American-owned business enterprises abroad are understandably unwilling to incur the additional cost of reimbursing our branches for the interest equalization tax on dollar loans maturing in 1 year or more. As a result, our branches are in effect prevented from making such loans to these firms, which in the normal course of events would be the prime customers of these branches. Naturally, a bank can accept deposits and pay competitive interest rates thereon only if the funds so deposited can be loaned to customers at a proper rate of return. Consequently, the effect of the interest equalization tax on foreign branch loans is to cause our foreign branches to refuse to accept certain dollar deposits from foreigners which, in the absence of tax, could be used to make term loans to the subsidiaries of U.S. businesses. My own experience is that many millions of U.S. dollar deposits from foreign sources for maturities ranging to a year or more have had to be turned down—despite the needs of U.S.-owned firms for foreign money—because of the inability to use these medium-term deposits to make loans for which there is a heavy and unfulfilled demand.

The existing exemption from interest equalization tax for foreign branch loans made in foreign currency is not of practical significance, since our branches abroad normally can attract only limited amounts of foreign currency deposits. Moreover, because of the impossibility of covering the foreign exchange risk over a series of years, it is not feasible for our foreign branches to take U.S. dollar deposits from foreigners and to convert such dollars to foreign currency for the purpose of making loans, even if the potential borrrower itself is willing to borrow in a foreign currency.

As a result, U.S. subsidiaries, urged by the Government to finance their foreign operations to the maximum extent feasible from foreign sources of funds, have been forced to turn elsewhere. As you know, European capital markets are poorly developed and very congested, and indigenous foreign banks are already unable to meet fully the needs of their own domestic customers. The consequence is growing doubts over the ability of U.S. firms to complete their foreign borrowing programs.

Branches of American banks could make a significant contribution toward breaking this impasse if they are freed from the interest equalization tax. Removal of the tax would permit us to seek medium-term dollar deposits from foreigners freely in competition with indigenous banks, and to place those funds at the disposal of our borrowing customers, who are primarily U.S.-owned concerns. As a result, without any transfer of funds from the United States, the total financing available to U.S. firms abroad would undoubtedly increase, to the direct benefit of our balance of payments.

I should emphasize that removal of this tax from our foreign branches would be fully consistent with the voluntary balance-of-payments program. The Federal Reserve System, in conducting the voluntary restraint program for banks, has fully and repeatedly recognized that the loaning by our foreign branches of dollars already located abroad is not detrimental to this country. More than that, to the extent these loans enable businesses to reduce transfers from the United States, the balance of payments will be improved.

Presumably, the tax was originally extended to foreign branches to provide assurance that U.S. banks did not themselves transfer funds