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FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
1. memo	Governor Brimmer to Records Section re developments in the commercial paper market	7/7/70	C
	<u>2. memo case, Solomon to Burns, 8/13/70</u>		
2a. telegram	American Embassy Monrovia to Sec. of State, Monrovia 3133, re Brimmer's talks with financial officials (3 pp.)	7/30/70	A
	<u>3. memo case, Broida to FOMC, 8/27/70</u>		
3a. paper	"Highlights of Visit to West Africa" by Andrew F. Brimmer (14 pp.)	8/70	C(A)
3b. memo	Michael O'Connor to Files re the African Development Bank (4 pp.)	8/19/70	C(A)

FILE LOCATION

Arthur Burns Papers
 Federal Reserve Board Staff Files, Box C2.
 Brimmer, Andrew (4)

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BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

DATE July 17, 1970

TO Chairman Burns

FROM *Andrew F. Brimmer*



Attached is the correspondence from Elmer Staats concerning the proposed GAO audit of the NAC. I am waiting for Elmer to return my call.

I have discussed the procedure with Assistant Secretary Petty in the Treasury Department, and we have reached basic agreement with respect to the procedure.



UNITED STATES
GENERAL ACCOUNTING OFFICE
441 G. Street, N. W. Room 7000
Washington, D. C. 20548

GENERAL
STATES
C. 20548

July 1, 1970

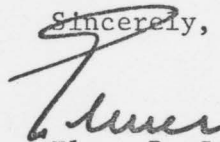
Dear Andy,

Attached is the exchange of correspondence with Secretary Kennedy to which I referred in our telephone conversation yesterday. I am also enclosing a copy of the statement which was presented yesterday by Secretary Kennedy before the House Banking and Currency Committee which touches on the same subject.

I am also enclosing a copy of the statement which I presented before the House Foreign Affairs Committee which is related to our earlier work with United Nations agencies. Should you be interested in individual reports, please let us know.

We believe we can perform a useful role, and I am certain that the long-standing issue on access to records in the Federal Reserve Board should not be a handicap.

Sincerely,



Elmer B. Staats

Enclosures

The Honorable Andrew F. Brimmer
Board of Governors of the Federal
Reserve System





COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-161470

April 27, 1970

Dear Dave:

In our meeting a week or so ago, I told you I would explore the feasibility of our undertaking a study of the organization and procedures of the United States' participation in international lending institutions without the necessity at this time for access to individual loan files.

While we do not concede that this Office does not have a right of access to all files that are relevant to the direction and management of United States interests in international lending institutions, we do appreciate your views that our access to information in individual loan files could be an extremely delicate issue with the international institutions. Accordingly, we are agreeable to undertaking our study without access to the individual loan files, provided that other reports and management data furnished United States officials by the lending institutions would be available for our review.

The subject is a very important one, particularly in light of comments on this general subject made in the Pearson report, the Jackson report, and the more recent Peterson report, along with the increasing interest and concern being expressed in the Congress. Moreover, we feel that we have developed a series of most constructive reports relating to United States' backstopping of various United Nations organizations, and these reports have been well received in the State Department and in the interested committees of the Congress.

While it is unnecessary to emphasize that our objective here is to explore ways of improving coordination, with all that is at stake and as an arm of Congress, we feel that it is important that we proceed. I think it is increasingly urgent that we be able to have a working understanding that will permit our CAO staff to proceed without continuing impediments. Enclosed is an outline of the alternative for this immediate study which we believe can be accomplished without access to the loan files.

I would appreciate it if we could hear from you soon since our ability to carry out our responsibilities in this instance will be



dependent upon a working arrangement for cooperation within your
Department.

Best wishes.

Sincerely yours,

(SIGNED) ELMER B. STAATS

Comptroller General
of the United States

Enclosure

The Honorable David M. Kennedy
Secretary of the Treasury



GENERAL ACCOUNTING OFFICE
STUDY OF UNITED STATES PARTICIPATION
IN INTERNATIONAL LENDING INSTITUTIONS

April 24, 1970

BACKGROUND

A primary function of GAO is to make independent examinations for the Congress into the manner in which U.S. Government agencies are discharging their responsibilities, and to review the manner in which Federal programs are carried out.

An increasingly significant Federal program is that of providing developmental assistance to foreign countries through international lending institutions and other international organizations as distinguished from direct bilateral assistance efforts.

In its participation in international developmental assistance organizations including the international lending institutions, the United States participates with other member governments in the governing bodies. Generally the United States is the largest financial contributor to the support of the organization. However, the information obtained by the United States appears in most cases to have been minimal.

Recognizing the responsibility of U.S. officials for continuing management by them of U.S. interests, the President in 1966 set the goals for such management, stating several basic guidelines, among them, the purposes to see that:



- expansion of activities of the international organization is governed by tests of feasibility and reasonableness,
- the programs are vigorously scrutinized, and
- each international agency operates with a maximum of effectiveness and efficiency.

These responsibilities for managing U.S. interests have been reiterated from time to time.

With the prospect of an increased proportion of U.S. developmental assistance being channeled through international lending organizations the mandate for effective management of U.S. interests becomes more important. In its report to the President on March 4, 1970, the President's Task Force on International Development stated that--

"***as these (international) organizations expand their operations, they will have to prepare for a parallel buildup in their control procedures so as to assure continued high operating standards. Also, member governments will have to become more fully involved in the work of these international agencies."

Purpose and Objectives of GAO Reviews

In the simplest terms the GAO objectives in reviewing the management of U.S. interests in international lending programs are to:

1. Ascertain how U.S. interests are being managed (not the operation of the international organization, but the operation and involvement of those U.S. agencies and U.S. officials who are responsible for managing U.S. interests).
2. Evaluate the Executive branch systems and procedures, including necessary coordination mechanisms among U.S. federal agencies, that are being employed by the responsible



executive agencies having financial and management responsibilities from the viewpoint of the U.S. participation.

3. Report to the Congress and to the heads of the agencies concerned on how the U.S. participation operates, with recommendations to the Congress or to the Executive agencies wherever they appear to be needed.

In carrying out these objectives GAO staff members are expected to:

- (1) Identify the U.S. agencies involved for the program or entity being reviewed, such as Department of the Treasury, Agency for International Development or Export-Import Bank, and including the roles of the National Advisory Council, the Bureau of the Budget, or any other participating unit or group.

- (2) Ascertain how the system and the various elements function and whether they fit together or make an effective overall mechanism. What is the U.S. policy or stated program purpose, and is it being followed?

- (3) Determine how the management of U.S. interests is carried out--for example, what is the U.S. role--how information is obtained upon which to make informed U.S. decisions--are informative management reports furnished by the international organization to its component nations--are there effective mechanisms for weighing or evaluating program results, etc.?



(4) Identify the extent of internal audit or other review or evaluation information made available to the U.S. as a member government.

Sources of Information

Information will be obtained by discussions with officials in the respective agencies having responsibilities; by obtaining copies of reports, instructions, procedures, and other pertinent documents used by U.S. officials in carrying out their management responsibilities concerning U.S. participation in and financial support of the institution; and by information as to current policies, coordinating mechanisms, and plans for financial support of the institution.

Examples of the types of information presumed to be available in Department of the Treasury or other participating agency, would be:

1. Identification of organizations and pertinent officials having responsibilities to the U.S. Government, and statement of their functions and responsibilities.
2. With respect to these organizations or offices--operating instructions, identification of operating or financial reports prepared and received, and U.S. agency files or records maintained for carrying out U.S. interests.
3. Information showing interrelationships between NAC, Treasury Department, and other agencies or groups concerned.
4. Statements of functions and responsibilities of the U.S. Executive Directors of the various international lending institutions.
5. Identification of reports, financial data, program results or other management data currently made available to the U.S. by the lending institutions for the U.S. officials responsible for managing U.S. interests.



THE SECRETARY OF THE TREASURY

WASHINGTON

MAY 27, 1970

Dear Elmer:

Thank you for your letter of April 27, 1970, concerning the study which the General Accounting Office wishes to undertake of the organization and procedures of the United States participation in international financial institutions.

The international financial institutions play a significant and growing role in the development process. Their objectivity, their expertise and the vehicle they provide for an equitable sharing of the burdens of providing development assistance are just a few of the many important advantages that they have for both the United States and other member countries -- developed and less developed. An essential feature which makes all of these advantages possible is their multilateral character.

It is for these reasons and others that recent United States and international reports analyzing the development process have recommended that a greater part of development assistance be channeled through international financial institutions. The President has decided to place more emphasis on United States development assistance through these agencies and the Congress already has specific proposals before it and in the future additional proposals will be made to implement this objective.

Because the multilateral banks will be undertaking even greater responsibilities in the future than they have in the past, it is essential that they continue to meet the highest standards of performance in fulfilling their responsibilities. The international financial institutions themselves have recognized that as their responsibilities have grown so has the need for internal controls and other mechanisms for assuring that their work is carried out effectively and efficiently. They already have provision for financial audits by independent outside auditors of international reputation, as well as for internal performance evaluation. Because the expert management of these institutions is acutely aware of the need for these procedures, existing arrangements will evolve to meet the new problems that may arise as a result of broadened responsibilities.

In approaching the United States role in assuring high standards of performance, I must bear in mind twin objectives. The first is that of making every effort to assure that the U.S. taxpayers' investment in these institutions is expertly managed. The second is that of preserving



the international character of the multinational banks so that they may fulfill the purposes assigned to them by international agreement. These objectives are not exclusively those of the Treasury or the Executive Branch. Indeed, the Congress has a vital interest in assuring that these twin objectives are fully implemented. I welcome the interest of the GAO in helping to meet these objectives, knowing that your efforts will contribute to our own self-examination and through us to the multilateral institutions.

However, I have been concerned that a GAO review of United States participation in these agencies might be so broad in scope as to constitute a GAO review of the institutions themselves, thus raising the possibility that it would jeopardize the international character of the institutions. Consequently, I have emphasized that such a review should be confined to Executive Branch organization and procedures. Because I consider this to be such a fundamental point, I would like to review the reasons why I have taken this position.

GAO review of the international financial institutions would be inconsistent with their international status and would violate the purpose behind the privileges and immunities, such as the immunity of their records from disclosure, that have been accorded to them by international agreement and by Congress. It would also be inconsistent with the objective of carrying out the work of these institutions through the use of expert and impartial management staffs. It is also important to note that the administrative budget of these institutions is supported through earnings from lending and investment operations rather than from funds appropriated by member governments and that they are subject to the discipline of the private capital markets of the world which are a major source of their funds. Congress has, through legislative action, already recognized that a review of the international financial institutions should be done through multilaterally established processes of the multilateral banks and not through a governmental agency of any one member.

I would also be concerned that a unilateral review by a United States agency could result in a breach of confidential banking relationships and a threat to the banks' sources of information. It could also provide the impetus for unilateral investigations by the national governments of other participating members, particularly those for whom the loans are destined.

For these reasons, the suggestion you have made for limiting the scope of the GAO review to the procedures followed by the Executive Branch is a useful one, although I feel that some further modifications are necessary in the approach you suggest. I believe that there is a basis for our staffs to work out a procedure for your study, operating

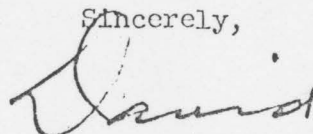


within the basic framework which I have outlined above. In order to be consistent with this framework, the GAO staff access to the documents should be confined to those initiated within the Executive Branch. However, I am sure that without access to specific documentation of the international organizations, your staff, through cooperation with my staff, should be able to obtain adequate knowledge of the extent and types of information which the United States obtains from them.

With these guidelines in mind, I suggest that your staff contact Mr. John R. Petty, Assistant Secretary for International Affairs, for the purpose of working out detailed procedures.

With best wishes,

Sincerely,



The Honorable
Elmer B. Staats
Comptroller General of the
United States
Washington, D.C. 20548



For Release on Delivery
Wednesday, July 29, 1970
12 Noon (Monrovia); 6:15 a.m. (E.D.T.)

ECONOMIC TRENDS IN THE UNITED STATES AND THE
OUTLOOK FOR DEVELOPING COUNTRIES

Remarks By

Andrew F. Brimmer
Member
Board of Governors of the
Federal Reserve System

Before the

Hungry Club

Ducor Hotel
Monrovia, Liberia

July 29, 1970



ECONOMIC TRENDS IN THE UNITED STATES AND THE
OUTLOOK FOR DEVELOPING COUNTRIES

By
Andrew F. Brimmer*

I am flattered by the opportunity to address this assembly of Liberian business and professional men and Government officials. I am especially pleased to see so many Americans in the audience. Unlike many American Negroes who have only recently discovered the rich traditions which have bound our countries together for nearly 150 years, I was introduced to Liberia as a small child. I learned of your legacy not simply as a story of black people returning to Africa but as the romance of an epic journey from slavery to freedom. So for a number of years, I have looked forward to the day when I could visit this land.

I have long been aware of the close economic ties between our countries. Against this background, it might be helpful to sketch the main contours of economic trends in the United States and to assess their implications for Liberia -- and for other developing countries as well. Clearly the prosperity and growth of these nations depend heavily on the economic well being of the advanced countries which provide the major export markets as well as the principal source of capital and technological resources to promote rapid economic development. Therefore, it is important that the advanced countries maintain their own economic strength, if the developing countries are to prosper.



I am fully conscious of the crucial role of the United States in aiding the growth of the developing countries. At the present time, our responsibilities in this respect require that we bring an end to the inflationary pressures which are still present in our own economy. This is proving to be a longer and more difficult task than some of us had hoped.

Even a brief survey of the economic scene in the United States provides a reasonably firm basis for assessing the outlook for the next few years:

- The American economy is finally responding to the restrictive monetary and fiscal policies followed for the last year or so, and we are making genuine progress in moderating an overheated economy. Yet, strong upward pressures on costs and prices are still evident. Thus, the time has not come for us to give up the campaign against inflation.
- While the distortions produced by inflation are still being corrected, several indications suggest that moderate economic expansion will resume in the near future. For example, the output of goods and services (corrected for price changes) apparently rose slightly in the last quarter -- after declining during the preceding six months.
- Looking farther ahead over the next two or three years, we can expect continued strong demands for goods and services in the United States. In fact, it seems highly likely that total demands on the American economy will far exceed the economy's potential. Thus, the shadow of persistent inflationary pressures will continue to cloud the outlook. Consequently, we will have to continue our reliance on stabilization policies to keep inflation under control.



- Moreover, it appears that the United States will not face these difficulties alone. Most of the other major industrial countries may also have to cope with the same kinds of demands on resources -- which might generate the same kinds of upward pressures on prices and interest rates.
- Under these circumstances, the road ahead for developing countries may be a difficult one to travel. While they will face increasingly strong needs to lift their standards of living, the availability of financial and other resources from developed countries to assist them may be considerably less than required.
- Expanding demand in industrial countries may provide a growing market for the exports of developing countries. However, there is a real danger that spreading protectionist devices in developed countries -- including the United States -- may undercut the progress already achieved at such substantial costs.
- The heavy demands for capital on all fronts may seriously limit the pace of development for most countries struggling to get ahead. Given the unpromising outlook in most advanced countries for further expansions in official foreign aid, it appears that developing nations will have to rely increasingly on private investment if they are to make genuine headway.
- Because of this conjuncture of circumstances, the international financial policies of the developed countries will be of vital importance to developing areas. In the particular, the industrial nations -- including the United States -- will have to ensure that measures taken to protect their own balance of payments do not place undue burdens on those countries trying to enter the mainstream of economic progress.

In the rest of these remarks, these main points are amplified further.



The Battle Against Inflation in the United States

For this audience, there is no need to dwell on the origins of the current inflation in the United States. It will be recalled that it was propelled by a business investment boom and the acceleration of the Vietnam War in mid-1965. At that time, the economy was already on the eve of full employment, pushed forward partly by public policies designed to stimulate fuller use of the nation's physical and manpower resources. The rapid rise in demands for goods and services for military and business purposes added to an already expanding economy and resulted in the rapid acceleration of inflation we have seen in the last five years.

Over the last year, however, as a result of restrictive monetary and fiscal policies, we have been making significant progress in eliminating excess demand in the American economy. The rate of economic expansion has slowed appreciably, and some slack has developed in markets for labor and other resources. There has been no growth in real output for the last nine months. Employment has declined, and the unemployment rate has risen significantly. Unused industrial capacity has increased, profits have fallen, and investment in plant and equipment has begun to slow appreciably. Thus, measured by any standard, the economy has been operating well below its potential.

However, while we have succeeded in erasing excess demand in our economy, we are still experiencing strong upward pressures on costs and prices. The distortions resulting from the past persistent



rise in prices have become deeply rooted. Expectations of consumers, businesses, and workers have not yet fully adjusted to the current balance of aggregate demand and supply.

Progress in getting inflation under control in the United States has been slow, and the effort itself has caused difficulties in many sectors of the economy. But there is reason to believe that we are making headway. The rate of productivity growth in manufacturing -- which showed little change last year -- is now improving noticeably. This turnaround has been reflected in a slowing in unit labor costs -- which in turn should temper price rises. There have also been a number of signs recently of a moderation of increases in prices in several major areas. Wholesale foods prices have declined, and especially encouraging has been the slower rise in the prices of a number of important industrial commodities.

There are also indications that economic progress will be resumed in the near future. Real output which declined for two quarters rose slightly in the April-June months. To an important extent, the economic adjustment that has been underway reflected efforts of businesses to bring excessive inventories into better balance with final sales. This apparently has been largely accomplished, and as sales strengthen, inventories are likely to be replenished. In addition, both monetary and fiscal policies have become somewhat less restrictive in recent months, and interest rates have begun to decline. With rates declining and money more readily



available, a significant recovery in home construction and State and local government outlays should become more apparent in the near future and should act to bolster aggregate demands. At the same time, probable declines in capital spending and in defense outlays should serve to limit the upswing.

If we continue to pursue appropriate stabilization policies, and I think we will, there should not be any reemergence of excessive demand pressures later this year or in 1971. Thus, with reasonable confidence, I look forward to a resumption of sustainable economic growth as well as to further diminution in the rate of advance in prices over the next year and a half.

A Longer View of Economic Prospects

Looking farther down the road perhaps two or three years from now, internal demand for improving our standard of living and increasing our productive capacity will continue to provide stronger underpinnings to the United State's economy. Of course, both internal and external demands are limited by the real rate of growth in the economy. Over the next few years, it seems highly likely that total demands on the economy will far exceed the economy's potential. This prospect raises the specter of continued inflationary pressures and the need for the continuation of stabilization policies to keep inflation under control. But it also means public policy will continually be faced with establishing priorities among those competing for the available goods and services.



It may be helpful to get a better grasp of some of the constraints the United States is likely to face in the near future. For this purpose, it would be useful to present some rough estimates of the potential output 3 years from now and some of the more pressing internal demands that we now foresee. With a resumption of real growth in output, productivity in the private economy should climb again to about 3.2 per cent per year by 1973. If unemployment is held to about 4.0 per cent of the labor force, the potential growth of real gross national product (GNP) for our country in the next few years should increase to about 4.3 per cent a year. By 1973, with allowance for the present under-utilization of resources, this would mean a GNP in 1969 dollars of around \$1.1 trillion. I realize that the prospective rise in productivity in the United States may appear low in comparison with trends in some other countries, but it mainly reflects a large and growing percentage of personal consumption expenditures devoted to medical, educational, and personal services where productivity gains are limited by high labor intensity. X

The potential growth of the American economy will also reflect the expansion of resources available to the Government from what economists have defined as a "fiscal dividend," a gain in revenue that automatically accrues from our progressive tax structure as the economy grows. Total receipts of Federal, State, and local governments (excluding grants-in-aid to States and localities) are expected to increase over the next decade at an average rate in real terms of X



around 5 per cent per year. Savings that might result from declines in defense spending in the next year or two may be used for other social programs in later years. However, defense budgets will probably become stable and there are not likely to be continuous cutbacks in defense spending that might yield funds for alternative uses in the longer-run.

At first glance, it would seem that with all our available resources, we could meet both public and private needs. But a brief review of some of the major claims on national output (including public programs already in existence) may help bring the problem into focus. A projection of the claims on our national output suggests that the Federal Government's budget will most likely be just as tight in 1973 as in the current year. So pressure on resources and the curtailment of excess demands will have to be limited by appropriate monetary and fiscal policies. In great part, these pressures reflect a greater social awareness of the needs of the disadvantaged -- whether because of advanced age, race, or urban locality -- and funds for these programs are expected to compete with the more traditional requirements of national security and health and welfare demands. To these demands, the American people are also increasingly adding a high social priority for clean air and water and the preservation of our natural resources of all types.

These important social goals, moreover, must compete for their share of GNP with the strong private demands. Demographic



factors in the United States are now particularly favorable to a consumer boom, and the pent-up demand for housing (which has resulted from the slowdown in residential construction activity in 1966 and 1969-70) will intensify the pressures. Business requirements for expanding inventory outlays and plant and equipment expenditures are also likely to be exceedingly intense.

Personal consumption. Significant changes in the age composition of the population and labor force over the next few years will contribute to a high rate of economic growth. But at the same time they are likely to affect patterns of household consumption as well as the level of investment in plant and equipment, the volume of residential construction, and the types of public programs which will be given high priority. Because of a large increase in births in the immediate post-World War II years, the population between the ages of 18 and 35 is increasing rapidly -- an age group with a very high propensity to consumer. In the five years ending in 1973, the number in this age group may increase by 7.5 million. Most of these young adults will enter the labor force, a fact which explains the expected increases in the growth of the civilian labor force from an average of 1.2 million per year in the 1960's to 1.5 million per year in the decade of the 1970's. The number of marriages will also increase sharply, and as a consequence, net household formation is expected to jump by almost 20 per cent.



These demographic changes probably mean not only a higher propensity to consume but also a lower saving ratio than we have experienced in recent years. These young families, despite their more altruistic ideals, for the most part will still want new cars, appliances, furniture, recreation and all the other goods and services which an affluent society had lead them to expect. These outlays will probably result in a higher percentage of disposable income being devoted to durable goods and a somewhat lower percentage to nondurables and savings.

Business investment in plant and equipment. The growth in real private business investment outlays in the United States has been very rapid, averaging 6.5 per cent annually in the 1960's -- well above the 2.7 per cent annual growth in fixed investment during the 1950's. In 1969, real plant and equipment expenditures increased by 7.1 per cent.

Part of this unusually large volume of investment in recent years is undoubtedly attributable to inflationary psychology. The rapid rise in the price of plant and equipment, especially in construction costs, has caused business to push ahead with new programs, even when the need for these facilities was not urgent. As price increases moderate, this source of stimulus should fade.

However, strong consumer demand -- especially for durables with their greater capital investment requirements, the expected demand from the public sector -- particularly for urban transportation



systems -- and requirements for changes in the production process which will curtail pollution of the environment will undoubtedly generate large capital requirements. In addition, the need to keep up with accelerating technological advances implies large future capital expenditures. Moreover, businessmen seem to be increasingly aware of long-term trends in the economy and are planning their investments accordingly, with less regard than previously to short-term fluctuations, and greater attention to the prospective rise in unit labor costs. All this suggests heavy demands for capital funds and continuing pressure on capital markets.

Residential construction. The goals of the housing industry are equally impressive, and they have been clearly defined by our Housing and Urban Development Act of 1968. This legislation calls for the construction of 26 million new homes over a 10 year period; the rehabilitation of scores of urban centers throughout the country, and the creation of 110 new cities. These requirements in part reflect the backlog of housing demand from the severe curtailment of home building in 1966 and again in 1969-70 due to restrictive monetary policies. The legislation was also influenced by the recognition that continued urban sprawl would create almost unsurmountable transportation difficulties. For some time yet, workers will continue to move farther and farther from their work into the suburbs, and in some cases, factories have moved out to these workers -- but the rehabilitation of center city housing must be part of the solution.



The public sector. As I have mentioned, governments at all levels in the United States are under great pressure to expand existing social programs and to embark on new ones. Yet, without new changes in our tax laws, demands for personal consumption and private domestic investment are likely to absorb most of the increase in real GNP which may accrue by the end of 1973. When the Council of Economic Advisers added up competing demands on output earlier this year, they found that -- even with no increase in public expenditures by governments -- claims against our potential GNP would just about equal gross national product in 1972. Only in 1973 did the Council suggest that an anticipated rise in public expenditures of \$3 to \$4 billion might be possible, and an additional \$3 billion might be available for allocation to high priority public programs. The reason for this is that with actual GNP below potential and because of the loss of revenue due to the changes in the tax law in 1969, there will be -- at best -- only a modest net gain in revenue until 1973. In the interim, most of the additional Federal funds for social and environmental problems must come from the projected decline in defense spending.

In these projections, the Council of Economic Advisers also foresaw a shift of funds from Federal expenditures to State and local governments. In 1969 dollars, actual Federal government purchases were \$102.0 billion, and State and local outlays were \$112.7; by 1973 these were projected to shift to \$87 billion for Federal and \$131 for State



and local. Despite an increase in grants-in-aid to the State and local governments, which have primary responsibility for the administration of many important social programs, the States themselves will have to raise considerably more funds. About one-third of the projected increase in estimated expenditures will be directly attributable to population increases, and the remainder was allocated toward higher real per capita services provided by the State and local governments. This increase in quality, however, is less than the actual increase from 1962-1968, and it is certain that there will be considerable pressure for additional funds to improve the standard of living of poor families, to mitigate the hardships of the urban environment, and to preserve our natural environment for our expanding population. All together, despite the substantial rise expected in the level of public spending, this package will leave most Americans disappointed.

Outlook for Developing Countries

In the face of this inevitable and universal pressure of demands for goods and services of all types in the United States and other industrial nations, there will be even stronger desires and greater needs for improvements in the living standards of developing countries. What can we say about the ways in which flows of real and financial resources between the developed and less-developed worlds will be influenced by these intensified demands?

Let me stress at the outset that, in these general remarks, I am aware of the great differences among the developing countries.



Some will be in a better position than others to benefit from growing foreign markets or to take care of their own developmental needs. On this occasion, my primary purpose is to assess in broad terms the implications for developing areas over the next few years of trends that are already under way in the industrial regions of the world.

Foreign trade. As far as trade flows are concerned, the industrial countries will need much greater quantities of primary materials produced in the rest of the world, and the prices of these commodities are likely to rise substantially. Moreover, if we are correct about the intense pressure on the availability of labor and other resources to meet future demands in the industrial countries, we should envisage a rising flow of manufactures into those countries from the countries where such resources are underemployed. I will come back to this point in a moment.

Meanwhile, the developing countries will have even faster population growth and a much greater absolute gap between needs and resources -- and they will have an accelerating demand for the products of the industrial nations. Consequently, it would seem likely that net merchandise imports of the developing countries as a group should be expected to rise. This is simply another way of saying that developed countries as a whole should be providing part of the real resources needed for economic progress in the less-developed areas.

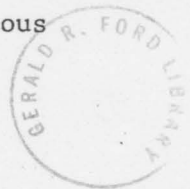
We are very much concerned in the United States that the developed countries of the world recognize that these development



needs have to be accommodated within the balance of payments objectives that seem to be emerging. It seems to me that if we are not careful the measures taken to deal with our excessive domestic demands may conflict with the needs of the developing countries.

One obviously contradictory domestic policy stand is the attempt to protect industries from external competition. To do so in the face of a long-term prospect of excessive pressure on domestic supply capabilities is clearly counterproductive. It seems to me to make a great deal of sense to open up our markets to goods available abroad. Beyond that, we should make a special effort to encourage countries with unemployed resources to develop them more effectively, with the potential of export markets in the industrial countries acting as an incentive. If we could move this process along fast enough it could help to solve the problems of both groups of countries. But experience shows that it will take determined policy measures to reduce existing barriers to trade. As you know, it is difficult at times -- and the present is an example -- not to lose ground in the movement toward freer trade.

By the same token, I do not believe that less-developed countries can help themselves in the long run by trying to encourage industrial development behind a barricade against imports. It will certainly not be possible to create industries capable of competing for export markets, or satisfying domestic requirements at reasonable cost, if they are either inherently non-competitive for various



reasons, or if their operating costs are raised by tariffs on the materials or equipment they use in production.

For the foreseeable future, then, we must anticipate that developing countries will be net importers of goods and services on a large scale.

International capital flows. That brings us to the problems of financing. What we have said about the intense demand pressures to be expected in the industrialized countries implies a continuing strong demand for capital. The cost of capital will be high, and the task of allocating capital availabilities so as to satisfy high priority social needs will be formidable. It will not be easy to fit into this picture the mounting flow of financing to developing countries that will be required. Unless strenuous efforts are made, I would doubt very much that a sufficient flow of financing can be generated.

As I stressed above, national governments in industrial countries are confronted with aggregate plans for expenditures at home that will require very high levels of taxation if inflationary borrowing in their own capital markets is to be avoided. There will be considerable resistance to including in their budgets larger amounts for foreign assistance.

According to reports of the Development Assistance Committee of the OECD, the net flow of financial resources from member countries averaged a little over \$6 billion a year from 1961 to 1966 and was about \$7 billion in 1967 and 1968. There was only a small upward



trend over the period. I doubt that figures for 1969 and 1970, which are not yet available on a global basis, will show much of a change. Taking into account price increases over the period, and rising interest charges on that part of the flow involving credits rather than grants, there has probably been little if any increase in the financing flow in real terms. Over the whole period, the share of the United States in the resources provided by the DAC countries has been about 50 per cent. For all DAC members together, the net flow of financial resources to developing countries equalled about 1 per cent of their combined national incomes in 1968.

There are many efforts to find ways to increase this flow -- and to make it more productive. We would like to see more use of the multilateral agencies in this process, less tying of aid to exports of individual donor countries, and more recognition of the problems of debt financing -- especially when credits are at high interest rates and for relatively short maturities. I do not have to recite all the problems -- they have recently been analyzed in the reports of the Pearson Commission, sponsored by the World Bank, and the Peterson Report, reviewing the United States' experience with foreign assistance.

My point is that a very great effort will be necessary on the part of the Governments of the developed countries to raise future flows of developmental assistance. They will have to convince their citizens that this is a high priority national objective; they



will have to make room in tight budgets; they will have to find ways to make the aid process more efficient, and they will have to avoid the build-up of crushing burdens of debt repayments. For my part, I would be prepared to work very hard to bring about a larger and more efficient assistance effort. But I also want to stress that recipient countries must understand that we are not talking about providing excess resources, we are talking about the sharing of scarce resources. And this process will not work at all unless the resources are really put to work in the recipient countries. The more evidence we can show that the aid process is achieving its developmental goals, the easier it is for us in the industrialized countries to convince our citizens that they should finance the process through their tax payments.

Private capital movements. The place of private foreign financing for development is a good deal more controversial, as we all know, Nevertheless, I think we need to take a fresh look at both the costs and benefits of such investment.

In the first place, if much more financing will be needed by developing countries in the years ahead -- and the increase is more than can be counted on from official sources -- there will be a need to cultivate international capital markets to bridge the gap. Again referring to the reports of the DAC, the net flow of private capital from member countries to developing areas has been rising over time, from about \$3 billion on average in 1960-64 to \$4 billion



in 1965-67 and nearly \$6 billion in 1968. In 1968, net private flows were only \$1 billion less than official flows, and for the whole 1960-68 period private flows accounted for about 40 per cent of all financial flows to the developing countries from DAC members.

Undoubtedly, there are problems connected with rising flows of private capital with which we have to cope. One obvious problem is that a rising portion of the private flow seems to be export credits -- many of which are relatively short-term with relatively high interest rates. Although a rising volume of export credit outstanding is a normal complement to an enlarged flow of trade, we must be on our guard to avoid dependence on such credits as a substitute for long-term financing. If not, before long, we will find a larger and larger part of our developmental flows being absorbed in repayment of commercial credits. Frankly, industrial nations -- and not alone the United States -- that are supplying long-term developmental capital will not be happy if they find they are merely financing the repayment of export credits from other countries.

Another potentially important source of capital for developing areas is the public capital markets. Here we come directly into conflict with the fact that interest rates even to well-known domestic borrowers will probably remain very high. For most developing countries, there would need to be an expensive and extended effort



to create acceptance of bond issues by the general public in the United States or European markets. One way out of this is to make more use of the multilateral organizations as intermediaries in the borrowing process. To the extent their debt is guaranteed by the Governments of their members, and they are recognized entities in the market, they will be able to borrow on terms at least as good as those of other prime borrowers. Our capital markets in the United States have been very receptive to the bond issues of these organizations -- principally the World Bank.

Another hopeful development is the extraordinary growth of the European market for international issues, as well as the increased effort to open up some national markets to foreign borrowers. Here again, the international institutions are in the best position to raise funds on reasonable terms. On the whole, however, I believe it would be advisable for individual countries to be very cautious about incurring a large bonded indebtedness. To succeed in selling such issues, a country must be prepared to meet the test of the market -- which will look to the expected performance of the country in assessing the risk involved. In most cases, interest rates will be high, and I would urge borrowers to be very sure that the proceeds will have a productive use that will contribute -- directly or indirectly -- to the future ability of the country to repay debt.



Finally, I would like to comment on the other principal source of private capital -- private direct investment. This is really more than a source of financing, because along with a capital inflow comes the ability and knowledge to put idle domestic resources to use and to bring a quick return in the form of both rising incomes and balance of payments benefits. I know the historical record is mixed: sometimes the foreign enterprise has taken out of the country a disproportionate share of the product of the enterprise, and sometimes there have been undesired social or political consequences. But I believe the Governments of the developing countries are now better able to see to it that these investments are operated equitably and maintain a proper role in the society of the host country. For their part, the direct investors have learned, I believe, that their long-run interest requires that they fit into the society of the developing countries, and they recognize that their role must be developmental rather than exploitative.

Direct investors are not philanthropists -- they will invest because a profit can be made with reasonable security of capital. I believe the record will show that on the whole such investment makes a major contribution to foreign exchange resources -- even after deducting remittances of earnings -- and that its potential for generating employment, especially skilled employment, is substantial. I am not here to promote direct investment as a cure-all for development problems. But I believe it has an important place, and that



developing countries should consider its potentialities, in today's circumstances, without prejudice but in a straightforward business-like way. Calculate the costs and benefits realistically -- and remember to compare these costs and benefits with those that must be faced when one borrows abroad, or when one attempts to draw domestic savings into the development process.

Balance of payments constraints. I mentioned earlier the fact that mounting demands for more and better goods and services in the industrialized countries will create opportunities for the less-developed countries, but they will also create difficulties. Another problem we face today in the United States is that our balance of payments has been in deficit for a long time, and progress toward a stronger balance is disturbingly slow. We have only recently begun to improve our trade balance, and it will take careful demand management in the years ahead to avoid deterioration. Imports have been growing relative to our GNP -- particularly imports of finished goods -- and this has already triggered a strong protectionist drive. We have had to put restraints on capital outflows in order to avoid even larger deficits. Yet, I believe we have succeeded in confining the restraints to flows to the other industrial nations without interfering with flows to developing countries.

These are immediate problems, but they also cast a shadow on the prospects for the longer run that we have been discussing. It



seems to me that other industrial countries have to recognize that the United States cannot shoulder a rising burden of development assistance unless its export surplus on goods and services is considerably improved. This is very difficult to accomplish if competing countries also aim at rising export surpluses, and rising reserves, and resist exchange rate or other adjustments that would help to smooth the way for increasing world trade and capital flows.

Developing countries, therefore, have a direct interest in seeing to it that the international adjustment process works smoothly. More specifically, industrialized countries other than the United States will have to be prepared in the years ahead to finance their growing trade surpluses with long-term financing on terms that meet the needs of developing countries.

Concluding Observations

I do not want to leave the impression that we will fail to respond to the needs of the developing countries in the decade ahead. We all hope it will be a decade of progress in all parts of the world. I do want to emphasize, however, that there are not enough resources in sight to satisfy the aspirations of all of our people, and that it will take real statesmanship and determination to bring about the redistribution of resources that will be called for.



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DATE 8/13 [1970]

TO Chairman Burns

FROM ROBERT SOLOMON

You may be interested in this
report on Governor Brimmer's visit to
Liberia.

Attachment.



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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

August 27, 1970

~~CONFIDENTIAL (FR)~~

To: Federal Open Market Committee

From: Mr. Broida

At the FOMC meeting of August 18, 1970, Governor Brimmer mentioned that a report giving highlights of his recent trip to Africa, which was then in preparation, would be distributed shortly. A copy of that report is enclosed.

Arthur L. Broida

Arthur L. Broida,
Deputy Secretary,
Federal Open Market Committee.

Enclosure

Determined to be an
Administrative Marking

By TMIH NARA, Date 4/18/22



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