 10:00 AM

Mr. Chairman and Members of the Committee:

I am happy to appear before you today in support of H.R. 12080. This bill, which implements a recommendation in the President's Message to the Congress on the Balance of Payments of February 6, 1961, would exempt from the regulatory ceilings of the Federal Reserve Board the rates of interest that may be paid by commercial banks on the time deposits of foreign governments, their central banks or other monetary authorities, and international institutions of which the United States is a member. In effect, by making possible more flexible treatment of this limited class of deposits, the bill would add another degree of freedom to the international money market which has been evolving in the United States. It would permit creative, imaginative, and competitive commercial banking to adapt more effectively to the changing demands upon the dollar, and thereby support its role as the principal international reserve currency.

The problem to which this bill is directed arises because interest rate ceilings for commercial bank time and savings deposits, familiarly known as Regulation Q, have been established primarily on the basis of domestic considerations. Those considerations are important, but, in the new world of convertible currencies and expanding foreign trade, the mold cast for our thousands of banks engaged solely in domestic business no longer fits for that part of our banking activity which represents the servicing of the monetary reserves -- that is, the dollars -- which provide the "backing" for a large part of all the other currencies now circulating in the world. The responsibilities and the opportunities of the United States in its position at the center of the world's monetary system now make it appropriate that we permit banks to pay interest at whatever rate their earnings will permit on those foreign time deposits that are a part of the monetary reserves of most of the rest of the world.

Any country's decision to hold dollars as a part of its basic international reserves is based upon a complex of interrelated factors. Interest rates alone are only one, to be sure, and they are by no means the most important factor. Underlying all else is confidence in the willingness and ability of the United States to buy gold from, and sell it to, all responsible foreign monetary authorities and to make the exchange for dollars upon demand at the established price of $35 an ounce. That commitment, in the end, must rest solidly on the enormous productive capacity of this country and the ability of our industry to compete effectively in world markets for goods and services. 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 -- facilities that 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. Whether we would have wished it or not, whether others would choose it or not, the fact is that we are the only country now capable of providing those services on the scale needed to sustain the smooth functioning of the monetary system of the free world. And, of course, we gain, directly and indirectly, lasting advantages in trade and other relations as a result of our carrying these responsibilities.

The bill we are considering today has a direct bearing on one of the kinds of services which help in maintaining the versatility and universal acceptability of the dollar -- the ability of our financial system to provide a broad range of suitable investment media for foreign funds, including particularly funds for which no immediate disbursement is contemplated but which must be placed in investment media of unquestioned safety and ready availability in time of need. Time deposits with our leading commercial banks have traditionally provided to foreigners a desirable short-term investment vehicle of this sort. 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. Moreover, they have the additional advantage of encouraging close customer-banker relationships, helping to support or assure lines of credit when needed and broadening access to a host of other banking services. If our private enterprise system, through the banks, is to perform these services with full effectiveness, it must be free to compete for reserve balances in the form of deposits -- for banking pays its way by obtaining the accounts to match the services it performs.

For all these reasons, some foreign governments and international institutions prefer to hold at least a portion of their short-term dollar holdings in the form of time deposits rather than in other, more impersonal, short-term investment media. Thus our leading commercial banks are sometimes able to attract into time deposits funds that might otherwise be transferred to other countries or exchanged for gold. Today, over $2 billion of the funds of foreign governments and international institutions are held in this form, more than three times the volume of working balances held in non-interest bearing demand deposits.

In recent years, however, the interest rate ceilings applied to all time and savings deposits by Federal Reserve and Federal Deposit Insurance Corporation regulations (under the terms of paragraph 14 of section 19 of the Federal Reserve Act and subsection (g) of section 18 of the Federal Deposit Insurance Act) have sometimes prevented commercial banks from providing a return to foreign depositors as high as they themselves would be willing to pay in the light of the profitable investment opportunities open to them and their own longer-run interest in solid customer relationships. To this extent, our commercial banks have not been able to exercise their full potential, in concert with the broader public interest, for attracting and retaining funds of official foreign institutions in this country.

The root of the difficulty is that the language of the Federal Reserve Act and the Federal Deposit Insurance Act has been carefully interpreted to mean that the interest rate ceilings set by regulation must be applied to domestic and foreign depositors alike (including foreign governments and international institutions). Distinctions may be drawn, consistent with present law, between deposits of various maturities and types, or by reason of the location of the deposit itself -- but these distinctions cannot be based on the location or the nature of the depositor. Under these circumstances, the regulatory ceilings have necessarily had to be set on the basis of broad domestic considerations that importantly affect banks throughout the country, even at the expense of inhibiting the desirable interplay of competitive market forces in attracting and holding the reserve funds of foreign countries.

This bill would make a clear distinction between all other time deposits and those of foreign governments and monetary authorities and international institutions. By permitting banks freedom to offer these governments and institutions higher rates for their dollar balances, and to undertake more aggressively a broader range of services supported by a growing volume of such deposits, the bill may also reduce the alternative attractiveness of purchasing or holding gold. And the provisions of the bill do include, of course, all foreign bodies legally entitled to purchase gold from the United States. Moreover, American banks in some instances will be able to eliminate or reduce incentives to transfer reserve funds to other financial centers, or to place them in the increasingly active market which has sprung up for dollar balances in Europe or elsewhere. The growth of this "Euro-dollar" market has, in fact, been spurred in part by the interest rate ceilings imposed on American banks operating in this country. While the effect of these transfers on our own gold and dollar position is complex -- and does not necessarily lead to a loss of gold -- it may do so if the funds end up in the hands of other central banks that, as a matter of policy, tend to place a high proportion of their reserves in gold rather than dollars.

It would be a mistake to think of this bill as a major part of our attack on our gold and balance of payments problem. It will have no direct effect on our balance of payments deficit, as such, because it will not reduce the supply of dollars passing into the hands of foreigners. It will not permit us to create for ourselves a domestic island of easy money and low interest rates for borrowers at home, while at the same time attracting funds from abroad with very high interest rates -- for no bank will be prepared to offer uniquely high rates to foreign depositors when it, itself, cannot lend or invest those funds profitably in this country. Nor can the bill, directed as it is solely toward foreign governments, foreign central banks, and international institutions, effectively influence the decisions of private individuals or businesses or banks abroad who receive dollars. They may retain such dollars or they may sell them, and only in the latter event, if their governments or central banks should acquire them, will the provisions of this bill have any potential influence.

The decision which the competitive freedom permitted the banks by this bill will influence is the final -- but critical -- choice of foreign monetary authorities between holding dollars or gold -- or perhaps another currency. The level of rates available for time deposits at American banks can be only one of many factors bearing upon this decision, and, as I have suggested, it is not likely to be the most important. For one thing, time deposits are only one of several forms in which the dollars might earn interest. Moreover, more basic considerations than the rate of return on short-term investments lie behind most judgments of foreign governments to purchase -- or to refrain from the purchase -- of gold.

Nevertheless, 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. The bill parallels and supplements the ability of the Treasury itself to tailor its own securities to meet the investment needs of foreign governments. It will complement our efforts to keep the level of short-term rates in this country reasonably attractive in comparison to those available abroad. It will assist the leading money market banks in their effort to provide to foreign governments the attractive variety of services and credit facilities that are an essential part of our responsibility as banker to the world. And it is entirely consistent with our philosophy of relying to the maximum extent possible on the forces of a free competitive market and our rejection of exchange controls and other artificial barriers and incentives to the movement of funds between countries.

In our judgment, the narrow exemption from regulation provided by this bill will create no danger that intense competition between banks for these deposits could in any way undermine the safety and stability of the banking system. Competition for these deposits is virtually confined to the larger commercial banks able to maintain a full range of costly facilities required to service foreign accounts. These banks are in a position to make informed judgments concerning the risks and returns involved in this business and, in fact, have had long experience in competing for such deposits at home and abroad. Moreover, deposits of this type will, at best, account for but a small portion of their total deposits.

Finally, I should emphasize that this bill does not represent 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. For instance, the Treasury during the past year has, on several occasions, used its authority to provide official foreign institutions with special non-marketable issues of U. S. Government debt especially tailored to their maturity requirements. The Congress last year granted to all foreign central banks tax exemption on interest earned on their holdings of U. S. Government securities -- an exemption formerly limited to foreign governments, to certain types of central banks, or to countries where exemption was provided by terms of a specific tax treaty.

These devices have been helpful, but they cannot supplant the efforts of commercial banks. Within the basic framework of free, competitive markets, both Government and private finance have a role to play. Our aim is to achieve as diversified and attractive facilities for the investment of foreign official funds as we can.

I urge your approval of this bill as a limited, but nonetheless significant, measure in support of that aim.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 3, 1962

To Merritt Sherman

From Robert L. Cardon

Subject: Testimony by Chairman Martin before House Banking and Currency Committee on H. R. 12080

Chairman Martin will be asked to testify before the full House Banking and Currency Committee on H.R. 12080, introduced by Mr. Spence. This is the legislation submitted by the administration last year to authorize commercial banks to pay higher interest rates on deposits of foreign governments and central banks. The date has not been set for Chairman Martin's appearance, but it seems likely that it will be July 16 or 17. Mr. Roosa will be the first witness and will appear on July 10. Before leaving yesterday Chairman Martin asked that work get started on preparing his statement.

You will recall the Board indicated last year to the Bureau of the Budget that they had no objection to this proposed legislation. When Chairman Martin testified earlier this year on H.R. 10162 relating to the International Monetary Fund, Mr. Patman indicated that he felt the President's proposal to allow higher interest rates on official foreign balances "would save the people billions of dollars a year," by allowing lower domestic interest rates. The exchange between Mr. Patman on this subject can be found on pages 93-95 of the Hearings on H.R. 10162(February 27 and 28, 1962).

(58)

Subcommittee No. 1 of House Committee on Banking and Currency

Brent Spence, of Ky. (Chairman)

William A. Barrett, of Pennsylvania

Henry S. Reuss, of Wisconsin.

Thomas L. Ashley, of Ohio

William S. Moorhead, of Pennsylvania

Robert G. Stephens, Jr. of Georgia

Gordon L. McDonough, of Calif.

Florence P. Dwyer, of N.J.

Seymour Halpern, of New York

William S. Scranton, of Penn.

Statement of
Wm. McC. Martin, Jr., Chairman,
Board of Governors of the Federal Reserve System,
before
Subcommittee No. 1
of the
House Committee on Banking and Currency,
on S. 1771, H. R. 8874, and H. R. 7796
July 19, 1962

My appearance today is in response to the invitation of your Chairman to present the views of the Board of Governors on S. 1771, H. R. 8874, and H. R. 7796. These bills would amend the banking laws in response to developing needs in the fields of international finance, automation, and housing.

S. 1771, relating to foreign branches of national banks

S. 1771 would authorize the Board to permit foreign branches of national banks to exercise, in addition to powers that are otherwise authorized to national banks, such further powers "as may be usual in connection with the transaction of the business of banking in the places where such foreign branches shall transact business." The bill is consistent with legislative policy already expressed in the field of foreign banking operations in that it would extend to foreign branches of national banks the same kind of flexibility that is afforded to so-called "Edge Corporations" by section 25(a) of the Federal Reserve Act. With safeguards similar to those found in section 25(a) and the Board's Regulation K, the bill would make it possible for foreign branches to compete more effectively with foreign institutions.

The Board has become increasingly aware of the difficulties that foreign branches of American banks have encountered in competing abroad, and the problem has been the subject of extensive consideration for a period of years, both within the Federal Reserve System and by others, notably your Committee, who are concerned with the role of banking in the "furtherance of the foreign commerce of the United States"--the express statutory purpose for which national banks were originally authorized under section 25 to establish branches abroad.

Business methods and operating conditions in foreign countries often differ considerably from those in this country, and banks in foreign countries are often subject to few if any of the rules that apply to national banks in this country. It is apparent that in this situation American banks may often find their effectiveness materially handicapped. I would like to emphasize, however, that I would not interpret this bill as a carte blanche for the full equalization of foreign branch powers with those of foreign banks. Apart from the fundamental limitations in the bill itself, it would not allow foreign branches to exercise any additional powers except as expressly permitted by Board regulations that would be formulated after consideration of actual conditions and with due regard for the integrity and soundness of the American banking system.

It would be extremely difficult to anticipate in comprehensive detail the various kinds of powers that might suitably be authorized under this bill in the various circumstances that may now exist or that may develop in the future. To cite a few examples, however, it has been suggested that this legislation might appropriately be used to relax some existing restrictions on the issuance of certain types of guaranties, exchange of negotiable instruments with full recourse endorsements, and acceptance financing of foreign inland shipments. Powers granted would commonly relate to the forms in which banking business is transacted, and variations in substance from the practices now permitted to national banks would be authorized only with particular circumspection.

Various provisions of section 25 of the Federal Reserve Act in its present form would assist in supervising activities that might be authorized under this bill. Although separate accounting is not required of national banks with respect to their domestic branches, the eighth paragraph of section 25 requires that every national banking association "shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office . . . ." In addition, under the sixth paragraph of section 25, "every national banking association operating foreign branches shall be required to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand . . . ."

I might point out that State member banks would share in the benefits of this legislation, to the extent permitted by State law, because the third paragraph of section 9 of the Federal Reserve Act provides that:

> ". . . nothing herein contained shall prevent any State member bank from establishing and operating branches in the United States or any dependency or insular possession thereof or in any foreign country, on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks . . . ."

S. 1771 would be beneficial to American commercial activities abroad and to the national economic interest, and its enactment would not jeopardize the fundamental character of American banking. The Board of Governors, therefore, recommends its enactment.

H. R. 8874, relating to bank service corporations

Next, I will offer some observations and suggestions concerning the bill H. R. 8874, which would authorize member banks of the Federal Reserve System to invest in "bank service corporations". As set out in its report on H. R. 8874 to your Committee, the Board favors the objective of the bill, but suggests some changes in it. The bank service corporations established under the bill would serve as a means whereby banks--and especially small and medium-size banks--and their customers could benefit from the improved efficiency and economies possible today only through automation. The operations of a bank entail a tremendous volume of data processing, such as the various kinds described in section 2(a) of the bill. At one time much of this was associated with the high desk and quill pen. Today, high speed electronic and related mechanical equipment designed to handle this work is being used by banks with increasing frequency.

Notwithstanding the high initial cost of equipment of this kind, some banks--especially the larger banks--are purchasing or leasing this equipment. Other banks are gaining access to this equipment through various contractual arrangements with data processing centers operated by private commercial concerns, and some banks that have purchased or leased this equipment are doing data processing for other banks and business concerns.

Under the bill, two or more banks would be able to pool their resources through the corporate device in order to gain the benefits--for themselves and for their customers--of this expensive equipment. This approach to the problem is not now open to member banks, because they are quite limited by the Federal banking laws as to the stock or securities that they may acquire. Of course, even if this bill is enacted, State member banks will be able to invest in bank service corporations only if authorized to do so by State law, but I understand that at least six States have recently enacted laws that specifically authorize such investments by State banks.

The Committee may be interested in some of the findings of a survey conducted by the System in March of this year concerning automation accomplishments and plans of commercial banks. This survey covered nearly all of the 975 banks with deposits of $25 million or more. In Federal Reserve Districts where interest in automation was believed to be relatively high, several hundred smaller banks also were surveyed.

Nearly 500 banks indicate that they either are already using electronic computers or some other form of automation equipment or have firm plans for automation within three years. Nearly all large banks are in this group, but the ratio of automating banks to the total number of banks falls rapidly as one moves down the scale in bank size, particularly among banks with deposits of less than $50 million. Only about one-fifth of the banks with deposits of $25-50 million have automation plans, and at smaller banks the proportion is negligible.

About one-fifth of the automating banks indicate that they are using or plan to use outside facilities for their automation operations, mainly those of an independent service bureau or a correspondent bank. Twenty-four banks, according to the survey, are planning to use some form of cooperative arrangement, despite the difficulties of doing so under present law.

I will not take the Committee's time to discuss the details of H. R. 8874 or to elaborate on the suggestions for changes which the Board set out in its report on the bill. These changes do not affect the bill's essential purpose. The Board's staff will be glad to be of all possible help to the staff of your Committee, Mr. Chairman, with respect to any of these changes.

H. R. 7796, relating to real estate loans by national banks

The third bill before you today is H. R. 7796, relating to real estate loans by national banks.

Under existing law, national banks may make construction loans on residential and farm buildings provided the maturities of such loans do not exceed nine months. These loans are classified as ordinary commercial loans and are not subject to the various limitations which, under section 24, apply to loans secured by real estate. Section 2 of H. R. 7796 would increase the permissible maturities of such loans from 9 to 18 months. This change would be helpful in meeting situations where, for some reason beyond the control of the contractor, it is not possible to complete construction within a nine-month period or where there are other unavoidable delays. National banks would continue to be limited in the aggregate amount of construction loans which may be made to 100 per cent of unimpaired capital and surplus.

Under the first paragraph of section 24 of the Federal Reserve Act, a national bank may now make real estate loans in an aggregate amount not in excess of the amount of the capital stock of the national bank paid in and unimpaired plus the amount of its unimpaired surplus funds, or not in excess of 60 per cent of the amount of its time and savings deposits, whichever is greater. Section 1 of H. R. 7796 would increase the second alternative to 70 per cent. Last year the Board reported to your Committee that it had no objection to this increase. The Board adheres to that view, but desires to call your attention to the fact that in the interim there has been a considerable increase in time and savings deposits, which may well reduce the need for relief in this form.

87th Congress, 2d Session - - - - - - House Report No. 2062

BANK SERVICE CORPORATIONS

REPORT

OF THE

COMMITTEE ON BANKING AND CURRENCY

HOUSE OF REPRESENTATIVES

EIGHTY-SEVENTH CONGRESS

SECOND SESSION

TOGETHER WITH

DISSENTING VIEWS

ON

H.R. 8874

JULY 30, 1962.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE

85006 WASHINGTON : 1962

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87TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { No. 2062

BANK SERVICE CORPORATIONS

JULY 30, 1962.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

MR. SPENCE, from the Committee on Banking and Currency, submitted the following

REPORT

together with

DISSENTING VIEWS

[To accompany H.R. 8874]

The Committee on Banking and Currency, to whom was referred the bill (H.R. 8874) to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill, as amended, do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert the matter which appears in italic in the bill herewith reported to the House.

WHAT THE BILL WOULD DO

H.R. 8874 would enable banks to utilize modern equipment through stockownership in a jointly owned service corporation. At the present time nine States have enacted legislation specifically authorizing State banks to invest in bank service corporations, and in New York and possibly other States, State banks are authorized to invest in such service corporations under general provisions of the code. However, Federal law prevents national banks and certain other federally supervised banks from sharing this privilege because of investment restrictions in the applicable Federal statutes.

The bill removes all limitations and prohibitions of Federal law exclusively relating to banks, regardless of how owned, which would otherwise prevent banks from investing up to 10 percent of their capital and surplus in bank service corporations. The bill requires that initially, at least two banks must own stock in any such corporation, but provides that if one bank ceases to own stock and participate in a bank service corporation, the remaining bank may continue to hold stock in it.

Provision is made that a bank service corporation must, if requested, furnish its services to competing banks unless comparable services at competitive cost are available to the applying banks from another source, or unless the furnishing of the services sought by the competing bank would be beyond the practical capacity of the corporation. If required to furnish such services the corporation would have the option of either issuing stock and furnishing bank services on the same basis as to other stockholders, or furnishing the services at cost (including the reasonable cost of capital). Bank service corporations are prohibited from performing more than one-half of their services for persons other than banks.

The last section of the bill provides that whenever a federally supervised bank has bank services performed for it, regardless of whether they are performed by an affiliated service corporation or by some wholly independent enterprise, the performance of such services must be subject to examination, and performed in accordance with regulations of the supervisory agencies, to the same extent as if the bank itself were performing them on its own premises. Quite apart from the investment problem dealt with in the preceding sections of the bill, it would obviously be unwise to permit banks to avoid the examination and supervision of vital banking functions by the simple expedient of farming out such functions.

THE NEED FOR THE BILL

The demand for bank services is increasing at an extremely rapid rate. Many banks have found it difficult to acquire adequate personnel to handle this mounting workload. Testimony indicated that the volume of checks in circulation has increased tremendously during the past two decades. The estimated check volume in 1939 was 3.5 billion. The volume is increasing at the rate of about one-half billion items per year. By 1970 the number of checks is expected to be at an annual rate of 22 billion. In addition to check handling there is a need for automation of other bank services. Some banks are now processing their savings accounts, computing payrolls, calculating other credits and charges, and preparing and mailing statements through the use of automatic equipment. For the majority of banks the high cost of equipment makes this impossible.

Larger banks are generally able to afford this automatic equipment, but smaller institutions find the cost prohibitive. According to a study made by the Federal Reserve System, nearly all large banks in the group they surveyed are presently using some form of automated equipment or plan to do so within the next 3 years. However, the ratio of automating banks to the total number of banks falls rapidly as one moves down the scale in bank size. Thus, it is becoming more and more difficult for smaller banks to compete with larger banks in offering complete and efficient banking services to their customers. Testimony was received which indicated unless a satisfactory means is devised whereby smaller banks may acquire benefits of automated equipment, many of them may be absorbed by larger banks.

Under this bill two or more banks would be able to pool their resources through the corporate device in order to gain the benefits of this expensive equipment for themselves and for the people in their communities.

VIEWS OF THE FEDERAL BANK SUPERVISORY AGENCIES

All of the bank supervisory agencies have submitted reports on the bill. The reports are as follows:

APRIL 26, 1962.

Hon. BRENT SPENCE,
Chairman, Committee on Ranking and Currency,
House of Bepresentatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your request for the comments of this Department on H.R. 8874, to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes.

The bill would authorize national banks, district banks, and State member banks to invest in a corporation organized to perform clerical services for two or more banks.

The Treasury Department is in accord with the objectives of the proposed legislation but feels that its scope should be extended in two respects. Clerical services are not the only services which might be performed better or at lesss cost by a service corporation. Furthermore, no reason appears why a corporation organized to provide services for a single bank should be excluded from the benefits of the proposed legislation.

The Treasury, therefore, recommends (1) that the committee give consideration to other services which a service corporation might properly be authorized to perform and (2) that such corporation be authorized to perform services for one or more.

The Department has been advised by the Bureau of the Budget that there is no objection from the standpoint of the administration's program to the submission of this report to your committee.

Sincerely yours,

ROBERT H. KNIGHT, *General Counsel.*

JULY 25, 1962.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department with respect to committee amendments to H.R. 8874, a bill to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes, as amended.

This bill would authorize national banks, district banks, member banks, or nonmember insured banks to invest an amount not in excess of 10 percent of capital and surplus in the stock of a corporation organized to perform services for two or more banks. The bill, as amended, subjects the service corporations to regulation by existing Federal banking agencies and also prescribes certain other limitations on the activities of the service corporations.

The Department prefers the original bill, which was designed to remove the impediment in existing law to investment in the stock of such service corporations. The Department believes that H.R. 8874, as amended, by incorporating a number of additional restrictions on such investment, unnecessarily limits the possibilities for banks to obtain the benefits which were intended to be afforded under the original bill. These restrictions have been discussed in detail by members of my staff and the staff of your committee. The Department will be glad to supply a memorandum setting forth its objections to the proposal, should your committee so desire.

In view of the need for the expedition of this report, it has not been possible to obtain the customary Bureau of the Budget clearance prior to its submission.

Sincerely yours,

ROBERT H. KNIGHT, *General Counsel.*

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, March 1, 1962.

Hon. BRENT SPENCE,
Chairman, Banking and Currency Committee,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your letter of August 28, 1961, asking for a report from the Board on the bill H.R. 8874, to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes. If enacted, the bill would be cited as the "Bank Service Corporation Act."

While it favors the objective of the bill, the Board wishes to emphasize the relatively new and rapidly developing field to which the bill addresses itself. Suggestions as to changes in some of the features of the bill are set forth in the latter part of this letter.

The basis for the bill is the improvements in recent years in data processing through the use of electronic and related equipment designed for that purpose. This equipment is being utilized by more and more banks. For example, some banks have purchased the equipment because, notwithstanding the high initial cost, its use makes possible operating economies and improvements in services not otherwise attainable. Other banks have service contracts with data processing centers operated by private commercial concerns. H.R. 8874 undertakes to make the benefits of such equipment available to banks through an additional device that might be attractive especially to many smaller or medium sized banks.

"Banks service corporation" is defined by the bill as "a corporation whose primary purpose is to perform for two or more banks, each of which has an investment in such corporation, services such as check and deposit sorting and posting, computation and posting of interest and other credits and charges, preparation and mailing of statements, notices, and similar items, or any other similar clerical or bookkeeping function."

H.R. 8874 would permit any national bank, any bank organized under the law of the District of Columbia, and any State bank that is a member of the Federal Reserve System and is authorized to do so under State law, to make investments in a bank service corporation, either by the purchase of its stock or by loans or advances thereto. In the absence of such an authorization, investments of this kind by member banks would be prohibited or restricted under various provisions of the Federal banking laws. But, if a State member bank had no authority under the applicable State law to invest in a bank service corporation, State enabling legislation would be necessary, notwithstanding enactment by Congress of legislation like the present bill. It is understood that enabling legislation has been enacted thus far by six States; i.e., Connecticut, Iowa, Maine, Michigan, Ohio, and Pennsylvania.

The bill limits the total amount of investments outstanding at any one time in a bank service corporation by any such bank to 10 percent of its capital and surplus, unless approved by the Comptroller of the Currency in the case of a National or a District bank, or by the Board of Governors of the Federal Reserve System in the case of a State member bank. Investments in excess of that limitation may be approved by the Federal supervisory agency concerned if, in its judgment, (1) the investment is reasonable and prudent in relation to the financial strength of the bank; (2) the corporation may be reasonably expected to effect for the bank reduced clerical costs or improvements in customer services sufficient to justify the investment; and (3) the appropriate Federal supervisory agency receives satisfactory assurances that, whenever the 10-percent limitation is exceeded, *(a)* the corporation will make such reports to the agency as it may require, and *(b)* the corporation's charter, capitalization, scope of operations, or schedule of charges for services will not be changed materially without the agency's approval.

Bank service corporation.—The definition of "bank service corporation" in section 2(a) of the bill is quoted above. As the definition recognizes, the efficiency of a bank service corporation and the resulting benefits to the investing banks might be increased in some circumstances if the corporation were not limited to serving the banks exclusively. The Board believes, however, that the definition should be changed to make it clearer that over one-half of the corporation's business would have to be that of serving the investing banks, and to limit any business of the corporation with others to serving them in the same way permissible as to banks. These suggestions might be accomplished by substituting for the language "whose primary purpose is to perform" in line 7 on page 1 of the bill, the language "(1) whose principal purpose is to perform"; and by adding at the very end of the definition new language reading "and (2) whose other purposes, if any, are limited to the performance of comparable services for others."

The definition of "bank service corporation," includes an enumeration of the services to be performed for the banks, followed by the language "or any other similar clerical or bookkeeping function." (See p. 2 of the bill, lines 2 and 3.) In order to assure the maximum benefit from the operations of a bank service corporation, it is suggested that the language just quoted be broadened to read "or any other similar clerical, bookkeeping, accounting, or statistical function related to the business of the banks."

State nonmember insured banks.—Despite the provision of the bill, section 6(a)(1) of the Bank Holding Company Act (U.S.C., title 12, sec. 1845) would continue to preclude a State nonmember insured bank that is a subsidiary of a bank holding company from investing in a bank service corporation that is also a subsidiary of the holding company and is not engaged solely in serving the holding company or its subsidiary banks. It is believed that this could be remedied by an amendment to section 3 of the bill which would include State nonmember insured banks among the banks which may invest in bank service corporations, and by an appropriate change in section 2(d) of the bill. The Board would have no objection to amendments to the bill in these respects.

Investments exceeding the 10 percent limitation.—In connection with approval by the Federal supervisory agency concerned of total investments by a bank in a bank service corporation in excess of 10 percent of the bank's capital and surplus, section 4(2) requires the agency, among other things, to be satisfied that "the corporation may reasonably be expected to provide a reduction in clerical costs, or an improvement in the services offered by the bank to its customers, or some combination thereof, which is sufficient to justify the investment." At the same time, section 4(1) would require the agency to be satisfied that "the investment is reasonable and prudent in relation to the financial strength of the bank." The Board suggests that section 4(2) be deleted. The detailed nature thereof would not only be conducive to administrative difficulties, but the provision itself is not necessary in view of the broad scope of section 4(1).

Section 4(3)(B) requires, in effect, that whenever the 10-percent investment limitation is exceeded, "no amendment shall be made to the charter, and no substantial change may be made in the [bank service] corporation's capitalization, scope of operations, or schedule of charges for services without the approval of" the Federal supervisory agency concerned. It is suggested that the language just quoted be changed to read "no substantial change may be made in the capitalization or operations of the corporation without the approval of such agency." This simplified provision would seem entirely adequate to protect the investing banks.

Reports and examinations.—Under section 4(3)(A) of the bill, the Federal supervisory agency concerned is entitled to reports from the bank service corporation whenever the bank's total investment therein exceeds the 10-percent limitation. The Board believes that the purpose of a provision for reports from a bank service corporation would be better effectuated if the provision were broadened to include also examinations of such corporations and certain regulatory safeguards, and if the provision, as so broadened, were made applicable irrespective of the 10-percent limitation. This might be accomplished by deleting section 4(3)(A) of the bill and adding at the end of section 3 a new sentence such as the following:

"No investment shall be made pursuant to this section unless the bank first obtains from the bank service corporation an agreement that it will permit examiners appointed by the Federal supervisory agency concerned to make such examination of the corporation as the agency may deem necessary, will make such reports to the agency as it may require, and will comply with such regulations as the agency may prescribe as necessary or appropriate to assure both to the bank and the corporation adequate systems of insurance protection and internal audit and control."

Relations with other data processing organizations.—As pointed out above, some banks have already availed themselves of services of the kinds contemplated by H.R. 8874 for bank service corporations, through contractual arrangements with data processing centers operated by private commercial concerns. It would seem reasonable to expect the number of such banks to increase. The Board believes that its suggestion above with respect to examinations, reports, and regulations in the case of bank service corporations should be made applicable as well to other data processing organizations serving banks. If the foregoing suggested addition to section 3 of the bill should be adopted, the latter suggestion might be accomplished by adding to the bill a new section 5 along the following lines:

"SEC. 5. No bank of a kind referred to in section 3 of this Act shall enter into any contract or other arrangement for the purpose of obtaining services described in section 2(a) of this Act from any person other than a bank service corporation, unless the bank first obtains from such person an areement of the kind required by the last sentence of section 3 of this Act. As used in this section 'person' includes an individual, corporation, partnership, association, and any other organization whether or not incorporated."

In addition to the above suggestions, the Board's staff will be glad to discuss with your staff a few minor suggestions relating solely to technical or drafting matters.

It is hoped that the foregoing may be helpful in connection with such consideration as your committee may give to H.R. 8874.

Sincerely yours,

WM. McC. MARTIN, Jr.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, July 25, 1962.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the Board's views on the substitute amendment to H.R. 8874, adopted yesterday by Subcommittee No. 1 of the House Banking and Currency Committee.

As indicated to you in the Board's report submitted under date of March 1, the Board favors the objective of this bill. The substitute amendment adopted by the subcommittee in substance would carry out the suggestions made by the Board in its earlier report, and the Board is especially pleased to note that the new bill includes in section 5 provisions that are needed to insure adequate regulation and examination of bank services performed off the bank's premises. The Board, accordingly, recommends enactment of the bill as amended.

Sincerely yours,

WM. McC. MARTIN, Jr.

FEDERAL DEPOSIT INSURANCE CORPORATION,
OFFICE OF THE CHAIRMAN,
Washington, April 25, 1962.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: The Corporation has been requested to express its views on H.R. 8874, a bill introduced in the House of Representatives on August 23, 1961, by Mr. Spence. The proposed bill would permit national banks and State member banks, when authorized by State law, to invest not exceeding 10 percent of the bank's capital and surplus, or such additional sum as might be approved by the appropriate Federal supervisory agency, in stock in a bank service corporation, established to provide clerical and bookkeeping services to the banks participating in the establishment of the corporation and in the services to be rendered by the corporation.

The capacity of the banking system, to adequately service the needs of commerce and industry, depends on its ability to expeditiously process daily a mountainous volume of paper instruments evidencing approximately 95 percent of all business transactions. The bank clearing system is under heavy strain due to the tremendous expansion in the national economy and also by reason of the very great enlargement in bank services which has taken place during the past 15 years.

The electronic computer, with related equipment, is ideally suited to the accounting needs of banks, but unfortunately is so costly that only the large banks can afford the machines. Were the small banks, and 10,000 of the 13,400 banks of the country are classed as small banks, unable to utilize the electronic computer because of cost, they would be placed at a serious disadvantage and ultimately have to become a part of a larger banking system in order to survive.

Fortunately, the great speed and capabilities of computers make it possible for one installation to perform the accounting function for several smaller banks located within a county or regional area possessed of good communications. By sharing the expense, two or more banks may enjoy the benefits of a computer system on a par with large banks. For these reasons we should recommend that national banks, and insured State banks when authorized by State law, be enabled to invest in bank service corporations up to 10 percent of the bank's capital and surplus, without prior approval of Federal bank supervisory agencies, and to such additional amount, and under such conditions, as the Federal bank supervisory agencies may permit.

The Corporation endorses in principle the proposal outlined in the subject bill. However, it offers for consideration the following amendments thereto that appear to improve the proposal:

(*a*) For purposes of more accurately defining the functions of the bank service corporation, it is recommended that the word "accounting" be added to line 2 of page 2 (sec. 2(a)) between the words "clerical" and "or."

(*b*) The definition of Federal supervisory agency at line 11 through line 15 on page 2 (sec. 2(d)) should be expended to include the Federal Deposit Insurance Corporation for insured State nonmember banks.

(*c*) The authorization appearing in section 3 on page 2 should be extended to include "any insured State nonmember bank."

(*d*) There should be added a new section—"Section 5"—which would provide for the examination, visitation and supervision by State and Federal bank supervisory authorities to the same extent as the banks, or any of them, which are serviced by the bank service corporation, are subject.

(*e*) There should be added another new section, which should provide that no insured bank could contract for services, such as those provided by a bank service corporation, unless the servicing party agrees to and, in fact, does permit the State and Federal bank supervisory authorities to exercise the right of visitation in the same manner and to the same extent as contemplated in the preceding paragraph.

With these amendments, the Corporation would favor the bill's enactment. We would be glad to have our Legal Division assist your staff in drafting the provisions of these amendments, if they meet with your approval.

We have been advised by the Bureau of the Budget that it has no objection to the submission of this report from the standpoint of the administration's program.

Sincerely yours,

ERLE COCKE, Sr., *Chairman.*

FEDERAL DEPOSIT INSURANCE CORPORATION,
OFFICE OF THE CHAIRMAN,
Washington, July 24, 1962.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. SPENCE: In accordance with your request, we have examined the committee print of H.R. 8874, dated July 24, 1962, as amended by Subcommittee No. 1, a bill to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes, and recommend its enactment.

Sincerely yours,

ERLE COCKE, Sr., *Chairman.*

DISSENTING VIEWS OF HON. WRIGHT PATMAN AND HON. HENRY B. GONZALEZ

We dissent to H.R. 8874 on seven grounds:

(1) The bill raises serious problems under the antitrust laws and may open the door to restraints of trade, price fixing, and bank mergers. This very important question was not raised in the hearings. We are presenting an opinion of Judge Lee Loevinger, Assistant U.S. Attorney General, Antitrust Division, Department of Justice, herewith, that is convincing that further study be given this proposal.

(2) Inadequate hearings were held to guide us in this very new pioneering venture. More time should be given for developments and experience.

(3) Billions of dollars are involved in this bill that is presented in very short hearings where limited information was presented and where few questions were asked. This is a bonus to the banks since it allows 10 percent of their capital funds to perform double duty. Banks' capital can also be diluted by investments in small business investment companies. Capital funds are sacred and should be carefully guarded.

(4) No foundation has been laid for the necessity for banks to *invest* in service corporations as the only means of securing the advantages of electronic clerical services.

(5) The bill as written is tailormade to benefit particularly branch and holding company banking.

(6) Banks should not be permitted to dilute their capital structure in this fashion, when the banks already complain about inability to make loans because of insufficient capital.

(7) It is doubted that small or independent banks will permit even friendly competitors to have access to their confidential transactions and business, so we can reasonably expect that only branch and holding company banks will utilize the provision, with the result that they will have an advantage over their small and independent competitors. The bill thus would have consequences which its sponsors claim they are preventing.

BILL RAISES SERIOUS QUESTIONS UNDER THE ANTITRUST LAWS

The committee might well have elicited testimony from the Chief of the Antitrust Division of the Department of Justice to explore the possibility of problems this bill might create under the antitrust laws. Mr. Patman undertook to ask Judge Loevinger about this and received the following reply—which speaks quite eloquently of the problems this bill might raise:

JULY 27, 1962.

Hon. WRIGHT PATMAN,
House of Representatives, Washington, D.C.

DEAR CONGRESSMAN PATMAN: This is in reply to your request for my views on the possible antitrust consequences of H.R. 8874, a bill to authorize certain banks to invest in corporations whose purpose is to provide clerical services for them, and for other purposes.

While I do not disagree with the basic objectives of this bill, you may wish to consider possible abuses which might raise questions under the antitrust laws.

The exchange of confidential business information among competitors carries with it the possibility that such information will be used for anticompetitive purposes. Thus the exchange of information concerning interest rates and charges to particular customers could result in an elimination of competition for the account and an artificial stabilization of interest rates at noncompetitive levels. Past experience has illustrated that such anticompetitive results have in fact occurred in the operation of many bank clearing house associations. To avoid this possibility, it would be desirable to provide that no information furnished to the service corporation may be made available to participating banks other than the bank directly involved.

Moreover, such jointly owned corporations could become vehicles through which large banks could enhance their dominant position in the market. Competition in the offering of services is one of the most important types of competition which the antitrust laws seek to preserve. Frequently, service competition is the principal means by which small businesses, including banks, are able to attract and maintain business. Any diminution in the incentives to small banks to engage in competition of this type would be of serious concern to the Department of Justice.

In view of the fact that the formation of such corporations is not exempted from the antitrust laws, any antitrust violations occurring in the operation of the service corporations would, of course, be subject to prosecution by the Department of Justice. If, for example, the acquisition of stock in any of these corporations should substantially lessen competition or tend to create a monopoly, section 7 of the Clayton Act would be fully applicable.

Time has not permitted a detailed analysis of the bill or coordination of these views either within the Department or with the Bureau of the Budget. However, I hope that these observations may be of some help in your consideration of this matter.

Sincerely,

LEE LOEVINGER,
Assistant Attorney General,
Antitrust Division.

Judge Loevinger raises the question about the possible "exchange of confidential business information among competitors" and the possibility that this procedure might "be used for anticompetitive purposes."

This is obviously a serious matter, as witness the statement made by Mr. Wolcott:

> The bank service corporation will have in its possession records and data of two or more banks, *confidential in nature*

> *and vital to the banks' operations.* For that reason the supervisory agency must be put in a position of immediate control of any conduct by the bank service corporation constituting a violation of any provision of the bill or of any regulation thereunder.[1] [Emphasis added.]

Thus, both the supervisory agencies and the Antitrust Division would, under this bill, be required to undertake additional burdens; namely, to observe very carefully the conduct of any bank service corporation, to determine whether they would involve any violations of law.

Judge Loevinger speaks of the danger of jointly owned corporations becoming:

> * * * vehicles through which large banks could enhance their dominant position in the market.

He also stresses that:

> Competition in the offering of services is one of the most important types of competition which the antitrust laws seek to preserve.

Further, he notes that:

> Frequently, service competition is the principal means by which small businesses, including banks, are able to attract and maintain business. Any diminution in the incentive to small banks to engage in competition of this type would be of serious concern to the Department of Justice.

Finally, Judge Loevinger points to the danger of monopolistic mergers. There is a tremendous merger movement underway among banks. The growing monopoly of money and credit—the lifeblood of our economy—poses an ominous threat particularly to opportunities for small business. The Congress should not take steps to accelerate this trend.

HEARINGS INADEQUATE FOR SUCH A PIONEERING VENTURE

H.R. 8874 would permit any two or more National banks and State member banks, when authorized by State law, to invest not exceeding 10 percent of each bank's capital and surplus in stock of a bank service corporation, established to provide clerical and bookkeeping services.

The hearings were exceedingly brief. Testimony was heard from the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and a Director of the Federal Deposit Insurance Corporation (Mr. Wolcott). Statements were also filed by counsel of the Connecticut Bankers Association and by the executive vice president of the Massachusetts Bankers Association. Very few questions were raised by committee members. Comptroller of the Currency Saxon termed the bill:

> * * * purely a technical, procedural one in essence, and intended primarily to meet the requirements of smaller institutions.[2]

[1] Hearings on H.R. 8874, p. 47.
[2] Hearings, p. 40.

He commented further that:

The proposal is not an earthshaking thing * * *.[3]

Comments of the banking officials notwithstanding, this is a serious pioneering venture for banks into nonbanking fields. More thorough testimony should be elicited and more time should be given for development and experience in this area before taking the major step the bill provides.

BANKS SHOULD NOT BE PERMITTED TO DILUTE CAPITAL STRUCTURE

It need hardly be documented, in view of the complaints we have heard in increasing volume in recent years, that banks—particularly small banks—feel that their capital ratios are inadequate. It is contended that inadequate capital ratios are an impediment to making much needed loans.

The 1961 Annual Report of the Federal Deposit Insurance Corporation, a copy of which I have just received, reveals a further decline in the capital ratio of insured banks. This is shown by the following tabulation:

Ratio of total capital accounts to total assets other than cash and U.S. Government obligations (percent), of all insured banks in the United States, Dec. 31, 1958, through Dec. 30, 1961.

Call dates:	*Percentage*
Dec. 31, 1958	14.1
June 10, 1959	13.9
Dec. 31, 1959	13.5
June 15, 1960	13.6
Dec. 31, 1960	13.7
Apr. 12, 1961	13.9
June 30, 1961	13.9
Sept. 27, 1961	13.9
Dec. 30, 1961	13.6

Source: Annual Report of the Federal Deposit Insurance Corporation, 1961, p. 107.

As shown above, the ratio of capital accounts to total assets other than cash and U.S. Government obligations has declined in recent years. As of December 30, 1961, it stood at 13.6 percent as compared with 14.1 percent at the end of 1958. During this same interval, total loans and discounts (net) of all insured banks rose from $117 billion at the end of 1958 to over $150 billion at the end of 1961.

That investment in service corporations will dilute the capital structure of banks is reflected in the efforts of the Comptroller of the Currency to raise the effective limit to 25 percent.

Already, the capital funds of the banks are doing double duty, since they can be diluted by investments in small business investment companies.

[3] Ibid.

QUESTION NOT EXPLORED AS TO WHETHER BANKS COULD SECURE ELECTRONIC CLERICAL SERVICES WITHOUT INVESTING IN SERVICE CORPORATIONS

Were this a matter simply of enabling banks to secure the cost-saving benefits of electronic devices, it would not cause any great concern. However, it is in the means of securing such services that serious problems arise. Is it essential that banks secure an ownership interest in a service corporation in order to have the benefit of electronic services? No testimony was heard on this point. The matter was not raised by any of the members of the committee.

The limited testimony was to the effect that only by being permitted to join together with other banks and investing in service corporations would the smaller banks be able to secure the cost-saving efficiency of electronic bookkeeping.

Mr. Wolcott testified:

> The electronic computer, with related equipment, is ideally suited to the accounting needs of banks, but unfortunately is so costly that only the large banks can afford the machines. If the small banks, and 10,000 of the 13,400 banks of the country are small banks (under $10 million), were unable to utilize the electronic computer because of cost, they would be placed at a serious disadvantage.
>
> Fortunately, the great speed and capabilities of computers make it possible for one installation to perform the accounting function for several smaller banks located within a county or regional area possessed of good communications. By sharing the expense, two or more banks may enjoy the benefits of a computer system on a par with large banks * * *.[4]

Mr. Saxon stated:

> Many of them singly lack the capital required to undertake these extensive programs in view of the cost of the equipment.[5]

Mr. Martin stated:

> Under the bill, two or more banks would be able to pool their resources through the corporate device in order to gain the benefits—for themselves and for their customers—of this expensive equipment.[6]

Electronic devices have been so publicized in recent years that one would think that nothing can be done without them. They are thought to be so efficient and so magnificent that merely to suggest their use is to induce enthusiasm. Maybe this is the reason why no questions were raised as to whether the only way banks could utilize such electronic equipment would be to own them. But this overlooks a very important fact; namely, that the major electronic companies provide these services through their own service bureaus. It is not necessary to own the equipment. Indeed, it is rare that the more expensive computers are purchased. It would be most uneconomical

[4] Hearings, p. 46.
[5] Id., p. 40.
[6] Id., p. 34.

to own some of the more expensive machines unless the load factor were extremely heavy.

In short, until it is demonstrated that electronic clerical services can be secured only through the *owning* of service corporations, banks should not be permitted to join together for this purpose. Moreover, we should have some information as to the number of people in small communities that might be thrown out of work by the introduction of these electronic services.

BILL BENEFITS BANK HOLDING COMPANIES AND BRANCH BANKS

It is clear that the great beneficiaries of this bill are the bank holding companies and the branch banks. They are the ones who have the financial resources to undertake investment in service corporations. But more significant, the independent banks guard carefully information on their confidential accounts. Once other banks gain access to such information, the way is paved for overt merger, bank holding company takeover, or covert branching.

It is significant that no testimony was heard on H.R. 8874 from representatives of the small banks. The Independent Bankers Association did not testify on behalf of the bill. We have not received a single letter from banks in our districts recommending that the bill be passed.

In view of the serious questions raised by H.R. 8874, it is our sincere belief that it should be rejected.

Respectfully submitted.

WRIGHT PATMAN.
HENRY B. GONZALEZ.

○

87TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { No. 2047

NATIONAL BANK BRANCHES IN FOREIGN COUNTRIES

JULY 27, 1962.—Referred to the House Calendar and ordered to be printed

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

REPORT

[To accompany S. 1771]

The Committee on Banking and Currency, to whom was referred the bill (S. 1771) to improve the usefulness of national bank branches in foreign countries, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE OF BILL

S. 1771 would add a new paragraph to section 25 of the Federal Reserve Act so as to authorize the Federal Reserve Board to issue regulations which would permit foreign branches of national banks to exercise, in addition to powers which they may exercise under other provisions of law, such further powers as are usual in connection with banking operations in the places where the foreign branches transact business. The bill specifically provides also that such regulations could not authorize a foreign branch to engage in any business in goods, wares, or merchandise; nor in the business of underwriting, selling, or distributing securities except to such limited extent as the Board may deem necessary with respect to securities issued by any foreign state, or political subdivision thereof.

NEED FOR LEGISLATION

In the legislative recommendations of the Federal supervisory agencies to the Senate Committee on Banking and Currency (committee print, 84th Cong., 2d sess.) the Federal Reserve Board expressed the opinion that legislation which was similar to this bill would reduce the obstacles to effective competition by national banks abroad by permitting the powers of foreign branches to be adjusted more realistically to the conditions existing in places where they are located, while at the same time providing suitable safeguards to assure that such foreign branches would not engage in such business as investment banking or manufacturing.

The Board of Governors has also expressed the opinion that through the regulatory authorization of certain limited kinds of guaranties, repurchase agreements, acceptance financing, real estate loans, and other practices usual to the banking business abroad but restricted under existing laws relating to national banks, the activities of foreign branches of national banks abroad may be greatly facilitated, under appropriate regulations, without jeopardizing the integrity of American banking.

Testimony from representatives of national banks having a considerable number of foreign branches indicated that their branches were primarily engaged in the financing of import and export transactions. They advised your committee that American banks operating branches in foreign countries are at a competitive disadvantage with local banks or banks of other foreign countries if the American branches cannot perform the banking functions that are normal in the country where such branches are located.

A representative of one of the largest American banks engaged in international banking advised that their experience over a period of approximately 45 years demonstrated clearly that the establishment of foreign branches under section 25 of the Federal Reserve Act has furthered the foreign commerce of the United States. This witness further stated such foreign branches of American banks have served as important factors in stimulating development in those countries and in serving the interests of our Government there. Notwithstanding this good experience in the past the witness testified that foreign branches could do a still better job if this bill is passed.

BANK SUPERVISORY AGENCIES

All of the bank supervisory agencies in formal reports have reported favorably on the bill.

The committee wishes to make clear to the Federal regulatory agency involved that it does not believe nor intend that this legislation should offer any opportunity for tax evasion. Additionally the committee requests that in the implementation of this legislation by regulation that every effort be made to guard against the creation of any such opportunities.

CONCLUSION

The committee wants to take constructive action to increase the exports of this country because it believes that expanded American exports are the best single method of enabling this country to achieve relative balance in its international payments and thereby protect its gold reserve. This bill is a right step in that direction. No objections to the bill have been made known to the committee.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, September 11, 1961.

Hon. BRENT SPENCE,
Chairman, Banking and Currency Committee,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: It is our understanding from Mr. Robert L. Cardon, clerk and general counsel of your committee, that you would like to have a report from the Board on the bill, S. 1771, now pending before your committee.

S. 1771 would amend section 25 of the Federal Reserve Act to permit the Board of Governors of the Federal Reserve System by regulations to authorize foreign branches of national banks to exercise, in addition to powers which they may exercise under other provisions of law, "such further powers as may be usual" in connection with the business of banking in the places where such branches transact business. The exercise of such additional powers would be subject to such conditions as the Board's regulations might prescribe, and the regulations could not authorize a foreign branch to engage in a general business in goods, wares, or merchandise, nor in the business of underwriting, selling, or distributing securities.

S. 1771 is virtually identical to section 44(f) of title II of S. 1451 (85th Cong.), the "Financial Institutions Act of 1957," which passed the Senate on March 21, 1957. In recommending such an amendment in 1956, the Board of Governors expressed the opinion that it would reduce the obstacles to effective competition by national banks abroad. (Legislative recommendations of the Federal supervisory agencies to the Senate Committee on Banking and Currency, Oct. 12, 1956 (committee print, 84th Cong., 2d sess.), pp. 111–112.)

The Board of Governors continues of the opinion that such legislation is desirable "for the furtherance of the foreign commerce of the United States," the express purpose for which national banks were originally authorized to establish branches abroad (12 U.S.C. 601). Accordingly, the Board of Governors recommends the passage of S. 1771.

Sincerely yours,

WM. MCC. MARTIN, JR.

SEPTEMBER 14, 1961.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

MY DEAR MR. CHAIRMAN: Reference is made to your request for a report on S. 1771, a bill to improve the usefulness of national bank branches in foreign countries.

The proposed bill would permit the Board of Governors of the Federal Reserve System to issue regulations to authorize foreign branches of national banks to exercise powers which are usual in connection with the transaction of the business of banking in the places where the foreign branches transact business. This legislation is necessary because in some places foreign branches of national banks cannot exercise powers normally incident to banking in these places and, therefore, cannot serve to the fullest extent possible the banking needs of their customers. For example, national banks are limited in their authority to guarantee obligations of others, whereas in some foreign countries this is a usual and necessary activity of banking institutions. The proposed legislation would enable the Board of Governors of the Federal Reserve System to permit foreign branches of national banks to engage in this activity and other similar activities to the extent and subject to whatever safeguards are deemed necessary.

It is the view of this Department that the proposed legislation will benefit the national banking system and the interests of the United States abroad, and that it will help to carry out the original purpose for which national banks were authorized to establish foreign branches. Accordingly, the Treasury Department favors the proposed legislation and urges its enactment.

The Department was advised by the Bureau of the Budget that there was no objection from the standpoint of the administration's program to the submission of an identical report on this bill to the Senate committee.

Very truly yours,

ROBERT H. KNIGHT,
General Counsel.

FEDERAL DEPOSIT INSURANCE CORPORATION,
OFFICE OF THE CHAIRMAN,
Washington, September 11, 1961.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Mr. Cardon of your staff has requested that the Corporation submit to your committee its views on S. 1771, a bill which has as its overall purpose the improvement of the usefulness of national bank branches in foreign countries.

The proposed bill would permit the Board of Governors by regulations to authorize branches of national banks in foreign countries, or dependencies or insular possessions of the United States, to exercise such additional powers as may be usual in connection with the business of banking in the places where the foreign branches are transacting business, subject to conditions and requirements prescribed in such regulations. Such regulations may not authorize a foreign branch to engage in the production, distribution or sale of goods or in the investment banking business except as the Board of Governors may deem to be necessary with respect to securities issued by any foreign government or any department, district, province, county, possession, or other similar governmental organization or subdivision of a foreign government and any agency or instrumentality thereof.

National banks with capital and surplus of $1 million or more are now authorized, with the approval of the Board of Governors and upon such conditions and under such regulations as the Board may prescribe, to establish branches in foreign countries or dependencies or insular possessions of the United States for the furtherance of foreign commerce of the United States. National banks with the same approval may invest an amount up to 10 percent of their capital stock and surplus in the stock of one or more banks or corporations chartered under the laws of the United States or any State thereof and principally engaged in international or foreign banking or banking in a dependency or insular possession of the United States. The Board of Governors has also power from time to time to increase or decrease the number of places where such banking operations may be carried on (12 U.S.C. 601–604).

The Board of Governors is now authorized to approve the establishment of corporations under the laws of the United States to do a foreign banking business (12 U.S.C. 611–631). Among the stated powers of such a foreign banking corporation is the right "to exercise such powers * * * as may be usual, in the determination of the Board of Governors of the Federal Reserve System, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein" (12 U.S.C. 615).

The Corporation supports the views expressed by the Board of Governors on this proposal to the effect that the powers of foreign branches of national banks should be adjusted more realistically to the conditions existing in foreign countries to enable foreign branches to operate and compete more effectually in the countries where they do business. As examples, the Board has pointed out that foreign branches of national banks, unlike the banks in some foreign countries, may not give guarantees for the payment of customs duties, or for the payment of funds when specified deliveries are made or other transactions performed and may not accept drafts for shipments within the foreign country, in which it is located, even though they may accept drafts for shipments within the United States. Such disparities would seem to impair the usefulness and competitive strength of foreign branches of national banks. Under the proposed bill the Board of Governors could permit guarantees in certain circumstances and also relieve foreign branches of restrictions that apply to operations at home but are not appropriate abroad. The Board has indicated that the broader powers it would grant would be limited to established commercial banking practices in the particular foreign country and kept within prudent limits.

The Corporation approves this proposal and endorses its enactment.

We have been advised by the Bureau of the Budget that it has no objection to the submission of this report from the standpoint of the administration's program.

Sincerely yours,

Erle Cocke, Sr., *Chairman.*

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 (new matter is printed in italics, existing law in which no change is proposed is shown in roman):

SECTION 25 OF THE FEDERAL RESERVE ACT

FOREIGN BRANCHES

SEC. 25. Any national banking association possessing a capital and surplus of $1,000,000 or more may file application with the Board of Governors of the Federal Reserve System for permission to exercise, upon such conditions and under such regulations as may be prescribed by the said board, either or both of the following powers:

First. To establish branches in foreign countries or dependencies or insular possessions of the United States for the furtherance of the foreign commerce of the United States, and to act if required to do so as fiscal agents of the United States.

Second. To invest an amount not exceeding in the aggregate ten per centum of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United States or of any State thereof, and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions.

Until January 1, 1921, any national banking association, without regard to the amount of its capital and surplus, may file application with the Board of Governors of the Federal Reserve System for permission, upon such conditions and under such regulations as may be prescribed by said board, to invest an amount not exceeding in the aggregate 5 per centum of its paid-in capital and surplus in the stock of one or more corporations chartered or incorporated under the laws of the United States or of any State thereof and, regardless of its location, principally engaged in such phases of international or foreign financial operations as may be necessary to facilitate the export of goods, wares, or merchandise from the United States or any of its dependencies or insular possessions to any foreign country: *Provided, however*, That in no event shall the total investments authorized by this section by any one national bank exceed 10 per centum of its capital and surplus.

Such application shall specify the name and capital of the banking association filing it, the powers applied for, and the place or places where the banking or financial operations proposed are to be carried on. The Board of Governors of the Federal Reserve System shall have power to approve or to reject such application in whole or in part if for any reason the granting of such application is deemed inexpedient, and shall also have power from time to time to increase or decrease the number of places where such banking operations may be carried on.

Every national banking association operating foreign branches shall be required to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and every member bank investing in the capital stock of banks or corporations described above shall be required to furnish information concerning the condition of such banks or corporations to the Board of Governors of the Federal Reserve System upon demand, and the Board of Governors of the Federal Reserve System may order special examinations of the said branches, banks, or corporations at such time or times as it may deem best.

Before any national bank shall be permitted to purchase stock in any such corporation the said corporation shall enter into an agreement or undertaking with the Board of Governors of the Federal Reserve System to restrict its operations or conduct its business in such manner or under such limitations and restrictions as the said board may prescribe for the place or places wherein such business is to be conducted. If at any time the Board of Governors of the Federal Reserve System shall ascertain that the regulations prescribed by it are not being complied with, said board is hereby authorized and empowered to institute an investigation of the matter and to send for persons and papers, subpoena witnesses, and administer oaths in order to satisfy itself as to the actual nature of the transactions referred to. Should such investigation result in establishing the failure of the corporation in question, or of the national bank or banks which may be stockholders therein, to comply with the regulations laid down by the said Board of Governors of the Federal Reserve System, such national banks may be required to dispose of stock holdings in the said corporation upon reasonable notice.

Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accrued at each branch as a separate item.

Regulations issued by the Board of Governors of the Federal Reserve System under this section, in addition to regulating powers which a foreign branch may exercise under other provisions of law, may authorize such a foreign branch, subject to such conditions and requirements as such regulations may prescribe, to exercise such further powers as may be usual in connection with the transaction of the business of banking in the places where such foreign branch shall transact business. Such regulations shall not authorize a foreign branch to engage in the general business of producing, distributing, buying or selling goods, wares, or merchandise; nor, except to such limited extent as the Board may deem to be necessary with respect to securities issued by any "foreign state" as defined in section 25(b) of this Act, shall such regulations authorize a foreign branch to engage or participate, directly or indirectly, in the business of underwriting, selling, or distributing securities.

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87TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { No. 2048

REAL ESTATE AND CONSTRUCTION LOANS APPLICABLE TO NATIONAL BANKS

JULY 27, 1962.—Referred to the House Calendar and ordered to be printed

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

REPORT

[To accompany H.R. 7796]

The Committee on Banking and Currency, to whom was referred the bill (H.R. 7796) to amend certain lending limitations on real estate and construction loans applicable to national banks, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE OF BILL

The first section of H.R. 7796 would amend the first paragraph of section 24 of the Federal Reserve Act. Under this paragraph a national bank may now make real estate loans secured by first liens in an aggregate amount not in excess of its paid-in and unimpaired capital stock plus its unimpaired surplus funds, or not in excess of 60 percent of the amount of its time and savings deposits, whichever is greater. The bill would increase the second alternative limit, i.e., 60 percent of a national bank's time and savings deposits, to 70 percent of its time and savings deposits.

The second section of the bill would amend the third paragraph of section 24 of the Federal Reserve Act which regulates the making of construction loans for industrial and commercial buildings and residential and farm buildings. Under existing law construction loans on industrial and commercial buildings are limited to maturities of 18 months or less; construction loans on residential and farm buildings, however, are limited to maturities of 9 months or less. The amendment would increase the limitation on maturities for construction loans on residential and farm buildings to 18 months or less.

REAL ESTATE LOANS

The present aggregate limitation for a national bank with regard to the amount of conventional real estate loans it may make has been the law since 1935. Since that time many things have changed in the field of real estate financing. The most notable change has been the development of and almost universal use of the amortized loan. An amortized loan is considered to be a much safer investment for the bank and generally a much better form of repayment for the borrower than what was available prior to the development of this type of financing. Also the commercial banks' interest in residential mortgages has increased greatly in recent years partly because of the development and use of the amortized loan and partly because of a need for banks to be more effective in meeting the real estate mortgage needs of their communities.

Your committee believes that the simple amendment contained in the bill (which increases the aggregate real estate loan limitation from 60 to 70 percent of a bank's time and savings deposits) would add substantially to the mortgage investment potential of national banks. The witness for the American Bankers Association estimated such increased mortgage investment potential at about $4 billion. Since the three bank supervisory agencies have reported favorably on this legislation and the hearings indicate that the proposed increase in the aggregate limitation on real estate loans could be made without undue risk to the banks and their depositors and because of the great need for additional sources of mortgage credit, your committee believes the amendment should be adopted.

CONSTRUCTION LOANS

As heretofore indicated, construction loans on residential and farm buildings under existing law may not exceed 9 months and the bill would increase this maximum maturity limitation to 18 months.

Testimony received by the committee disclosed that the proposed change in the law is desirable since experience has shown that often conditions beyond the control of the builder have delayed completion of the construction beyond the now maximum limitation of 9 months. Such testimony cited delays of 6 to 8 weeks in order to obtain a commitment for a governmental guarantee or insurance. The report of the Chairman of the Federal Deposit Insurance Corporation states:

> * * * in many instances the construction work financed by residential and farm loans has, because of weather conditions and other conditions which do not affect the risk of the loan, not been completed within the 9 months limit * * *.

Each of the bank supervisory agencies, as well as the Federal Home Loan Bank Board has reported favorably on the bill. The reports are as follows:

TREASURY DEPARTMENT,
July 31, 1961.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to your inquiry of June 23, 1961, requesting a report on H.R. 7796, a bill to amend certain lending limitations on real estate and construction loans applicable to national banks.

The bill would amend present law to enable national banks to make real estate loans in aggregate sums not in excess of 70 percent of the amount of time and savings deposits instead of the present limit of 60 percent, and to permit construction loans to be made on residential or farm buildings for periods not to exceed 18 months instead of the present limit of 9 months.

This Department has no objection to the passage of the proposed legislation.

The Department has been advised by the Bureau of the Budget that there is no objection from the standpoint of the administration's program to the submission of this report to your committee.

Sincerely yours,

ROBERT H. KNIGHT, *General Counsel.*

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
Washington, July 14, 1961.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your letter of June 23, 1961, requesting a report on the bill, H.R. 7796, which would amend section 24 of the Federal Reserve Act in order to liberalize lending limitations on real estate and construction loans by national banks.

Under the first paragraph of section 24 a national bank may now make real estate loans in an aggregate amount not in excess of the amount of the capital stock of the national bank paid in and unimpaired plus the amount of its unimpaired surplus funds, or not in excess of 60 percent of the amount of its time and savings deposits, whichever is greater. H.R. 7796 would increase the second alternative to 70 percent.

Under the third paragraph of section 24 loans by national banks to finance the construction of residential or farm buildings, maturing in not more than 9 months, are not subject to the limitations and requirements of that section applicable to "loans secured by real estate." H.R. 7796 would increase the permissible maximum maturity on such loans to 18 months.

This is to advise that the Board has no objection to favorable consideration of the bill.

Sincerely yours,

C. CANBY BALDERSTON,
Vice Chairman.

FEDERAL DEPOSIT INSURANCE CORPORATION,
OFFICE OF THE CHAIRMAN,
Washington, August 18, 1961.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Receipt is acknowledged of your communication requesting a report from the Corporation on H.R. 7796, a bill which you have introduced to amend certain lending limitations on real estate and construction loans applicable to national banks.

Under present law the limit applicable to national banks relating to the making of real estate loans secured by first liens upon improved real estate is the amount of the bank's paid-in and unimpaired capital stock plus its unimpaired surplus fund, or 60 percent of its time and savings deposits, whichever is greater. The first section of the proposal would increase the limit from 60 to 70 percent. We are advised that a survey conducted by the American Bankers Association has revealed that approximately 12 percent of the national banks surveyed have reached or are approaching their present lending limitation, as it relates to the ratio to time and savings deposits. It is the view of the Corporation that the lending limits of national banks may be increased as proposed in this section of the bill without undue risk to the banks and their depositors.

Section 2 of the bill proposes to liberalize the rules in reference to temporary construction loans for residential or farm buildings. Under present law loans having maturities of 9 months or less to finance the construction of residential or farm properties are not considered to be loans secured by real estate. The current proposal would change the maturity limitation on such loans to 18 months. We are advised that the basis for this extension is the fact that banks have learned from experience that in many instances the construction work financed by residential and farm loans has, because of weather conditions and other conditions which do not affect the risk of the loan, not been completed within the 9 months' limit and, therefore, it is deemed appropriate that this extension be granted. An 18 months' provision is in the statute for construction loans on industrial and commercial buildings, provided that there is a "takeout" agreement. Notwithstanding the proposal offers some hazard to the soundness of insured banks, we, nevertheless, conclude that the proposal provides a flexibility to bank lending operations that will better enable such lending institutions to provide funds for construction operations throughout the country. The extension of time for maturity of construction loans is reasonable and is justified by experience. The present and continuing prohibition against national banks making construction loans in the aggregate, commercial as well as residential and farming, in excess of the unimpaired capital stock and the surplus of the lending bank provides a restriction against an excessive volume of construction loans in any bank. The Corporation believes that the liberalization of the lending requirements in the bill would not be detrimental to national banks or their depositors.

Accordingly, the Corporation would interpose no objection to the enactment of this bill.

We have been advised by the Bureau of the Budget that it has no objection from the standpoint of the administration's program to the submission of this report.

Sincerely yours,

ERLE COCKE, Sr., *Chairman.*

FEDERAL HOME LOAN BANK BOARD,
Washington, D.C., July 26, 1962.

Hon. BRENT SPENCE,
Chairman, House Banking and Currency Committee,
House of Representatives,
New House Office Building, Washington, D.C.

DEAR CONGRESSMAN SPENCE: In accordance with the request of your office, we are pleased to present our views on H.R. 7796. We are fully in accord with the amendment to section 24 of the Federal Reserve Act provided in the bill.

In our opinion, enactment of this legislation would make for more effective participation by national banks in the mortgage market without detracting from the safety or soundness of commercial banks.

Sincerely,

JOSEPH P. MCMURRAY, *Chairman.*

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):

THE FOURTH SENTENCE OF THE FIRST PARAGRAPH AND THE FIRST SENTENCE OF THE THIRD PARAGRAPH OF SECTION 24 OF THE FEDERAL RESERVE ACT (12 U.S.C. 371)

* * * No such association shall make such loans in an aggregate sum in excess of the amount of the capital stock of such association paid in and unimpaired plus the amount of its unimpaired surplus fund, or in excess of [60] *70* per centum of the amount of its time and savings deposits, whichever is the greater. * * *

* * * * * * *

Loans made to finance the construction of industrial or commercial buildings and having maturities of not to exceed eighteen months where there is a valid and binding agreement entered into by a financially responsible lender to advance the full amount of the bank's loan upon completion of the buildings and loans made to finance the construction of residential or farm buildings and having maturities of not to exceed [nine] *eighteen* months, shall not be considered as loans secured by real estate within the meaning of this section but shall be classed as ordinary commercial loans whether or not secured by a mortgage or similar lien on the real estate upon which the building or buildings are being constructed: *Provided*, That no national banking association shall invest in, or be liable on, any such loans in an aggregate amount in excess of 100 per centum of its actually paid-in and unimpaired capital plus 100 per centum of its unimpaired surplus fund. * * *

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Chairman Martin

August 30, 1962

To Board of Governors

From Robert L. Cardon

Subject: Hearing before Senate Banking and Currency Committee on H.R. 7796, H.R. 8874, H.R. 12577, and H.R. 12899.

The Senate Committee on Banking and Currency heard several witnesses this morning on four bills: H.R. 7796, relating to real estate loans by national banks; H.R. 8874, authorizing banks to invest in bank service corporations; H.R. 12577, transferring control over trust powers of national banks to the Comptroller of the Currency; and H.R. 12899, relating to retention of branches on conversion to a national bank or mergers resulting in national banks.

Comptroller of the Currency Saxon was the lead-off witness, and at one time or another during his appearance seven Senators were present: Robertson, Sparkman, Clark, Proxmire, Long, Capehart, and Tower. Only Senators Robertson, Sparkman, and Proxmire asked questions. All Senators except the Chairman left the hearing soon after Mr. Saxon left the stand.

Mr. Saxon used the occasion to make the same points he had made before the House Committee regarding the tendency of "the other Federal supervisory agencies" to encroach on the rights of State banks. He characterized the enforcement provisions of H.R. 8874 (designed to make sure banks could not frustrate existing Federal examination and supervision authority by farming out their functions to service agencies) as "a huge overlay of visitorial, regulatory, and investigatorial power" which was totally unnecessary, but which he would accept rather than defeat the bill. He regretted that the "fine sorting requirements" of the Federal Reserve force small national banks "which are mandatory members of the Federal Reserve System, unfortunately" to send their checks to bigger correspondent banks for collection. He praised the change in Regulation Q, claiming it had resulted in lower mortgage rates because of increased real estate lending by banks. He advocated further reforms to stimulate such lending, calling H.R. 7796 a step in the right direction, and suggesting removal of the 20-year maturity limitation as another step for the future. Having shifted into high gear, he twice expressed satisfaction that banks had not engaged in the questionable practices of other real estate lenders, citing "points, discounts, and so forth". This brought a reminder from Senator Robertson that the Federal Home Loan Bank Board supports H.R. 7796. Senator Proxmire added that the Committee should find out where the savings and loan industry stands on it.

Witnesses following Mr. Saxon were heard with dispatch. FDIC Chairman Cocke and our own Fred Solomon upheld the enforcement provisions of H.R. 8874 that Mr. Saxon had attacked. Both supported all four bills, except that Mr. Cocke, left "to the discretion of (the) Committee" the question of whether H.R. 12577 would encroach on the rights of State banks

tax
by making the/treatment of common trust funds administered by State banks depend on their compliance with regulations issued by the Comptroller of the Currency for national banks.

Robert L. Myers, Jr., President of the National Association of Supervisors of State Banks, had written Chairman Robertson on August 22 opposing H.R. 8874, because of its enforcement provisions. This morning, he testified that this letter expressed his personal view, and the Association did not oppose the bill. His testimony focused, instead, on the same question Mr. Cocke had raised about H.R. 12577. He recommended that the bill be amended so that tax treatment of common trust funds should depend on regulations issued by someone other than the Comptroller of the Currency, preferably the Internal Revenue Service. Senator Robertson indicated he would carefully consider this question, and I had the feeling he meant it.

Three witnesses for the American Bankers Association supported all four bills. When Senator Robertson asked for their views on the tax provisions of H.R. 12577, the witness on that bill (Frank Gunther, President of Security Bank, Washington, D. C.) said he preferred the bill as it passed the House, but would not object to the NASSB amendment. When Senator Robertson asked for a State banker's view, Cowles Andrus, who had testified for H.R. 7796, said he was inclined to prefer the NASSB amendment.

The rest of the witnesses concentrated on H.R. 8874. A witness for the National Society of Public Accountants urged an amendment prohibiting bank service corporations from engaging in any revenue-producing activity other than services for banks. He argued that without such a prohibition a bank would force borrowing business firms to use the bank's service corporation for their accounting work. An Illinois banker opposed the bill on the ground it would make small banks dependent on large banks, which may dominate the bank service corporations. At this point Senator Robertson read into the record a telegram just received from the Independent Bankers Association opposing the bill on the same ground. The next witness, an official of a company that makes bank equipment, testified that his company could supply "ODP systems" to banks for $50,000 to $60,000, which would provide all the advantages of complete automation. He recommended amendments to prevent large banks from gaining control over small banks through domination of bank service corporations or through directly furnishing automated services to small banks. The final witness, a banker speaking for nine New York banks, defended the bill against the arguments of the preceding witnesses.

cc: Each Board Member

Mr. Young	Mr. Knipe	Mr. Solomon
Mr. Molony	Mr. Kenyon	Mr. Farrell
Mr. Fauver	Mr. Hackley	Mr. Shay

AUG 15 1962

The Honorable James J. Saxon,
Comptroller of the Currency,
Treasury Department,
Washington 25, D. C.

Dear Mr. Saxon:

Thank you for your letter dated August 1, which we received on August 7, with regard to my testimony on H.R. 7796.

Whether the substantial growth in time and savings deposits in the past year is relevant to the necessity of a change in the percentage of such accounts that banks can hold in mortgages is a matter on which judgments may differ. This does not excuse us, it seems to me, from mentioning a development so striking as the estimated increase of $7 billion in time deposits at national banks in the past year, which has expanded by roughly $4 billion the volume of mortgages national banks may hold under existing law.

As I indicated in my testimony, the Board has no objection to the proposed legislation. However, we would be less than honest if we left a Committee of the Congress with the impression that this was an urgent matter or that action on it would have any appreciable effect in the near future on mortgage lending by banks. While we have no way of determining the precise number, we understand that only a small number of banks are limited by the present 60 per cent requirement.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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Comptroller of the Currency

TREASURY DEPARTMENT

WASHINGTON 25, D.C.

ADDRESS REPLY TO
COMPTROLLER OF THE CURRENCY

August 1, 1962

Honorable William McChesney Martin
Chairman of the Board of Governors
Federal Reserve System
Washington 25, D. C.

Dear Mr. Martin:

We have noted with regret certain comments in your statement made before Subcommittee No. 1 of the House Banking and Currency Committee on July 19, 1962, in reference to H.R. 7796.

In reference to the proposal to increase the alternative aggregate limitation of real estate loans of National Banks from 60% to 70%, you stated to the Committee: "Last year the Board reported to your Committee that it had no objection to this increase. The Board adheres to that view but desires to call your attention to the fact that in the interim there has been a considerable increase in time and savings deposits which may well reduce the need for relief in this form."

We question the relevance of the recent increase in time and savings deposits to the question at issue. The proper question is whether the present limitations serve the public interest to best advantage. For this purpose, the temporal factor of the extent to which present authority is now being utilized is not pertinent. Indeed, aggregate figures obscure the fact that banks vary in the degree to which they have utilized their authority to make real estate loans. We should be concerned, in any event, with future opportunities rather than past practices.

We can take it for granted that the public interest would be served if commercial banks could safely be allowed to compete more effectively in the real estate lending field. The issue then becomes one of determining the need to hold the limitations in their present forms. Twenty-four states now impose no limitations at all on real estate loans and several others have restrictions more liberal than those applied to National Banks. As to the question of substance, the limitation of real estate lending powers according to the volume of time and savings deposits is based on the assumption that loans of this nature are not suitable forms of investment for demand deposits. In fact, however, the later maturities of such loans have a degree of liquidity comparable to many other forms of loans and investments which are regarded as proper uses of demand deposits. A well distributed set of maturities in a real estate portfolio thus affords a high degree of liquidity.

The recent increase in time and savings deposits in commercial banks does have a bearing, however, on the practices which are developing among commercial banks in the field of real estate lending. Under the impetus of this change, and the added costs which have thus been imposed on commercial banks, this somewhat neglected field is now being more extensively explored by many commercial banks. This additional competition is publicly beneficial and, we believe, should be encouraged. The proposed legislation would serve this purpose, without impairing bank liquidity.

Sincerely,

James J. Saxon

James J. Saxon
Comptroller of the Currency

Miss Muehlhaus

July 17, 1962

Mr. Roland Pierotti
Assistant to the President
Bank of America
San Francisco 20, California

Dear Roland:

Thanks for your letter of July 12 concerning S. 1771, which would authorize the Board to permit foreigh branches of national banks to exercise certain additional powers where necessary to meet competition in the country in which they operate.

As you may know, the Board supports this bill, and the material you enclosed with your letter of July 12 will be helpful to me in presenting the Board's views at Thursday's hearing before Chairman Spence's Subcommittee.

With all good wishes,

Sincerely yours,

(Signed) Bill

Wm. McC. Martin, Jr.

RLC:ac

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 3, 1962.

To Merritt Sherman

From Robert L. Cardon

Subject: Chairman Martin's Testimony before House Banking and Currency Committee on S.1771, H.R. 7796, and H.R. 8874

Chairman Martin has been asked to testify before the full House Banking and Currency Committee on July 18 on three banking bills: S. 1771, to authorize foreign branches of national banks to exercise additional powers; H.R. 7796, raising the limits on real estate and construction loans by national banks; and H.R. 8874, to authorize banks to form corporations to provide automated clerical and related services.

Hearings were held September 12, 1961, on S. 1771 and H.R. 7796 by Subcommittee No. 1 of the House Banking Committee. The subcommittee reported the bills favorably to the full committee early this year but the full committee decided that additional hearings were needed. The Board, on July 14, 1961, sent a letter to Chairman Spence indicating it has no objection to H.R. 7796. And on September 11, 1961, the Board wrote Chairman Spence recommending passage of S. 1771. On March 1, 1962, the Board wrote Chairman Spence "that it favors the objective of H.R. 8874" and recommended certain amendments.

Before he left yesterday, Chairman Martin asked that work be started preparing testimony on these bills.