FR609

Minutes for February 5, 1965.

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date.

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin	WM
Gov. Mills	
Gov. Robertson	R
Gov. Balderston	CCB
Gov. Shepardson	CNS
Gov. Mitchell	GM
Gov. Daane	Dwd

Minutes of the Board of Governors of the Federal Reserve System on Friday, February 5, 1965. The Board met in the Board Room at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Mitchell
Mr. Daane

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Young, Adviser to the Board and Director, Division of International Finance
Mr. Noyes, Adviser to the Board
Mr. Molony, Assistant to the Board
Mr. Cardon, Legislative Counsel
Mr. Fauver, Assistant to the Board
Mr. Brill, Director, Division of Research and Statistics
Mr. Solomon, Director, Division of Examinations
Mr. Hexter, Assistant General Counsel
Mr. Shay, Assistant General Counsel
Mr. Koch, Associate Director, Division of Research and Statistics
Mr. Partee, Adviser, Division of Research and Statistics
Mr. Hersey, Adviser, Division of International Finance
Mr. Katz, Adviser, Division of International Finance
Mr. Reynolds, Associate Adviser, Division of International Finance
Mr. Leavitt, Assistant Director, Division of Examinations
Mr. Gemmill, Economist, Division of International Finance
Mr. Furth, Consultant

Mr. Holmes, Vice President, Federal Reserve Bank of New York

Foreign lending by U. S. banks. This meeting was devoted to consideration of a memorandum from Messrs. Holmes and Young dated February 4, 1965, outlining the President's program to help correct the U. S. payments deficit as it seemed likely, according to current drafting, to be set forth in his Balance of Payments Message to the Congress next week. The program was to be directed especially to the curtailment of U. S. capital outflow, and the role of the Federal Reserve System in this phase of the program would require that the Board give prompt consideration to the scope of a Federal Reserve direct-influence program, along with steps essential to its effective execution.

It was understood that the President's program would provide for: (1) extension for two years, through legislation, of the interest equalization tax as regards foreign security issues; (2) extension of the tax, through the Gore amendment, to bank loans to foreigners with maturities in excess of one year, effective immediately; (3) an increase, through legislation, in the effective tax rate on new foreign loan commitments of banks with maturities over one year to a maximum of 2 per cent on shorter maturities graduated to 1 per cent on longer maturities, effective immediately; and (4) application, through legislation, of the interest equalization tax to nonbank loans to foreigners over one year in maturity and subject to the tax rate applicable to bank credits, effective immediately. The Federal Reserve--in cooperation with the Treasury--would work closely with banks in a voluntary program to limit foreign lending by banks, and the Comptroller of the Currency and the Federal Deposit Insurance Corporation would be directed to support the program. There was some possibility that the Federal Reserve program might be expanded to include certain classes of nonbank financial institutions as well as banks. There would be no legislation now on direct investment, but large corporations would be asked to cooperate with the Department of Commerce in limiting such investment and to report quarterly on progress being made.

The program to curtail capital outflow was to be supplemented by: (1) an invigorated export promotion drive; (2) tax relief to foreign investment in the U. S.; (3) a tourist "See the USA First" program, plus a reduction in the duty exemption to overseas tourists from $100 to $50 on goods accompanying the traveler; (4) a further cutback in overseas military expenditures; (5) continued tying and utmost savings in the foreign aid program; and (6) stability of domestic costs and prices.

The suggested aim of the Federal Reserve program would be an over-all limitation on 1965 expansion of bank foreign lending, including deposits abroad and export financing, of 5 per cent over and above outstandings at the end of 1964. Banks would be generally free to act within this limit, but certain guidelines, if specifically approved after discussion by the Board, might be suggested to banks within the over-all constraint. Several possible guidelines were suggested in the memorandum.

To implement the Federal Reserve program, it was suggested that upon release of the Presidential message a communication be sent from the Chairman of the Board to the presidents of a representative group of banks active in foreign lending inviting them to meet with him, other members of the Board, and Reserve Bank Presidents in Washington on a specified date. The date of the meeting would be arranged with the White House in order that the group could also meet with the President on the same day. On the day of the message the Board would issue a press release regarding the Federal Reserve program, and a Reserve Bank circular would be sent to all banks advising them regarding the objectives of the President's program, the rationale for including bank lending, and the Federal Reserve program, including the objective of an over-all limitation on expansion of bank credit to foreigners of 5 per cent in 1965. On the day of the message or soon thereafter, a letter would be sent from Reserve Bank Presidents to banks with outstanding loans to foreigners in excess of $5 million, inviting the president of each such bank to consult with the Reserve Bank President regarding details of the program. At least on the day before the message, and if possible sooner, there would be a telephone conference of the Board with the

Reserve Bank Presidents to advise them of the President's balance of payments program, particularly insofar as it involved bank foreign lending. The Board would develop in cooperation with the Reserve Bank Presidents, soon after the message, appropriate guidelines for use by Reserve Banks in administering the program. The Board would consider, at an appropriate time, amendment of the general principles of Regulation A, Advances and Discounts by Federal Reserve Banks, to include increases in member bank foreign lending as a factor in Reserve Bank administration of the discount window. Consideration would be given to providing for consultation with groups of bankers (in an advisory capacity) on special problems encountered in implementing the System's program.

In order to insure that banks were in fact adhering to the program guidelines, the Reserve Banks would follow closely the pattern of bank foreign lending. Monthly statistics on short-term lending, term loans, bank acceptance financing, and investments would be currently available from Treasury foreign exchange reports. Additional reports would be required from foreign branches of U. S. banks in order to keep track of a possible shift of loans from head offices to the branches, and it might become necessary to have banks file reports on financing of exports. The present program under which banks report large projected loans prior to their conclusion would be continued and strengthened. While reports would be limited to banks with outstanding foreign loans in excess of $5 million, the Reserve Banks would follow in general the lending activity of banks with lower outstandings in order to detect any shift of lending from the larger to the smaller banks. The Reserve Banks would discuss informally with each member bank any case where the guidelines were not being followed.

A concerted effort--undertaken in cooperation with the Commerce Department, which would be assigned the leading role in curtailing credit by nonfinancial corporations to foreigners--might be required to minimize bank borrowing by domestic corporations for the purpose of relending to affiliates or customers abroad.

An expanded exchange of information, as well as consultations and cooperation, might be required with foreign monetary authorities in order to minimize a possible increase in dollar lending by foreign banks using American funds attracted through the Euro-dollar market.

During a general discussion by the Board of the President's program, with particular reference to the role therein that would be assigned to the Federal Reserve System, question was raised as to the rationale underlying the proposal for legislation that would provide for a graduated tax rate on bank loans to foreigners over one year according to maturity. Reasons that had been advanced for this proposal were reviewed. However, it was indicated that these reasons were not entirely convincing to Federal Reserve representatives who had discussed the matter with the Treasury, and it was stated that the Treasury had been urged to give the matter further consideration.

As to the possibility of including bank loans with maturity under one year in the coverage of the interest equalization tax, it was stated that the Treasury felt this would not be administratively feasible due to the complexity and variety of short-term financing arrangements. This meant that short-term credits would remain to be dealt with under the moral suasion effort.

On the moral suasion program, question was raised as to the time period that should be emphasized in presenting the appeal to the banks. It appeared to be the consensus that emphasis should be placed on what might be accomplished during the year 1965, recognizing that efforts of this kind usually could be expected to achieve substantial effectiveness for only relatively short periods.

Question also was raised whether the total approach was as strong as warranted by the balance of payments problem, and in particular whether it would be wise to establish a goal for the moral suasion effort that would allow an increase of bank foreign lending of 5 per cent beyond the total outstanding as of the end of 1964. Reasons for allowance of the 5 per cent increase were explained, and reference was made to the contribution toward reduction of the balance of payments deficit that would be accomplished if such a goal should be achieved. A different point of view held that it would amount to a better approach if a goal of no increase beyond outstandings as of year-end 1964 were stated, leaving the 5 per cent increase as something that could be borne in mind in the light of developments. The formulation of a goal was considered also from the standpoint of the effect on export financing. It was generally agreed that a curtailment of export financing should be avoided; however, any exemption of such financing from the over-all limitations of the program would run the risk that many types of credits might be extended under the guise of export financing.

On the question of "policing" the moral suasion program, the view was expressed that this would be basically inconsistent with the nature of such a program. It was agreed, however, that appraisal of the effectiveness of the program would be necessary, through the obtaining of reports of such scope and in such frequency as might be required.

Consideration also was given to guidelines that might be formulated for the guidance of the Reserve Banks or for participants in the moral suasion effort. This discussion was generally of an exploratory nature, no decisions being reached. Some doubt was expressed, however, whether any attempt should be made to delineate in guidelines for the benefit of lenders specific types of credits that would or would not be regarded as appropriate.

Reference was made to consideration being given by the Treasury to the need for legislation that would provide antitrust exemption for those participating in the voluntary restraint program, and it was understood that the Legal Division would provide such assistance on this phase of the matter as might be desired.

The problem of dealing with credit extensions by foreign branches of U. S. banks was recognized as a difficult one, warranting further work; the problem was said to be under study at the Treasury from the standpoint of the interest equalization tax.

As to the suggestion that had been made for amendment of the general principles of Regulation A, Advances and Discounts by Federal Reserve Banks, to buttress a moral suasion program, a view was expressed that the two approaches hardly seemed compatible. While a decision was deferred, it was generally agreed that this possibility should not be announced and instead should be held in reserve for later consideration if necessary.

It was understood that work would proceed on the drafting of the following documents: circular that would be distributed by the Federal Reserve Banks to commercial banks and perhaps others following the release of the President's balance of payments message; Board press statement concerning the Federal Reserve program; statement that might be made by Chairman Martin to bankers at a meeting at the Federal Reserve Building.

The meeting then adjourned.

Secretary