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United States of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 90th CONGRESS, SECOND SESSION

Republican Balance-of-Payments Seminar

REMARKS
OF
HON. CHARLES E. GOODELL
OF NEW YORK
IN THE HOUSE OF REPRESENTATIVES
Monday, February 5, 1968

Mr. GOODELL. Mr. Speaker, at no time in its history has the United States confronted a more serious crisis in its international financial relations than it does today. The effect of the British devaluation was to make the dollar—as the key currency in the world monetary system—even more vulnerable than it had been to speculation. Almost $1 billion in gold moved out of this country in the single month of December, bringing our total gold reserves to their lowest point in 30 years.

The speculation against the dollar continues and has been aggravated by the announcement that our balance-of-payments deficit for 1967 will be in the $3.5–$4 billion zone, the largest such deficit since the crisis of 1960–61. These developments have raised grave questions as to whether the existing international monetary system has not become so fragile as to be in danger of collapsing without warning and plunging the world back into the financial chaos and trade restrictionism of the 1930's. President Johnson's response to the crisis was his announcement on New Year's Day of a comprehensive program of controls on movements of American capital abroad, on bank lending abroad, and on tourist travel, primarily to Europe.

Do these measures not already constitute an ominous step backward toward the controls and protectionism of the unlamented 1930's? Are there no other options open to the American people for resolving the crisis and rescuing the dollar? These are issues which are clearly of momentous import to the Nation, not only in terms of today but probably for years ahead.

Mr. Speaker, it was to consider these very questions that the planning and research committee of the House Republican conference, of which I have the honor to be chairman, sponsored a seminar on January 24, 1968, on the balance-of-payments problem and the President's proposals for coping with it. Some of the Nation's most distinguished authorities in the field of international monetary affairs were panelists in our seminar. They included: Mr. Edward Bernstein, Edward Bernstein Consultants, Ltd.; Prof. Robert Triffin, Yale University; Prof. Gottfried Haberler, Harvard University; Prof. Robert A. Mundell, University of Chicago; Dr. Howard Piquet, Library of Congress; and Dr. Patrick M. Boarman, director of research, House Republican conference and professor of economics, Long Island University (C. W. Post College).

In addition, the following distinguished economic journalists and representatives of leading national associations participated in the seminar as observers: Mr. Edwin L. Dale, Jr., the New York Times; Mr. Hobart Rowen, the Washington Post; Mr. Richard Janssen, the Wall Street Journal; Dr. Carl Madden, U.S. Chamber of Commerce; Mr. George Hagedorn, National Association of Manufacturers; Mrs. Elizabeth Jager, AFL–CIO; and Mr. John Petty, Treasury Department.

We were fortunate in having in the audience and as participants in the discussions many Members of the Congress, both Democratic and Republican. The expression of interest in the seminar proceedings has been exceptional on the part of the Members, the press, and the public. In order to make this material available to a wider public, I include in the RECORD the individual supporting papers submitted by the seminar panelists and the transcript of the seminar itself:

THE U.S. BALANCE-OF-PAYMENTS PROBLEM

(Seminar, Planning and Research Committee the Republican Conference, House of Representatives, Washington, D.C., January 24, 1968)

The Committee met, pursuant to notice, at 9:30 A.M., Honorable Charles E. Goodell, presiding.

Present: Representative Charles E. Goodell, Chairman.

Dr. Patrick M. Boarman, Director of Research, House Republican Conference.

PANELISTS

Mr. Edward Bernstein, Edward Bernstein Consultants, Ltd.

Prof. Robert Triffin, Yale University.

Prof. Gottfried Haberler, Harvard University.

Prof. Robert A. Mundell, University of Chicago.

Dr. Howard Piquet, Library of Congress.

OBSERVERS

Mr. Edwin L. Dale, Jr., the New York Times.

Mr. Hobart Rowen, the Washington Post.

Mr. Richard Janssen, the Wall Street Journal.

Dr. Carl Madden, United States Chamber of Commerce.

Mr. George Hagedorn, National Association of Manufacturers.

Mrs. Elizabeth Jager, AFL–CIO.

Mr. John Petty, Treasury Department.

TRANSCRIPT OF THE SEMINAR PROCEEDINGS

Mr. GOODELL. It is my very great pleasure to welcome to our seminar today the distinguished members of our panel, my colleagues, particularly those in ranking positions on the key committees that are going to be considering this important subject in the weeks and months ahead, representatives of the Chamber of Commerce and the National Association of Manufacturers, the AFL–CIO, and particularly the gentlemen of the press.

This seminar is sponsored by the Republican Planning and Research Committee in the House of Representatives. Our subject is the balance of payments problem and President Johnson's recently announced proposals for dealing with it. As Republicans, as Members of Congress, and as Americans we are deeply concerned by the persistent deficits in our balance of payments, particularly by the record deficit of almost $4 billion in 1967.

We are not meeting here on partisan terms and our participants certainly are not here as Republicans or as Democrats. They are here as experts on a most serious matter which we feel should be debated and discussed to enlighten the Congress and the American people to the fullest extent possible.

We are alarmed at the massive decline in our gold reserves which followed the devaluation of the British pound and, as a consequence of these developments, the threat of imminent international monetary crisis which hangs over this country and the entire world. We are equally concerned, may I add, by some implications of the remedies recently proposed by the President.

On January 1 and again in his State of the Union message on January 17, President Johnson proposed a series of measures of a drastic nature aimed at reducing the balance of payments deficit by $3 billion in 1968.

Misgivings have been expressed on many sides about the possible impact on the world economy and our own long-run international position of the President's announced mandatory restrictions on direct private foreign investment, the proposals to reduce the tourist deficit by a head tax on tourists, or possibly by rationing foreign exchange to tourists, and the suggestions to allow a tax rebate for exports, and to levy new imposts on imports.

Many serious questions have been asked and must be asked concerning the domestic and international implications of the de

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facto exchange controls proposed by the President. At the same time, I would like to emphasize the fact that in convening this seminar, we have no preconceptions with respect to the substantive issues that may be raised. The issues are, indeed, bipartisan, and are of momentous import not only to the Congress, which must act on certain portions of the President's program, but to all Americans.

For this reason we believe it is imperative to begin at once a public dialogue on the President's proposals. And we regard this seminar as the first step in making available to the Congress and the Nation an impartial evaluation of the President's recommendations and an equally unbiased examination of the feasible alternatives to his program.

To this end we have been most fortunate in assembling here a number of the country's most distinguished authorities in the field of international monetary affairs. I would like to present them briefly to you:

Mr. Edward Bernstein, of Edward Bernstein Consultants, here in Washington; Professor Robert Triffin, of Yale University; Professor Gottfried Haberler, of Harvard University; Professor Robert Mundell, of the University of Chicago; and Dr. Howard Piquet, Senior Specialist in International Economics in the Library of Congress.

Gentlemen, we deeply appreciate your taking the time from your busy schedules to help us, we hope, shed more light on a most complex subject.

In addition to our panelists, we have invited several distinguished representatives of the press who specialize in economic affairs and representatives of leading national organizations to participate in our seminar as observers.

May I introduce Mr. Ed Dale, of The New York Times; Mr. Hobart Rowen, of The Washington Post; Mr. Richard Janssen, of The Wall Street Journal; Dr. Carl Madden, of the United States Chamber of Commerce; Mr. George Hagedorn, of the National Association of Manufacturers; and Mrs. Elizabeth Jager, of the AFL-CIO.

In opening our discussion I would like to suggest the following simple agenda. It seems logical to divide our topic into the following three parts:

1. The problem.
2. The President's proposals for solving it.
3. The other options or alternative courses of action which are open to this country in lieu of the action program requested by the President.

We shall hear first from our distinguished panelists. May I suggest that, in the interest of making optimum use of our time, each participant keep his remarks within a reasonable time of eight to ten minutes. Let me add that our panelists have submitted longer statements of their views and that these are available here to interested members of the press and Congress.

After we have heard from all of the gentlemen on our panel, I propose that we allot a further period of time for an exchange of views among the panelists and that thereafter, until the close of our proceedings around noon, we open the seminar to questions and comments from the members of Congress who are here with us on the dias and from our distinguished observers. I note the presence of a good number of members of Congress of both parties in the audience and I hope they will feel free to submit questions also.

May we begin with a description of the problem? Professor Triffin, would you be kind eough to start us off?

Professor TRIFFIN. Thank you very much, Mr. Chairman.

As you very well said, we cannot really appraise a cure without knowing what the disease is. We cannot solve the problem without knowing what the problem is.

I think the difficulties which we face must be viewed as two problems and not one, two problems which are inextricably linked together: the problem of the balance of payments and the problem of the weaknesses of the international monetary system.

The solution of either one of these problems would have very beneficial effects on the other and would contribute to a solution of the other. I think, however, that neither of these problems can be solved fully in isolation from the other. We cannot expect our own balance of payments problems to disappear and be solved simply by international monetary reform nor can the problem of international monetary reform be fully solved as long as our balance of payments deficits remain as large as they have been.

Let me turn first to the problem of international monetary reform and be extremely brief and unpleasantly blunt about it. I think the basic fact is that the old gold exchange standard on which we have lived for the last fifty years is now dead or at least it is dying.

It rested essentially on two sources of supply for the increase of world reserves which are necessary to sustain international trade and production. These two sources of supply were gold, on the one hand, and, secondly, gold convertible foreign exchange, primarily sterling initially, and since the end of World War II, primarily, the dollar. Both of these sources have dried up.

I need not expand on the drying up of the gold source. Over the last five or ten years it has provided only an ever decreasing fraction of the general increases in world reserves, something of the order of 25 per cent, at most, in the years 1960–64, for instance. And two-thirds of this accretion came from Russian sales in Western markets.

But the problem is even worse today. In the last two years the official gold reserves of all central banks together (who are members of the International Monetary Fund) have been declining. They are no longer increasing. They had been declining by about $200 million previous to the big gold rush of last December. And then they declined dramatically to a point which has not yet fully been disclosed but which probably is well in excess of $1.5 billion, certainly of that order of magnitude.

Therefore, quite obviously, we cannot count on gold unless we adopt the insane solution proposed by Mr. Rueff, the doubling of or a substantial increase in the gold price. I need not, I think, indicate to this kind of audience the reasons which I gave in Paris last week why this is a most irresponsible type of action and contrary, in fact, to the rational long-run evolution of the monetary system.

Moreover, the second major source of increased world reserves after World War II, viz., gold convertible foreign exchange, sterling and dollars, also has dried up.

I think that, essentially, the system is bound to last only for a while. The death of a reserve currency is written in its birth certificate, for the simple reason that it can remain viable only by accumulating larger and larger short-term debt, convertible at any time into scarcer and scarcer gold metal. This cannot last indefinitely. Reserve currencies have never lasted and never will, in that form.

Events are quite clear as far as the two reserve currencies are concerned, the dollar and sterling. Together they still constituted $18 billion of net monetary reserves in 1949. Today this figure has declined to something of the order of minus $10 billion.

During the same period, the reserves of the rest of the world have increased from $18 billion to something approximating $54 or $55 billion. This is an evolution which cannot continue forever and it is bound to kill the reserve currencies that try to support it.

Now, if we do nothing, if the world cannot succeed in solving this problem, I think that the path is very clear. It is traced for us by the path of sterling in the years since 1931.

Somebody said—I think it was General MacArthur—old generals don't die, they fade away. I think that we can apply the same maxim to our reserve currency. It doesn't die, it shrinks.

When Britain found itself unable to continue to support sterling as a worldwide currency, it salvaged what it could by making it a regional currency, the currency of the sterling bloc in the 1930s. At that time, the members of that bloc, other than Britain, would accumulate the largest part of their reserves in sterling and Britain would manage the gold pool which would make settlements for the whole sterling bloc to outside members.

But the difficulties increased for the British. I must say that they were magnified, of course, out of all proportion by the Second World War and in the end the sterling bloc had to be transformed into a sterling area. To slow down leakages of gold from the members of the bloc to outsiders, a preferential system was organized within the area, which involved the institution of various kinds of trade preferences, and joint discrimination against the non-members of the area. This was the fate of the pound sterling.

Gentlemen, if we don't do something about it, the same kind of fate is going to befall the dollar. In fact, we are gradually slipping into a policy, the consequence of which would be to my mind immensely damaging, not only financially and economically but even politically.

There are some isolated voices which consider that a dollar bloc would indeed be a good solution. We are far more powerful than Britain. We could force many more countries than Britain ever did into a dollar area system. What would this mean insofar as it is successful? And I think it has helped us considerably already over the last few years. But what would it mean if you really tried to perpetuate such a system as some people would like to do?

The end result would be this: Total irresponsibility at home and a political blow-up abroad. At home it would be very hard for the Administration or for Congress to follow responsible economic and financial policies if we can incur continuous deficits and have these deficits financed by the accumulation of dollar IOU's by foreigners. This would invite irresponsibility here.

As far as the foreigners are concerned, it would put them on notice that they have entered the dollar area, that they are bound to finance any amount of deficits that the U.S. would incur. It would mean that foreigners would have to finance those deficits regardless of their size and their origins. I think that there would always be people to point out that foreigners would clearly view as irrational a system to have their own printing press work to finance our deficits. I am quite sure that in the end, even if central banks in some countries were inclined to accept this solution for fear of the alternative which would be chaos, these Central Banks would not, in the end, be supported by public opinion or parliament. This would be especially true when, as now, U.S. policies, decided unilaterally here, appear to be contrary either to the interest of the prospective lenders or to their view of international morality or common sense. And this obviously would be the case because of our absurd and immoral venture in Vietnam and in Southeast Asia.

Broad resolutions have already been adopted, many of them unanimous or nearly unanimous, by three parliaments of countries which are very friendly to us, expressing their desire to see the bombing of the North stopped or even withdrawal from Vietnam

itself. Will these people accept the financing of policies to which they are deeply opposed? I think this would be an invitation not only to an economic blow-up but to deepening and frightening divisions with our NATO allies.

This being said, gentlemen, I don't think that any responsible person that I know would favor such an awkward situation, but we may be slipping into it gradually without wishing to do so, as has happened to us in Vietnam itself.

To conclude this broad review (I think my time is just about up), I will refer very briefly to remedies proposed by the President on January 1.

I think this program can be interpreted in two different ways. It leaves us an option between long-run policies which could follow two diametrically opposed lines. The first one—and I sincerely hope it is the one which is in the mind of the administration—is to meet the conditions which have been requested by our European partners for honest and fair negotiations within the framework of the International Monetary Fund. They have been clamoring for years for correction of huge and persistent deficits as one of the prerequisites for activation of the new monetary agreement. We are now trying to give them full satisfaction. We are taking a major step to meet that demand.

I hope that this is the preface to a speedy and decisive negotiation of an international agreement which could become effective even before we activate the real machinery which, as you know, still has to be hatched by many congresses and parliaments.

There is, unfortunately, a second interpretation. We have been classifying all the countries of the world into three groups: The paradise or heaven, purgatory, and hell. This is perfectly justified if we look at their relative strengths or weaknesses because we don't want to hurt countries which are already weak or which are poor.

But, on the other hand, we see already the reactions we may expect (witness those of my former countrymen, in Belgium) when countless people are transferred from one classification to another. They will prefer to be in purgatory rather than hell, or in heaven rather than purgatory. One of the things we may be tempted to do would be to say, "All right, you may enter the dollar area as long as you take dollars and don't convert them into gold." We would be slipping, then, into the solution which I consider fatal to us in the long run.

Now—and this was the message which I tried to carry to Paris last week—it is for you to decide because I think that the Administration itself is deeply divided on this. I suspect that it has not fully made up its mind. In any event, we have to have cooperation and a new will to cooperate, more fully than we have had, on both sides of the Atlantic. We cannot do it on one side alone.

I am sorry to say, as of now, being purely an academic without any kind of official responsibility in this matter, I remain myself very much puzzled as to what the ultimate outcome will be.

Thank you.

Mr. GOODELL. Thank you, Professor Triffin.

At the outset I indicated to the participants that they could range across the board on any issues that they felt were directly relevant to our problem here. Let me express the hope, however, that while recognizing that Vietnam is relevant in many ways, we have enough issues to divide us without debating the propriety of our involvement in Vietnam and I hope we won't get off on that.

I think we would like to hear from Mr. Bernstein next.

Professor BERNSTEIN. I recognize as Professor Triffin does, that we have two problems here, though I think he does have a third problem that is bothering him and which I shall not discuss.

We have a balance of payments problem. The external evidence of this balance of payments problem is that in the last ten years our gold reserves have dropped over $10 billion.

It is interesting to note that the gold reserves of the United States on January 1, 1958, were slightly larger than they were on December 31, 1950. The real balance of payments problem, therefore, is a ten-year problem. That is long enough.

In the last year we have paid out about $1 billion of gold, nearly all of it in the last two months. Essentially, we have been spending or paying out far more dollars for imports, for services, for government military expenditures, for aid and for private investment, than foreigners have wanted to use in buying goods and services in this country or to add to their liquid investments, their private dollar holdings.

And when the foreigners get too many dollars they convert the dollars into their own currencies by selling them to the central banks. The central banks, in turn, convert the excess dollars into gold.

Now, we must not confuse the problem of our balance of payments with the outflow of gold. The outflow of gold is the symbol of the problem. The problem is that we have been paying out to the world an excessive quantity of dollars, excessive, that is, compared to what the rest of the world wants to use and wants to hold.

Now, the solution to that problem is the most urgent business which exists for our economy, domestic and international, and for our monetary system, for the monetary system of this country and for the international monetary system.

There are other problems of a long-range character. There is a long-range gold problem. That long-range gold problem is the fact that gold, the traditional reserve, is no longer growing. As Professor Triffin has pointed out, total gold reserves have declined in the last few years and have recently dropped sharply as the result of the movement of gold into private hoards and speculative holdings.

Now, there is no way of supplying gold reserves even if we had a strong balance of payments with the rest of the world. There is no way of providing gold to the rest of the world when there is a shrinking aggregate of gold reserves except by their cannibalizing our gold reserves.

Now, mind you, I am not arguing that this is already happening. It may be an element in the persistence of our balance of payments. It is, however, a problem we are going to have to deal with in the future. And, as Professor Triffin has already pointed out, a growing world economy needs a growing volume of reserves. There may be no mechanical link, no precise mathematical relationship between the growth of the world economy—that is international trade and payments and investment—and the quantity of reserves that the world needs. But it is quite clear that you cannot have zero growth of reserves while you have a continually expanding world economy.

Now, this problem of providing the world with adequate reserves is, I think, well on the way to solution through the special drawing rights. I am very hopeful that the lessons of the last three months will stimulate activation of the plan for issuing a new fiduciary reserve in the form of special drawing rights.

The gold problem, in my opinion, will remain and it needs very special treatment.

I come now to the basic problem, the one that ought to concern us most because it is the prerequisite for doing anything else. I said that our real problem is that we are paying out for goods and services, for military expenditures and aid, and for private capital investment far more than the rest of the world wants to use in purchasing goods and services and assets in this country or to hold as liquid dollar investments.

The solution to that problem has to be a reduction in our payments relative to our earnings. It would be wonderful if we could solve this problem by increasing our foreign exchange receipts. But in the short run, this is quite impossible, so the immediate solution must involve a reduction of the outflow of dollars to the rest of the world.

Now, I must warn you that there is no easy way to solve the balance of payments problem. Anybody who tells you that there is a painless, automatic way of reducing the payments of the United States so that we won't feel it and the rest of the world won't feel it is selling you an elixir, a patent medicine that really has no effect on the body economic except to intoxicate it. The truth of the matter is that every solution to a balance of payments problem involves pressures, pressures on the country itself and pressures on the world economy.

The big question is: having allowed ourselves to drift into this difficult position, what is the solution that will have a minimum adverse effect on us and a minimum adverse effect on the world. Without subscribing in detail to everything that is being done now, and I think it would have been well if we had done it sooner, what is being done is designed to have a minimum effect on the United States and a minimum effect on the world.

The most important aspect of the President's action program, is that it does not envisage any reduction in trade in goods and services, with the single exception of a penalty on travel outside the Western Hemisphere.

As Professor Triffin has said, the big part of the program is to reduce the private capital outflow. The reduction in the private capital outflow is to be achieved mainly in respect to the surplus countries of Europe. Presumably, these countries can afford to operate their economies at a high level even if their foreign exchange receipts decline. They can do this because they have strong balances of payments and large reserves.

Now, for the surplus countries of Continental Europe, there is to be no net new funds coming from the United States for direct investment there. With respect to those industrial countries and oil-producing countries on the edge of having some payments difficulty, we will permit the maintenance of a level of direct investment (through new funds transferred to England, Canada, Japan, and Australia) which, together with retained earnings, will be about 65 per cent of the average of what they had in 1965 and 1966. This is, incidentally, a very high historical base.

The poor countries, the less developed countries get very generous treatment. They are in heaven, as Bob Triffin has said. They can have 10 per cent more than the base they had in 1965–1966. In fact, that is more than they would get under normal conditions.

To facilitate adjustment by our own companies, transfers are allowed within each group of countries so that if, say, General Motors needs the money in Belgium instead of in Germany, it can transfer the funds (these may be earnings not required to be repatriated to the United States from Germany). And if United States companies operating in Canada find that they have more than enough money for Canadian investment, they can move money from Canada to England, if they have operations in the latter country. It is easy to exaggerate the impact the President's program will have on the group B countries because there is one big safety valve and that is the freedom of the

Canadians to borrow all they want here so that funds can move say, from Canada to England without violating either our regulations or without causing too much hardship.

Nevertheless, I don't want to brush the difficulties away. This program is going to be hard on the countries that are not in surplus (except for the less developed countries).

Now, superimposed on this essential program of direct investment control there is a requirement to bring back about $600 million in loans outstanding to the continental countries of Europe. In 1968, 40 per cent of the American short-term loan portfolio will be liquidated and as many of the long-term loans as mature.

The government itself is undertaking a program to save $500 million on the foreign exchange costs of its enormous operations overseas. Some civilian workers will be brought back. Another $100 million of aid will be tied. It is a wonder there is any more left to tie. And presumably there will be some method of economizing further on the foreign exchange costs of our military operations overseas.

As I said, this is not an easy program. I don't think there is any danger that this will lead to a world deflation. In fact, I think it is the only kind of program that could give us a quick improvement in our balance of payments without generating deflationary forces.

It is a pity that we have a balance of payments problem of this magnitude. It is a pity it wasn't dealt with more effectively before. That doesn't alter the absolute necessity of doing something drastic on a big scale to restore the dollar to a position where it is a currency that countries everywhere feel they want to use and want to hold. And that means that we have to restore equilibrium in our balance of payments.

Thank you.

Mr. GOODELL. Thank you, Mr. Bernstein.

Mr. Haberler?

Professor HABERLER. Mr. Chairman, ladies and gentlemen, I should like to start at the other end from which my friend, Robert Triffin started, namely from the domestic situation. Later, I shall comment on alternatives and the international monetary system.

Looking at the program outlined by the President in his New Year's Message, let me say quite frankly I find it absolutely shocking. It is a big step. It is really a big step in the direction of more and more controls. It is a big step in what used to be called the Schachtian system, the system which was invented by the Nazi economic wizard, Hjalmar Schacht.

Of course, this drifts into more and more controls. That has been going on for quite some time. Our policy has been one of drift to more and more controls. We started by reducing tourist expenditures, you may remember, and later capital controls were imposed. The capital controls were at first mild; then they were made tighter, and now they have been made mandatory. Controls on bank lending are also virtually mandatory.

If you reflect on the details, the President's program is simply horrible. And one very bad aspect about it is the discrimination that Professor Triffin mentioned. I believe Congress should act to counteract discrimination between the Western Hemisphere and the rest of the world, and I see no justification why tourists going to Israel or to Italy should be taxed and those tourists going to Mexico, which they adore, should not be taxed. If the program involves restricting the amount of money the tourist is allowed to take out of the U.S., that is very easily evaded. We shall need a lot of police supervision to reduce such evasions, including censorship of the mail, etc.

If on the other hand the objective is accomplished by putting a head tax on departing tourists, that is outrageously regressive. Rich men can afford the additional cost, the poor cannot. When the details of the program are examined, they add up to what used to be called Nazi methods. I only hope the Congress will not go along with that.

Now the capital controls are not quite so revolutionary because bank investments were previously subject to controls. However, the controls have been made far more stringent. It is interesting that there is a law already on the books—it was passed in 1917—which gives the President the powers to do all sorts of things in case of war, in case of a declared emergency.

Indeed, the President could have put the tourist controls into effect under the terms of this law. I think it covers this thing and much more. But evidently he felt that was going a little too far, and that is just as well.

The controls on direct investments will probably help in the short run. The program includes a moratorium on direct investment in Western Europe (excluding Great Britain, Greece and Turkey). Since Western Europe was the place where most of the direct investment went, this part of the program will doubless be effective. However, direct investment in the long run yields interest and repayments. In fact, investment income from abroad has grown very rapidly—it is now running the rate of $5 billion. The long term impact of these controls on the balance of payments will thus be adverse. In the short run, it probably also means a loss of exports. American affiliates and subsidiaries abroad account for a very large percentage, 25 per cent if I remember correctly, of the manufacturing exports of the United States.

So, in the medium run the program will reduce some of our exports and in the long run it will cut into investment income. Hence, the program will be counterproductive in the long run even in narrow balance of payments terms.

In addition, an enormous amount of supervision will be required. Any investment which exceeds the very narrow limits allowed outside Western Europe will have to be separately investigated. A new office has been established in the Department of Commerce which has already started to issue explanatory amendments closing loopholes and to make exceptions where necessary. It would be very easy to picture how this system will snowball into an enormous bureaucracy.

The other programs mentioned in the Presidential Message are partly things which have been said many times. We are going to stimulate exports. We are going to persuade foreigners to come to the United States. That has been said in every speech and every statement on the balance of payments for the last thirty-five years and it is becoming a little stale. And to stress them so much cannot help but arouse suspicion that nothing decisive will be done.

There is one thing on which I would like to comment, namely the proposal that a tax be levied on imports (the figure I have seen is 3.5 per cent), and a tax rebate on exports to compensate for internal indirect taxes. Now this is a system which other countries have operated. The Germans have it. The French have it. But the reason is that they have a national turnover tax which we have not. We have only local and state taxes of the indirect kind which makes the administration of such a measure rather complicated.

But what I would like to point out is that this is disguised devaluation. If you put a tax of x percent on all exports or imports, and apply a similar refund to all exports, this is a disguised devaluation of that amount. You can even look at the tourist proposals as a disguised devaluation of the tourist dollar. Most of the other restrictions are really disguised kinds of partial devaluation.

The port tax proposal plan—a tax on imports and a tax refund on exports—is a system which comes much closer to real devaluation than the other programs, because it would affect a large segment of the American balance of payments, all exports of commodities and imports of commodities.

Let me make just one further remark on this. For the United States, the proposed tax innovations would be something entirely new. The United States has not so far practiced export subsidies on any extended scale. So if this were not highly restricted, if all exports were subsidized to compensate for domestic taxes, an entirely new dimension for foreign economic policy and for trade policy would be opened up. And I think this is a very serious matter. You would have to set up a new administrative machinery which does not exist. The European countries are in a different situation because they have the requisite machinery in place.

It can be shown quite clearly that such a system, once installed, will be used for other purposes. The tax refund and the border tax on imports would not be uniform. They would be equivalent to a devaluation but would be differentiated according to commodities and according to countries, thus introducing a new kind of discrimination.

So I think the Presidential program is bad; moreover, it is quite inadequate. I should mention in passing that the figure which the President used referring to this year's balance of payments deficit of $3.5 or $4 billion is an understatement. If you allow for all the cosmetic devices which are being used to make the balance of payments look better, you have to add at least $1 billion, probably more.

But I don't want to be exclusively critical. I want to say something about alternatives. Here, I find myself in some disagreement with earlier speakers. It appears to me that the first thing we need to do is to stop or slow down inflation. After all, last year the quantity of money increased at a record rate, something like 7.2 per cent. Everything has gone up much faster than in prior years. By way of contrast, the period 1958 to 1964 was one of fairly stable prices.

Inflation, in short, has to be stopped. A record budget deficit is in the making and I don't see how it will be possible to avoid a tax increase. I am all in favor of reducing expenditures, but I don't see how you can cope with a deficit of $20 billion or more, realistically speaking, in political terms, by reducing expenditures. So a tax increase probably will have to come. The alternatives would be that monetary policy would have to become extremely restrictive, with interest rates rising sky-high, and so on.

Now, may I say a few more words about the things which Professor Triffin discussed. The international monetary system isn't quite what it is supposed to be, but I cannot take quite such a pessimistic view as my friend, Professor Triffin. For instance, the United States started out with a tremendous international reserve so there was really a lot of time and a big margin within which action could have been taken.

Of course, the answer will be that the United States had to have the deficit in the first years after the war in order to supply other countries with international reserves. This of course is perfectly true. The deficits in the American balance of payments up to 1960 and a little thereafter were necessary because gold production wasn't sufficient to meet the demands of the countries that wanted to accumulate international reserves.

But the situation has now changed. Other countries don't want more dollars, so the deficit in recent years cannot be justified on grounds that it was necessary to supply international reserves.

I agree that the point will come sooner or later, if world trade goes on rising as it has in the post-war period, when larger international reserves will be necessary. But I don't think this point has come. We have a confidence crisis which is rather different from a liquidity crisis. First, confidence in sterling, now confidence in the dollar has been shaken.

But somehow I imagine this problem will be solved. Our present system which has been criticized so much was able after all to surmount a number of confidence crises. The crisis of confidence in the pound was handled. The Italians got into trouble a few years ago. That was handled. Of course, if the dollar gets into still deeper trouble, that is a more serious problem. But I think the present system would be able to cope with that, too. And I would hope that the new scheme about which you heard so much, these special drawing rights which were accepted in principle at the Rio Conference of the IMF last summer, will come into being eventually and provide additional international reserves when they become necessary.

The only difficulty here is the disagreement between the big powers. The French are not willing to cooperate. Now I am not going to speculate on whether such an agreement will be reached. If an agreement cannot be reached, if the French remain adamant and the other Europeans go along with the French, then, of course, we would be in a difficult situation.

And now let me very briefly raise an issue on which I am sure most of the panelists will not agree, namely, flexible exchange rates. If an impasse is reached on the creation of international liquidity, our problem can still be solved by cutting the dollar loose from gold and letting it fluctuate. This might come in any event if inflationary policies are continued and our deficit goes on mounting. The present policy simply calls for controls where the alternative would be to cut the dollar loose from gold and let it float. I hope it won't come to it but I am not sure. If it comes to a floating dollar and if it is done in the proper way, I don't see any reason why that should do a lot of damage to the American economy.

An outright devaluation of the dollar by so many per cent—10 per cent or whatever it would be—would be difficult because we cannot know in advance what amount of devaluation is right. If you devalue a little too much, you get lots of other countries into trouble. If you devalue by too little, you don't solve the problem. So if it comes to the point where the international value of the dollar has to be changed, I think a much better system would be to let the dollar float. I am not optimistic that this will be done. I am afraid if we go on like we have, what we shall get is more and more controls. But one thing I am pretty sure about. People will get so fed up with controls, so disgusted with the petty annoyances they impose and with the supervision they make necessary, that they won't last very long. But to get rid of the controls won't be easy unless we do the right thing. The right thing is to let the dollar float; it will be fairly easy.

If you don't want to do that, then the alternatives are either to go on with the controls or have an outright devaluation where you are never sure whether it is too much or too little. Either route would be bad and it would be sheer luck if we were to hit upon exactly the right rate of devaluation.

Mr. GOODELL. Thank you, Professor Haberler. With you and Professor Triffin, we have set up a pretty good potential competition between Harvard and Yale here.

And I think now we will turn to the senior specialist on economic international economics from the Library of Congress, Dr. Piquet.

Dr. PIQUET. In twenty years of working for you gentlemen in Congress, I have learned that the more expert is the advice you get, the more confused you get.

I should like to approach this problem, not from the point of view of the many trees and shrubbery in the forest, but from the point of view of the forest itself, looking at it as a whole, from above, in fairly simple language.

For thirty-four years the United States has been the leader of the world in urging an open multilaterial trading system and a free and open payments system. It was our initiative that started the reduction of tariffs that culminated in the Kennedy Round. It was our initiative that resulted in the formation of the International Monetary Fund.

And now, in one day, we have cast doubt upon the credibility of the United States in really meaning what it has said in terms of fundamental policy. That is point one, which Gottfried Haberler brought out very well.

Point two, what is the problem? Is it a balance of payments problem or is it something else? There is always danger in economics of ignoring the fundamental on-the-scene forces and relationships and concentrating on the obvious, the superficial and the symptoms rather than the ailments. We have jumped at the conclusion, literally jumped at the conclusion that the only way that the United States can maintain international financial integrity is by having equality between its out-go of dollars or money and the in-flow of money across the national boundary line.

In fact, we have to do with two problem areas here. One is the financial area and the other is the monetary. The balance of payments itself is primarily a matter of financial transactions involving money transfers rather than money creation.

Now, if the United States were just another country, this accumulated balance of payments deficit would not have occurred because it could not have occurred. What would have happened was that the IOU's, the American dollars, would have come home to roost. The only place my IOU is good is with me unless you decide to use it as money among yourselves. Those dollars would have come back in the form of a demand for United States exports. And we would have been in balance. If we had had fluctuating exchange rates, balance would have occurred by way of a depreciation in the foreign exchange value of the dollar.

Now, then, if we analyze the figures in the balance of payments since 1960, we find that the subsidence of the gold rush at the fall of 1960, at which time we had a balance of payments deficit of $3.9 billion, followed upon President Kennedy's declaration that the United States was not going to raise the price of gold. The price of gold subsided in the London market from $41 an ounce back to $35 and our balance of payments deficit declined from $3.9 to $2.4 billion in 1961.

That deficit had been declining steadily through 1966. In 1965 it was down to $1.3 billion and in 1966 it was down to $1.4 billion. Taking the first three quarters of 1967 compared with the first three quarters of 1966, eliminating military expenditures only from the current balance—and they don't really belong in the current balance, in my opinion—but counting the trade balance and the balance on investment earnings and trade and transportation and miscellaneous services, we find an improvement in the first three quarters of 1967 over the first three quarters of 1966 by about $100 to $125 million.

There was, of course, an increase in the deficit on travel, largely explained by Expo '67 in Montreal.

In other words, what I am driving at is that it is possible that there was a big outflow of funds in the fourth quarter, but we don't have the figures on this. They are not yet available, except the global figures which were given by the President, $3.5 to $4 billion.* But at least through the first three quarters of 1967, with the exception of the travel account, we were in a better position than we had been previously.

Now this adoption of a restrictionist posture to solve the so-called problem casts doubt upon the credibility of the United States. Also, it will result in the long run, as Dr. Haberler pointed out, in a worsening of the balance of payments rather than a bettering of it. The simple reason is that the income returns on the direct investments which we're trying to curtail, looked at cumulatively for the last thirteen years, are about $16 billion larger than the total outflow.

Thus, even though the proposed program will provide some temporary relief for the balance of payments, there will not be a cure in the long run balance unless we get rid of these controls.

I cannot get away from the feeling that this problem is not a balance of payments problem. It is not a financial problem. It is a monetary problem. It is the question of whether the world wants to continue to use dollars as its fundamental money.

Throughout history the world has used many different things for money. Virginia used tobacco. Old Ben Anderson used to say, "You could use old dodo bones if people would accept them." The sole criteria of the value of money is its acceptability, the confidence that you can accept it and the expectation that you can pass it on to somebody else. Now what has happened?

Other countries decided long ago, because of the shortage of gold, to use dollars, the IOU's of the United States, the only country that hasn't devalued since 1933, at which time there was no reason to do it anyway. The dollar was the soundest currency in the world and they decided to use it as money. And there has been, as far as I can see, no actual loss of confidence in the dollar. If there were a fundamental loss in the credibility of the dollar, do you suppose that the dollars that are now circulating in Europe, dollars used by Europeans, loaned and borrowed and spent by Europeans, without any control by any government whatsoever, would have skyrocketed to the volume of $15 billion as reported in the Wall Street Journal for January 15?

Now, this doesn't mean to say that there won't be loss of confidence in the dollar and it doesn't mean that I disagree with my good friend, Robert Triffin, that there is not a strong need for a rationalized international monetary system. But mark you this, no monetary system will work unless the participants in that system, the leading participants want it to work. The gold standard can be wrecked if anybody wants to wreck it, if they have the power to do it. The dollar system can be wrecked. The IMF system can be wrecked.

Short of a world economy, a world sovereignty, a world government, we have the problem of international cooperation whether we want it or not. Why should we be the banker? Now we have been chosen as banker by the rest of the world and we're dealing in financial intermediation, meaning by that that we are serving as banker, that we are exchanging our short-run liabilities for the long-run liabilities of foreigners.

If I am a banker and you want to borrow to build a house, you give me your mortgage, your deed and your note and you repay me over, say, a period of ten years and I give you the cash. I am a banker.

Our obligations to foreigners now run about $60 billion, over half of which are short-term liabilities to banks, governments, and private people. Our claims against for-

*Official figures released in February 1968, showed a total balance of payments deficit for 1967 of $3.6 billion.

eigners amounted to $112 billion at the close of 1966. There is no question about the basic financial and economic strength of the United States. That is beyond question. The question is one of liquidity.

Liquidity in this case is the ability of the United States to redeem its dollars, its IOU's in gold at $35 an ounce.

We have now about a 40 per cent reserve of gold if we release the 25 per cent gold cover. A 40 per cent reserve, if the analogy of banking holds, is a pretty good reserve.

So what we need primarily, it seems to me, is confidence in ourselves, confidence in the fact that we are not weak and because the Europeans say we should do something doesn't mean that we should. I will conclude by saying that the President and you Members of Congress have other options. I don't think we are supposed to go into the options right now. We will come to them later.

But there are clearly other options than abandoning the long-run economic posture of the United States. This will start the world off again, as Dr. Haberler said, on a restrictionist path dangerously similar to what it was in the 1930's.

Thank you.

Mr. GOODELL. Thank you, Dr. Piquet.

Now we will move to that center of enlightenment, the University of Chicago, Professor Mundell.

Professor MUNDELL. Thank you, Mr. Chairman.

I hope you won't mind if I don't repeat the points on which I agree with other panelists. I should say first, I—I know I am disappointing Dr. Haberler in this—that I agreed with every word that Mr. Piquet, on my left, has just said. I think coming from outer space, that is Chicago, coming by airplane, it is unavoidable to escape the view when you travel up and look down that the world is round. But each time I come to Washington I see that the world looks flat. And having to present the idea that the world is indeed round is often shocking.

I find that analogy of some importance because had I been in Washington in 1960—I was here in 1961 or 1962—I could say this is where I came in. When I listened to Mr. Bernstein I wondered if his statement would have been changed in any sense had he been speaking ten years ago, in 1958 or 1960, when the balance of payments problem was first raised. Today, we have a particular set of balance of payments figures. We want to cut these figures on paper and so we impose restrictions, some voluntary, some mandatory. We put a little tax on this, a tax on that, in order to make the figures look a little bit better next year. But in fact the figures never look better next year and they won't look better next year and they won't look better ten years from now.

If we stop to think of what the U.S. balance of payments is going to be, not next year or five years from now, but ten years from now or fifteen years from now, we will find that when we examine these accounts in the balance of payments, going back to 1947 and 1950, and up to 1966, the U.S. deficit is larger than it is now. And it is larger than it is now not for spurious reasons but because of the systematic way in which the gold exchange standard operates.

And here I will have to part company with Robert Triffin. I don't think the dollar exchange standard is dead. I think it is going to get in the near future perhaps a new heart; such things are possible.

What has failed, as I think Dr. Piquet has made out, is our understanding of how the system is operating. If we look back over the figures for the past ten years of our balance of payments, we see this number, this magic number, $3.4, $3.9, $3.9, $2.4, $2.8, $2.7, $2.2 billion—all of the same order of magnitude. Why? Why is the balance of payments always $3 billion?

The gross national product increases by $50 billion every year. The gross national product in the United States is $800 billion; it is running at that rate at the present time. World income is of the order of $1.5 or $2 trillion. But the balance of payments of the United States is $2, $3 or $4 billion. It is always the same and this is an implementation of the working of the gold exchange standard itself. This is the way the system is operating. This is not a spurious figure. This is not a figure that is magic, for instance.

I remember in 1963 and 1964—I expressed the view a number of times that this figure is something that is persistent. It is part of the system. And this has been occasionally laughed at and derided and called a coincidence. But next year the same coincidence comes up and next year and next year. It is a persistent change and it is a persistent change that is related to the rate of world expenditure and of world growth and the world demand for international reserves, and the particular position that the U.S. dollar has become to occupy in the world.

Now, Robert Triffin has brought out the fact that the liquidity position of the U.S. looks bad. We started off back in the postwar period with a very liquid situation, a lot of gold and a few liabilities. Now we have less gold and more liabilities.

But this transition is the transition of the world economy from a system that did not have a dominant currency like the dollar to a system that had a dominant currency like the dollar. And the failure of policy over the past ten years, I would say, has been to not recognize the fact that the old figures that are applicable to an old system do not apply to the present system.

From 1844—the year of the Bank Act—to 1914, Britain ran the gold standard with no change in the gold price. It ran that system—the gold standard—but it was a standard that relied heavily upon sterling. It ran that system by allowing reserves to fluctuate but it never imposed exchange controls whenever a particular set of figures looked bad.

The U.S. has become a bank. It has become the world bank and it is creating dollars. It does this in a whole complex of different ways and I think the view that Charles Kindleberger and that Mr. Despres have expressed in this connection is worthy of note. The U.S. is a savings and loan association, if you like, with respect to the world economy. But the U.S. is more than that. The U.S. also manufactures dollars which are demand deposits which operate as international money, as an international medium of exchange for all private traders, what Robert Roosa calls "vehicle currency." The analog to that in the domestic economy is simply money.

The dollar is, in short, the cement of a great multiproduct financial system. The U.S. is the world's capital market. That is a new element in the picture. All these functions don't have to be concentrated in New York and Washington, but the domination of the U.S. economy in the world has made this necessary. Consequently, these policies of restriction, the interest equalization tax, the voluntary foreign purchases restriction program, the new measures are all operating against a natural evolutionary law in the world at large. They won't work. This would remain true even if one took the maximum steps to undermine confidence in the dollar, and I believe that the U.S. government for ten years, since 1958, has come close to taking the maximum steps to undermine confidence in the dollar.

Even if General de Gaulle has his way and his finance ministers continued to incite speculation against the dollar with the result that the price of gold is changed, or gold is demonetized, the dollar will emerge even more powerfully as the world's currency.

If you follow the advice of my colleague, Milton Friedman, who says get out of the gold market, then the dollar will become more important than it is now. If you don't follow his advice and simply do nothing, then the dollar will become more important than it is now. You cannot fight the basic fundamental evolutionary forces that have been at work in the international system for a decade and that are simply reflections of the fact that it is the dollar and not gold that is the determining factor.

Gold is not even a medium of exchange on the international economy. Gold can be bought and sold. Gold is an asset. It is a commodity that is subject to speculation and people will want to hold it as long as there is speculation that its price is going to rise. But when people say "In the long run gold has to go up in price," when this defeatist attitude toward the U.S. dollar is advanced, what they are really saying is something remarkable. Consider the world gold market: There are 60,000 tons of gold floating around in hoards in the world, $40 billion worth are in the central banks. Annual production is about 1,000 tons. Private demand is usually less than that but in the past couple of years it has been a little more than that. What people are saying is that it is impossible to keep the price of gold down.

Now, if that is true, then you must throw all the laws of economics out the window. They don't apply. If the world economy can maintain the present price of gold, the U.S. dollar can emerge without basic problems connected with the balance of payments deficit, which is simply a set of figures. It is the system which has to be run right. The system hasn't been run right.

The system comprises N countries in the world—the IMF says there are 105, but there are probably 175—and one key currency representing about 40 percent of the free world's production, and that is the United States. Adding up all surpluses of other countries indicates what the rest of the balance of payments deficit is. So it is ludicrous when someone says "we will put a tax on tourists," "we will tell this or that company they can't invest abroad."

What they are saying is that the surpluses of the N minus one countries are going to change by some aggregate amount. Now I don't know of a single economist in Washington who has gone around and calculated and predicted what the surpluses of the N—1 countries in the world are going to be. I know some have tried. Milton Gilbert, in his speech before the American Economic Association in Washington, did go around and try to calculate what the surpluses in the rest of the world would be, but he could not come to any direct answer.

But the current trend, the current movement, the current understanding of the system is simply faulty. The proposed program won't work and in ten years we will have the same kind of problem and perhaps we will have the same kind of panel talking about it the same as we are, and saying the same things.

Of course, as long as we keep talking, there is something to be said for that because talking is better than fighting.

Thank you.

Mr. GOODELL. Thank you, Professor Mundell.

Generalizations are dangerous in this area and we appear to have, however, at least two of our panelists who believe the proposals made by the President are necessary, at least two that think they are bad, and perhaps one who thinks they are necessary as a temporary evil.

I might say at this point that I did invite the President of the United States to send a representative to participate in the panel.

The indication from Secretary Fowler was that he felt that it was a very useful thing to have such a discussion but he declined to name a participant for our panel.

Now I saw Mr. Bernstein signaling a few minutes ago and I think we had better turn to him.

Mr. Bernstein?

Professor BERNSTEIN. Mr. Triffin and I have agreed that Mr. Mundell's very pleasant and reassuring conversation—Mr. Piquet's, too—need a reply. I am speaking for both Mr. Triffin and myself on this. This is one question we agree on thoroughly.

Let's first be clear about the balance of payments problem. It is quite true that the balance of payments deficit, the balance of payments problem can't be measured, it can only be analyzed. That is to say that there will be big differences of opinion as to the size of the deficit.

Now, I want to indicate that I, too, think that the United States is a different sort of country from others, that there will always be a demand for dollars, normally, to add to working balances, liquid holdings, and to some extent for monetary reserves. I have myself, elsewhere endeavored to make this point clear.

So far as I know, nobody in the world disagrees on this proposition. I had this question directed to me once at a meeting of the International Chamber of Commerce: Why is it that when we don't have a deficit the Europeans complain? And when we do have a deficit they also complain?

I think the reasonable answer is that using the definition of a deficit that the Commerce Department uses, which is the liquidity definition, Europeans would be opposed to a zero U.S. deficit. But if the deficit gets much larger than, say $1 billion by the liquidity definition, they do run into the problem of having unwanted dollars.

I am going to try to explain the limits of this proposition and indicate why the deficit stays at $3 billion and then indicate the fallacy of trying to talk away our balance of payments problem instead of dealing with it. In a 1959 report for a congressional committee, I pointed out that year after year, from 1950 to 1960, the increase in foreign holdings of dollars was $1 billion a year. When the balance of payments gave them more than $1 billion, the tendency was to take gold.

The $3 billion U.S. deficit persists for two reasons. One reason, of course, is that the figure is inflated, even though properly defined. That is to say we could tolerate by that definition, a deficit which would not exceed $1 billion or $1.25 billion a year.

We have been able to go on with a larger deficit primarily because we have used $11 billion of gold to meet that deficit from 1958 on. The reason the figures are never more than $3, $3.5 or $4 billion a year is because when they do get bigger the administration finds another way of selling another kind of paper which it then classifies, you see, as a capital inflow.

But if the figures were taken legitimately without making allowance for fancy paper, you would not get a steady figure of $3 billion. So, one explanation of the steady figure of $3 billion is that part of it is, in fact, not a deficit. That is about $1 or $1.25 billion a year. The rest of it is being operated on by the government to keep it within the $3–4 billion range because that is regarded as a figure which is correctable. Until the deficit moves well above this figure, everybody will say it will be easy for the United States to get back.

Now, let's clarify this business of "we are a great banking country" and it is only the ignorance of the foreigners in not realizing our special position that creates a problem. Of course, we're a banking country. That is why we can have an accumulation of the $1 or $1.5 billion by foreigners, by foreign banks, by foreign business firms, and by foreign central banks. But the notion that because we are a bank in this sense, there is no limit to the amount of dollars that they ought to accept on our initiative, really means that they turn over to us the job of deciding how much inflation there should be in the whole world.

Now, this is a pragmatic question. You can't define away a balance of payments problem. You can define away a deficit but not a balance of payments problem. When a country finds that the dollars it is paying out don't come back for the purchase of goods and services or for the holding of assets in this country, wanted assets, but is being presented for conversion into gold, you have a balance of payments problem.

The proof of it is that you can't go on with a balance of payments problem without changing something. In a few years the gold would be gone. What would you say then? You could say there is no deficit. The foreigners don't understand how to define our balance of payments. But the practical fact is you couldn't go on with that balance of payments.

Now that is the aspect we had better recognize. Whoever heard of bankers operating a good, sound sensible bank for the benefit of the bankers and their customers who have to twist the arm of a depositor when he comes in with a check to cash? That is what we are doing.

Whoever heard of the banker that keeps increasing his loans and investments year after year when the cash goes down and his deposits at the Federal Reserve show not net deposits but more and more debts to the Federal Reserve? Now I think we had better get rid of the notion that because we have 40 per cent of the world's industrial production and because the world did accept dollars in the past, somehow it is only their stupidity that keeps them from understanding that there is no limit to the outflow of dollars from this country which they are morally obligated to acquire and to hold. They won't do it.

Professor TRIFFIN. I don't think that this system is working very well.

But, secondly, and more importantly, what we have now is not the old gold exchange standard. The old gold exchange standard was, in my opinion, killed and for very good reasons. It was killed by Under Secretary of the Treasury, Mr. Roosa, when, in 1960, he had to go around and say that the gold convertible dollars should no longer be converted because this might bring the whole system crashing down. He was right, but at that point the system which previously functioned because foreign central bankers chose freely to accumulate dollars and could at any time decide whether they wanted to change the nature of their investment, ceased to function. That system was changed that day from a monetary system into a political football, as the results of which the United States was exposed to increasing political blackmail. It was, a year or two ago, General de Gaulle who suddenly decided to withdraw his dollars. Tomorrow, it may be the Germans if we run into trouble with them about the stationing of our troops in Germany.

The present system exposes us to gold withdrawal at any moment of time. That system cannot last. What can be substituted for it is, as I indicated, an institutionalization of the system along the lines indicated by Mr. Mundell. This assures that other countries agree and become wise and decide that they will run their printing press in order to finance our deficit and will abstain from converting into gold. That was the main message which I wanted to leave with you.

Mr. Mundell rightly said that the system worked this way for a hundred years for the British, before 1913. I would point out that in 1913, according to the best estimates available, the total amount of sterling balances in foreign central banks (many of which were in fact under the British in terms of political relationships) was of the order of $600 million.

The total amount of our present debts to foreign central banks, I believe, runs around above $16 billion. Secondly, as far as private gold holdings are concerned, I would like at least to correct the record. The total amount of gold produced since Columbus, which is not accounted for by increasing official reserves, is not of the order of $60 billion but of the order of $30 or $31 billion as of last September. It is slightly larger now because of the $1.5 or $2 billion that may have been lost to official monetary reserves since then.

Professor MUNDELL. I was including the central bank holdings in my figure.

Professor TRIFFIN. In that case, we have $45 billion, plus $30 billion, which would make about $75 billion.

Professor MUNDELL. The second point, in quoting the Bank of England's figures in 1914, I didn't hear you quote the Bank of England's gold reserves.

Professor TRIFFIN. The gold reserves of the Bank of England, I quote from memory now, were certainly very low, perhaps on the order of $200 or $300 million.

Professor MUNDELL. The liabilities were in any case very much larger than the gold reserves.

Professor TRIFFIN. I can give you the exact figure later on, but I think there is a supplement to be added there. At that time there was an enormous amount of private gold circulation in England.

Professor MUNDELL. Yes.

Professor TRIFFIN. And part of the balance of payments problem was met not from the gold of the Bank of England but from the gold in circulation, from the public's gold holdings.

Professor MUNDELL. You would agree, wouldn't you, that the Bank of England got along and ran the system on an incredibly small gold reserve?

Professor TRIFFIN. This is quite correct.

Professor MUNDELL. Right.

Professor TRIFFIN. But this was also a period, of course, which was characterized by an extraordinary degree of stability, by the absence of rumors about devaluation, by absence of exchange controls——

Professor MUNDELL. Yes.

Professor TRIFFIN. A very different world from the one with which we are concerned today.

Professor MUNDELL. Exactly.

Professor TRIFFIN. If I may turn very briefly, Mr. Chairman, to an appraisal of the measures which have been taken, I have submitted to you a four or five-page set of comments on a very brief and very simple table indicating the major changes which have appeared in our balance of payments since 1964. Let me say that these figures relate to the period previous to September of last year. It does not include the last deficits for which we don't yet have precise figures.

The major point to my mind is not the fluctuations in the balance of payments deficit, which is calculated differently every year, and which is affected by all kinds of changes which Dr. Bernstein mentioned. The major fact, I think, is that instead of running a current accounts surplus (minus foreign aid) of about $4 billion in 1964, we were running a deficit at an annual rate of about $200 million during the year, i.e., for the first nine months of 1967. That is a reversal of more than $4 billion in our current position.

Now, I will not, in deference to our chairman, make any comments on the reasons which to my mind explain all or practically all of that $4 billion reversal. Let me turn directly to the January 1 measures.

I think that these measures had to be announced. As Dr. Bernstein said, we had to do something spectacular, and we had to do it on January 1 because on January 3 we would have had to announce a loss of gold of nearly $1 billion in a single month. And it was necessary to ward off the speculation which such an announcement would have triggered if it had not been accompanied by a clear indication that we intended to do something about it.

This being said, I think it is essentially a short-run program put together on the basis of various studies which presumably have been in the making for some time at the Treasury. The study which the Treasury has just released on this point, is extremely interesting, though I would disagree with several of the interpretations in the document.

Turning now to the program of January 1: this program aims at saving about $3 billion of foreign expenditures by American residents. I am afraid that a substantial portion, perhaps $1 billion of these savings on the expenditures of American residents, including tourists, is likely to be offset for two reasons.

First of all, we must take into account the withdrawal of funds by foreign residents or reduced investments by foreign residents in the American market. Why should they withdraw funds or why should they invest less in New York knowing that such withdrawal of foreign funds will yield the same amount of deficit as the export of American funds?

The reasons are, first, that the new measures are expected to tighten the current markets for gold, to force up interest rates abroad, and to slow down interest rate rises in the United States. It may, therefore, become more profitable to invest funds in the foreign dollar markets, in Euro-dollar markets than in New York. And foreign residents will be free to do this, of course, unless we institute exchange control not only on American nationals but on the foreigners, thus at once killing the New York market itself. I don't think that we could even contemplate such measures.

Secondly, the purchase of U.S. securities abroad rather than here, securities floated by U.S. firms to finance their direct investment programs, allows American firms to continue to invest as long as they borrow the money abroad. But the money, the obligations which they float in Luxembourg or in Amsterdam or in Paris, may be subscribed to a large extent by foreigners who face alternatives of investing in New York or investing abroad. So that this will not mean a net saving of $3 billion. It will mean a somewhat lesser saving.

Secondly, and in a somewhat opposite direction, I would like to suggest that to the extent that these measures are successful, they will have tremendous repercussions on other countries. The United States hopes to improve its balance of payments by $3 billion. The British have taken measures and hope to improve their balance of payments by $1 to $1.5 billion. That means a total of $4 to $4.5 billion.

If we look at the estimates currently available for the total surpluses of the rest of the world for the first nine months of last year, we find that the Continental European countries show surpluses of $700 million and the rest of the world about $350 million. This is all in all, a little more than $1 billion in surpluses.

Now, it would be very nice if our measures affected only countries with a surplus. But even if it succeeded in doing that, it will still leave a gap of roughly $3 billion or $3.5 billion which will have to be met by putting some countries in deficit. And, secondly, I don't believe that, no matter how hard we try, we can simply hit the strong brothers. We are also going to hit the weak sisters. Our program will affect the British. The British program will affect us. And not only that but our joint programs will affect other countries which are already in a somewhat vulnerable position.

Therefore, these countries probably will have to react and when they react, of course, they will cut down our own exports and they will create difficulties for us. I think that we might start again a spiral reminiscent of the past in which the difficulties of one country entail difficulties for the others. It is frightening to contemplate what might happen if some of these countries felt no compulsion about devaluing and thus reopening the speculative moves which we saw in December.

As far as possible solutions are concerned, I would like to underscore the two directions I indicated. Clearly, we have to do something to improve our own balance of payments.

We shall also have to put into effect immediately measures that will improve the international atmosphere and that will reduce gold speculation. We will have to activate, if you like, the SDR's in order to meet the situation I have just been describing. Since it is impossible to activate those SDR's immediately, we will have to look for substitute methods of achieving the same purpose as soon as possible. In that connection, I have made proposals for the strengthening of the gold pool. This would really amount to an immediate implementation of some of the SDR techniques, avoiding the need to wait for parliamentary ratification of the SDR reform.

Let me again stress that we have two problems here, not one. There is the long-term problem, on which there is not yet full agreement, of how to increase world reserves in the future. This is a difficult problem because it implies that when you increase world reserves by fiat you have to decide who gets them, for what purposes they will be used for, and so on. It gives us lots of difficult questions.

The immediate problem which concerns us is to prevent a sudden contraction of world reserves. At the time of the Rio agreement, I pointed out that we had really for four years discussed essentially the long-run problem of how to increase world reserves in the future, but that we have not discussed the problem of how to prevent their contraction.

We have discussed how many SDR's we should create and how many SDR's other countries should absorb, without saying anything about what would happen to the other two reserve components, gold and foreign exchange. And it is for us very difficult to make national decisions about how you will work one piece of this paper machinery without knowing what happens to the other two. The amount of SDR's that might be needed to solve the liquidity problem would be very difficult to estimate if we continue to succeed in palming off dollars on Germany or Italy or if, on the contrary, they decided tomorrow to convert them into gold. This is a problem that we tried bravely to sweep under the carpet at Rio.

I said at that time that the current crisis of the pound and the dollar might eventually force us to put our nose in that dirt that we tried to sweep under the carpet. I said I hoped that on the occasion of the rescue operations in question, we would be able to indicate how the three reserve assets would be combined, how we would use gold, dollars, and the new reserve assets to make possible an orderly evolution of world reserves.

I think that we should have concentrated first, therefore, on preventing large-scale liquidation of dollar IOU's issued over the past fifty years under the gold exchange standard and accepted by all during those years. We cannot liquidate fifty years overnight. We have made the mistake of not discussing this issue and of trying to rush into the long-run problem without solving the short-term one.

If we could negotiate an agreement along these lines, this would make it easier for us to finance from our own resources and international borrowings from the IMF, the residual deficits that would still remain with us as long as we refuse to look at the real problem facing our current account balance. This would make possible a quick rescue operation without the need to impose mutually disastrous restraints on our capital exports.

But in the end we cannot avoid the need to achieve a current accounts surplus in our balance of payments which is consonant with the position and the responsibilities of the richest and most productive economy in the world. And what we are doing now is not going to solve that problem.

Mr. Goodell. Thank you, Professor Triffin. We would like to get to our distinguished observers as soon as possible. I think, Dr. Piquet, you wanted to make some brief comments?

Dr. Piquet. I certainly wouldn't want to say anything that would indicate, as I said before, that I am opposed to the Triffin plan for a world bank or a reorganization of the international monetary system. However, I think this is a long ways off.

Meanwhile, I tried to make clear that we had a big bulge in our balance of payments deficit in 1960, as we had in 1958 and previously. We made steady improvement through 1966, but now we have another bulge in the deficit in the fourth quarter of 1967.

We don't have the detailed figures but the figures that we do have for the first three quarters of 1967 and 1966 certainly indicate very strongly that the big increase in the outflow of funds in the fourth quarter of 1967 was speculative. There was no change in the fundamental balance; in fact, in the first three quarters of 1967 there was a decline in the outflow of direct investment capital.

People in the Department of Commerce have told me informally that they expected the errors and omissions item will be in the neighborhood of $1 billion, although that is not official, of course. Now, if the problem is speculation against the dollar, isn't that a psychological problem? Isn't it a monetary rather than a financial problem? Then what can we do to eliminate the speculation? The answer is to keep the dollar inviolate, that is, avoid inflation relative to other countries.

This is essential. The President could have announced on January 1 some curtailment of expenditures. We must choose between Vietnam and the moon and agriculture subsidies and all the rest. We can't have guns and butter and Cadillacs and everything else and still not tax the people.

Now, then, if we keep the dollar inviolate in terms of confidence by whatever that procedure might be, and adopt a few other devices to try to take the incentive away from the speculators in gold, that will help us substantially. There are steps that can be taken short of abandoning gold altogether, namely, throwing our entire gold supply into the international breach.

I understand we have gold in Fort Knox. I have never seen it but I am sure it is there. It certainly has no relevancy to the American dollars except as it reflects stability here at home or the lack of it.

Why shouldn't we be good bankers and just keep a straight poker face and pay out the gold as long as we have it. If we don't, other countries are not going to shoot us, and we're not going to commit suicide. They will use dollars as long as the dollar is acceptable. And that means the avoidance of inflation.

The answer the New York bankers would give us is to continue paying out the gold at $35 an ounce as long as we have the gold, $12.5 billion of it. But why in heaven's name should we support the price of gold at $35 an ounce by giving an advance guarantee that we will buy all gold presented to us at that fixed predetermined price?

Keep them guessing. At present, all that the speculator in gold has to do is to buy the gold, pay the interest cost of holding it, and then if we do raise the price of gold, he turns it back and makes a handsome profit, maybe 100 per cent.

If we don't devalue and don't raise the price of gold, all he loses is the interest on his investment. He brings back the gold and gets dollars for it. Why should we put a floor under the price of gold?

In fact, Fritz Machlup of Princeton suggested some time ago that we announce in advance that we're going to lower the price of gold in terms of dollars. He withdrew that because it was too complicated. [Laughter.]

Mr. Goodell. Professor Mundell?

Professor Mundell. I don't want to talk about solutions. I just want to underline my agreement with Dr. Bernstein on the point that we can talk about the U.S. balance of payments deficit or we can talk about the implications of the deficit.

Now, the implications of the deficit are quite clear. This, in fact, is the problem of world inflation. If the U.S. creates too much money, foreigners have to accumulate it and they spend it, and world spending goes up too much.

Here, the United States has a clear responsibility, not just to Americans but to the world economy; namely, to maintain control, over total spending and over the manufacturing of dollars. That is one problem.

And the second problem that is related to that is the gold problem, which is the problem of the mechanism we use for currently keeping a lid on the price of gold.

The inflation problem and the gold problem both require solution. The inflation problem requires responsible U.S. financial policies as well as responsible European financial policies. The gold problem requires a management of uncertainties in the world economy. Dr. Piquet mentioned one solution for it. There are other solutions for it. As Dr. Holtrop of the Dutch Central Bank has repeatedly said, we should not nourish speculation about increasing the price of gold. We must manage uncertainty in a better way.

Mr. Goodell. At this point I think before we move to the distinguished observers for any comments or questions to the panel, I would like to introduce our Director of Research, of our Planning and Research Committee, who is an international economist himself and an expert observer in this field, Dr. Patrick Boarman.

Dr. Boarman. Thank you, Mr. Chairman, and guests.

I thought I would at this point simply try to raise some general questions which we might try to cope with in the minutes that remain.

The point has been made several times that the United States has a powerful, rich and productive economy, the mightiest economy in the world. But I think it has also been made clear by a number of our panelists that in spite of this enormous wealth and productivity that backs up the American dollar, what we confront today is a classical liquidity crisis, the crisis that can confront any firm, no matter how rich, no matter how large its assets. If a business firm runs out of cash and can't meet the payroll, it has to close its doors. I think the analogy is applicable to the United States.

We have very large assets abroad, far exceeding our short-term obligations. But the short-term obligations are cash obligations. And the existence of these short-term claims of over $30 billion against our $12 billion in gold, suggest that we do have a most critical situation.

It has sometimes been argued that our problem is not as grave as it might appear in that that the balance of payments deficit, which has been running at between $1 and $3 billion for many years, and this year rather larger, is in reality very small compared to the annual gross national product of the United States.

We have to keep in mind that the balance of payments deficit is cumulative, that each year's deficit is added onto the previous year's deficit. So we're riding in a situation here where each year's additional deficit might become the straw that breaks the camel's back.

I would like to suggest that one of the aspects of our problem that has not been treated in the needed depth is the relationship between the domestic economy and the balance of payments problem.

Under the old gold standard system, to which reference was made several times, there was a direct relationship between the movement of reserves and what happened to the domestic economy. If reserves moved out certain things were done domestically to bring the national economy into balance with the international requirements. That was the classic way in which this system operated. There was no talk of international liquidity shortages under that system prior to 1913. There was no concern about balance of payments deficits because they never became a problem.

The constant adjustment of each individual nation to changes in the international economy kept the whole system in equilibrium and what changes there were tended to be microscopic.

This system was scrapped, in the twenties and in the thirties, in favor of a gold exchange standard which, in effect, cut the umbilical cord which connects the domestic economy to the international. This is the source of the problem we face today, which is, basically, that there is no mechanism any more which is able to induce the changes in the domestic economy which are required for international equilibrium.

I think we ought to consider what the options are that we have in our current situation. We have the option of devaluing the dollar. Most of us would not want to do this and we presumably will not do it. We have the option of trying to get other nations to cooperate with us and to increase international liquidity. We may be dealing here with an illusion in that international liquidity, I would suggest, is not related directly to international trade. In the past, international trade has expanded very rapidly without rapid increases in liquidity, and the British experience in the 19th Century, which was referred to here, is an example of that.

The British operated the world's trade and payments system on an absurdly small reserve base. The reason that they could do this was because the individual nations were adjusting their economies to balance of payments requirements.

It seems to me that the other option we have is to adjust our domestic situation to balance of payments necessities. What we confront is the old problem of transfer. Too many dollars have gone out and not enough are coming back to claim our goods and services. And there is no mechanism in operation to bring about adjustment of this sort.

The option we have, therefore, in addition to trying to find more liquidity, devaluing the dollar, and using controls, which is the option that the Administration chose, is that of trying to bring our domestic economy into balance by avoiding the internal fiscal excesses which have caused the dollars to flow out at a faster rate than they can be redeemed for goods and services.

This is an alternative that is available to us in contrast to the controls that have been offered by the Administration and of which there has been considerable criticism here this morning.

Mr. Goodell. We turn to the observers. Do you have any comments or questions?

Mr. Rowen?

Mr. Rowen. I would like to raise a practical question about gold reserves. Dr. Piquet suggested that we pay out the gold. Mr. Martin has used the phrase "we have to defend the dollar down to the last bar of gold." And the Administration is now proposing the abandonment of the gold cover to make this possible.

My question is: does any member of the panel think that any national administration or indeed any Congress would sit still for the total diminution of our gold reserves. Or rather wouldn't there arise at some point a kind of a panic in the country as gold reserves dwindled from $12 to $11 to $10 to $5 billion, or some number? If for no other reason than the creation of, say, a military security reserve of gold, would there not be a temptation to stop the outflow despite our insistence that we will let it all go?

Professor Bernstein. I think what Mr. Rowen said is precisely correct. In a system in which, in effect, you say that your currency is equal to gold and you freely offer to convert your currency into gold, you can go on for a considerable time, as we have done, averaging a decline of $1 billion a year.

Now, two things would happen. One of those, the one you mentioned, is that there would be people of responsibility, the Congress, the Administration, the banking and business community who would feel that continued loss of gold beyond some critical point would require a sharp break from previous policy. And that that change would have to be, in fact, suspension of gold payments.

Now, in truth, responsible people ought to be talking about this long before you get down to $5 billion. Perhaps we can count on an average loss of $1 billion a year, especially with the political pressure we can put on our friends to keep accumulating dollars. But as the gold holdings go down, the good fellows who have been standing on line and saying we're going to hold onto these dollars forever, begin to say that those fellows who are pushing up to the window aren't playing fair. We had better get ours before we are stuck.

And I want to tell you something—that those who deal with central bankers ought to know: the central bankers who would be willing to take a chance on the dollar are very numerous. Even those who criticize us the most, really only fear that someone else is going to get the gold and then they will be told that they have failed to protect the interests of their country. You would be astonished at the amount of ingenuity that central bankers are applying right now to the devising of techniques by which they will be able to tell their public, "Look, we protected our interests even if something happens to gold."

In my opinion, we have reached the stage where we must do something now or the movement toward a gold crisis will accelerate.

Mr. Goodell. Yes, Mr. Hagedorn?

Mr. Hagedorn. I would like to make a comment on the subject that is up before you people in Congress and that is the subject of the 25 per cent gold cover.

You in Congress are being urged that this has to be removed and you're being told that this is of no significance domestically and that it will strengthen the international position of the dollar.

But I think that you should go slow and reflect on what you're doing. The 25 per cent gold cover requirement is the only external impersonal limitation that exists now on the expansion of our domestic supply of money and credit. Without that the sky is the limit and you are left to the discretion of the people who manage the money supply.

Now, I have no reason to disparage the trustworthiness or the sincerity of our money managers, but do we really want to be in a position where the only limitation on our own domestic money supply is their own judgment?

Now, it may be that as you explore this question you will decide that the immediate arithmetic of the matter leaves you no choice except to remove or lower that 25 per cent gold requirement. But if that is your conclusion, I think that you should also reflect on the fact that the expansion of our domestic money supply is related to the expectation that when presented with this problem, the Congress would in fact remove the 25 per cent requirement or lower it to some degree.

I would suggest in your study of the problem, that you should consider at least some substitute for the impersonal limitation that has been imposed by a 25 per cent gold cover requirement. It seems to me highly desirable that we have some sort of a criterion, some limitation. Now maybe, as a practical matter, the thing to do when faced with the present arithmetic, is to reduce the gold cover to some percentage lower than 25 per cent, but with the indication that we are not going to be talked very easily into lowering it the next time. Or maybe you should think in terms of some other formula that would limit the ability of the managers of the money system to expand the domestic supply of money and credit. Some sort of a statistical formula may be the answer. I don't know.

But at least we have a serious problem here. And I think you are being asked to act very precipitously, in a rush, and the significance of this is being overlooked.

Mr. Goodell. Mr. Dale, do you want to make a comment?

Mr. Dale. I have a further question for the panel members.

Am I correct that every member here, regardless of their views on other things, favors a sharp reduction in our budget deficit and a tax increase to do it? Does anybody disagree?

Mr. Goodell. Members of the panel?

Professor Triffin. I would not want to answer that question and I don't want to go into the reasons why.

Mr. Goodell. You would not want to answer the question?

Professor Triffin. No, because we have been asked not to.

Mr. Goodell. Oh, I see.

Professor Triffin. But may I make a comment on the previous question, very briefly?

While I sympathize very much with what you have said, quite clearly, removal of the gold cover will not solve the basic problem, that is quite obvious. It doesn't change anything in respect to the basic reasons behind our deficit.

On the other hand, I think that if the question had not been raised maybe we might have lived with it, although I doubt it, really. But once the proposal has been put before Congress, the rejection of that proposal by Congress would put central bankers, many of whom now have become nervous nellies, on notice that we have only $14 billion of gold to meet $16 billion of gold convertible claims.

I think that this would not fail to precipitate the sort of crisis Dr. Bernstein mentioned.

So, therefore, I think it would be completely irresponsible at this stage for Congress to refuse to move in that direction.

Mr. Hagedorn. What do you think would be the reaction of the international bankers if Congress took the position—now I am not recommending this but I am introducing it for discussion—if Congress took the position that no, by God, we're going to stick to that 25 per cent if we have to deflate our economy to do it. What would be the reaction of the international bankers to that?

Professor Triffin. Yes, but there are $16 billion in claims which politically, at least, and legally are convertible into gold. What would happen if the next day or the next week $3 billion is presented for conversion?

Mr. Hagedorn. Suppose we said we are going to deflate our own economy so that there will be great bargains to be bought in this country. Maybe nobody would want to take our gold; they would want to take our goods instead.

Mr. Goodell. Mr. Haberler would like to make a brief comment.

Professor Haberler. I cannot get so excited about this problem. I think I have a somewhat higher opinion of the intentions of the foreign central bankers. Professor Triffin said they would be put on notice about our liquid liabilities. But they know already what these are and what the gold stock is.

I think they know something else which was not mentioned, namely that the Federal Reserve can at any time waive that provision and, if I remember correctly, Mr. Martin has said on one or two occasions he wouldn't hesitate to do it. And that could be continued indefinitely.

Mr. Goodell. Now almost everybody wants to be recognized. Dr. Piquet?

Dr. Piquet. I think we have to correct a misunderstanding here. As far as gold serving as an impersonal regulator of the money outstanding, that died long ago. The 25 per cent gold cover is only against the Federal Reserve notes outstanding, of which there are about $40 billion.

The great bulk of the transactions in the United States—that which is the real engine of inflation—is not the Federal Reserve notes but bank credit. And the cover on that was removed in 1965.

Mr. Hagedorn. But the currency bears a relationship to the expansion of credit, that is, the choice that the people of the country make in order to hold their liquid assets in the form of currency or in the form of bank credit.

Dr. Piquet. There is very little currency held.

Mr. Hagedorn. Yes, but when bank deposits expand you can expect that the currency will expand roughly in proportion.

Dr. Piquet. Yes, true. Oh, I will grant you that step by step in past years this impersonal restraint has weakened further and further. Congress is being asked to take the final step of destroying it altogether.

Mr. Goodell. Professor Mundell?

Professor Mundell. I would like to comment on both Mr. Hagedorn's and Mr. Dale's question. We have moved to a situation now in which the tying of the $10 billion in gold, which is scarce internationally, directly to domestic monetary circulation, will have a very severe impact on the use of gold throughout the world as an international reserve.

I think it is going to be an extremely heavy-handed weapon to force the Federal Reserve to suspend the gold cover. Congress has, after all, some control over what the Federal Reserve policy is to be. Chairman Martin has to justify his policy.

I would like to make a comment on Mr. Dale's question about the budget increase. That is moving into a different kettle of fish. The whole question of financial responsibility is tied up with the mix of monetary and fiscal policy. With respect to the tax increase: in 1966 I favored a tax increase and I think that in 1967 a tax increase would have been a good thing.

But the problem of predicting what is needed with respect to the tax increase is the problem of predicting how the economy is going to look in seven or eight or ten months from now, and that is a very complicated thing. It is a matter of projection. In my view, the Administration has to have a little flexibility. It may be that in two months or three months' time, a $10 billion tax increase will be far too much. It may be that the economy ten months from now will show signs of a serious downturn. And my own judgment at the present time is that a $10 billion tax increase is too large.

Mr. Hagedorn. Bob, would you agree that the removal of the gold cover is not getting at the basic imbalance in international equilibrium that we have here? It gives us more time but if we go on doing what we're doing and policies don't change, we could end up in a couple of years with no gold at all.

Professor Mundell. Well, I think there is a risk for foreign monetary authorities in holding more gold, as the amount of gold the U.S. has continues to decline. To go back to post-World War I days, the book "The Golden Avalanche," written in the 1930's, points out that the joke in the 1920's was to ship all the gold in Europe to the United States and then leave America holding the bag with all the gold, since Europe might have decided not to bring it back and to use some other standard.

After 1934, Congress raised the price of gold precipitating the golden avalanche that occurred in the late 1935's. One can object to that because it meant that Americans were exporting goods and services abroad and getting in exchange more gold for burial in Ft. Knox. It is a poor investment to ship goods abroad and get back gold.

Currently, world inflation has caught up with the excessive increase in the price of gold in 1934–35 and gold is now coming back into its own as a strong international reserve. If the United States raised the gold price today, we would have another golden avalanche. We would have to import a lot of gold but export goods and services to pay for it. That again would be a very poor bargain for the United States. And that is why the U.S. does have a responsibility to work toward an international solution of the gold problem. I don't think the Rio agreements even begin to touch the problem.

Mr. Hagedorn. If I might just follow through; isn't the gold problem really simply a reflection of the economic developments of the world? It isn't simply a symptom of the changing relationships between our productivity and world productivity?

Professor Mundell. Well, gold has become an attractive commodity because, while world prices of other commodities have gone up in the past thirty years two or three times, the price of gold has not gone up and so gold is becoming an increasingly attractive metal in jewelry, in teeth, and for industrial purposes.

In the past three years there has been a substantial increase in the industrial use of gold. Other prices have risen to the point where industries are beginning to substitute gold metal in airplanes and are using it for a wide variety of other industrial purposes.

Mr. Brock. But aren't we more concerned with flow than with price? It is the flow. It is where the gold is going that is creating the difficulty, not its price.

Mr. Goodell. Mr. Bernstein said he had a one-sentence comment.

Professor Bernstein. There is a one-sentence answer to this question. Much as we

love the notion that there is an objective measure of the proper quantity of money in the United States and the world as a whole, gold can't be it. This is because there has been a zero increment of gold in recent years. With a zero increment in gold, there could be only a zero increment in domestic money. Do you see what I mean?

If you want an objective measure of the proper quantity of money, you have to find something else.

Mr. Goodell. Mr. Dale, I don't know whether you got an answer to your question. You had a partial answer from Professor Mundell. Professor Triffin, do you wish to add a clarification?

Professor Triffin. My response is very simple. I do believe that, faced with the present situation, we will have to choose between a cut in expenditure and an increase in taxes. It so happens that I would not want to make easier the avoidance of certain cuts in expenditures which are obviously necessary for other reasons, anyway.

Mr. Dale. But you are for reducing the budget deficit in these circumstances?

Professor Triffin. Yes, in those terms, yes.

Mr. Goodell. Dr. Madden?

Mr. Madden. Yes, thank you.

I would like to ask this question. I find if one interprets various time periods implicit in the remarks here, it is possible to agree with everything that has been said, that is, we have a gold crisis, we have a liquidity crisis, we need a better system, the present program is necessary but it is bad. We've got it but we don't like it. We are powerful and the dollar would probably be strong without doing anything.

But one aspect of this whole question which I would like to see the panel discuss further is the political aspect, in the sense of the struggle of nations to assert their own interests while they are also attempting to cooperate together.

In this connection, someone has said that if we can't manage our own money, why do we expect that the International Monetary Fund can manage the world's money? I think the interesting point in the question is that we have conflicts here in the United States about the amount by which the money supply should increase and the level of the budget deficit or surplus, and so on. And we make errors such as in the present period in which inflation is occurring at a more rapid pace than we want. How then can we be sure that the much more difficult conflicts of interest, seen most vividly in the case of the French under the present circumstances, and the real differences about whether we should or should not be in Vietnam, can be reconciled by the power arrangements in the Fund and the institutional arrangements in the Fund that would accompany the SDR's.

Mr. Goodell. Professor Triffin?

Professor Triffin. I would like to answer that briefly. I think that you are perfectly right. I am quite sure that nobody trusts fully the management of money by anybody, neither by the United States nor by the Monetary Fund nor by the French. This is true everywhere.

But, as I said once to Rueff, it would be nice if we could escape our responsibilities because we will make mistakes. But it so happens that man cannot avoid managing his own affairs. Neither God nor gold will manage them for him.

To be a little more precise about my answer to your problem: I would say this, really, that the alternative to some effort to reach international agreement about the management of the increases in world reserves which will be required in the future, (and which will be an increasing of credit reserves because there isn't enough gold) would be to leave such a management function to the United States.

If there is not enough gold to increase world reserves, world reserves must increase through credit operations. Those credit operations may be simply credits to the U.S. banks and the U.S. Treasury. But if foreigners take dollars, then they have absolutely no voice in the amounts, in the use to which the credits are put. The alternative is to decide jointly, through the Monetary Fund, how much credit the nations are willing to create together.

There is one feature of the SDR's which is not morally sustainable in the long run. Whenever it is agreed that another billion or two billion dollars should be created, the nations are committed under the present RIO Agreement to give 26 per cent of that to the United States, 11 per cent to Britain (that is 37 per cent of the total) and to let 82 underdeveloped countries divide among themselves about 25 per cent.

This would involve using the power of international money creation for the support of existing national policies, whatever they are. This is not sustainable in the long run. If the lender disagrees with such policies, he will not finance them.

De Gaulle is wrong in asserting (and I am not sure that he has done so) that gold alone is enough. I think that if he had the choice between gold and something in which he would have a voice, he would take the latter. But as long as we don't give him that choice, and he doesn't have it at the moment, it is either gold or dollars or sterling.

I can well understand, for example, why De Gaulle would refuse to finance policies with which he is totally in disagreement, rightly or wrongly. If we want him to finance our policy, we first have to convince him that the policy is right. But we cannot ask him to finance it unless we have done that job first.

Essentially, the problem before us is this: the need to reach agreement on the total amount of reserves to be created and the purposes for which they will be used.

Those central bankers who said one cannot create or use short-term liabilities to make long-term investments of ten or twenty years affirmed, last September, in Rio, that with short-term liabilities one can make gifts, not for ten or twenty years, but forever. This is because 70 per cent of the SDR's will not have to be reconstituted or repaid. Curiously enough, this is exactly the opposite of all that has been said before.

I would like to point out that there have been a lot of contradictions of this sort. In 1962, when Mr. Maulding first suggested that some kind international reserve assets should be created, the Under Secretary of the Treasury said this was absurd; one could never create such a thing in advance of a world government. But one or two years later he was ready to support this new reserve asset very forcefully.

At the beginning of the negotiations of the Group of Ten, the French suggested a collective reserve unit in accordance with the technique, but not the purpose suggested by Dr. Bernstein. We threw up our hands at that point and said no, we want to use the traditional methods of the Fund. The French stuck to their collective reserve unit. Little by little our different point of views merged and then met.

Last March we saw the negotiations nearly break off because by that time the French no longer wanted the reserve unit; they wanted the Fund, and the United States wanted the reserve unit and not the Fund.

I think when you look at all these contradictions you wonder how far ahead the people who have been engaged in the negotiations have been looking.

Thank you very much.

Mr. Goodell. Dr. Boarman?

Dr. Boarman. I would just like to add in connection with the point Professor Triffin has been pursuing, that it seems to me that international liquidity, the SDR's, the International Monetary Fund arrangements, and so on, are needed not to finance trade but to finance balance of payments deficits. I suspect Professor Triffin would agree that all of these arrangements: the Group of Ten, the International Monetary Fund with its new facilities, and the SDR's, if approved, will not be sufficient to handle balance of payments deficits of the magnitude of those incurred by the United States, especially if these continue.

Professor Triffin. Mr. Chairman?

Mr. Goodell. Professor Triffin.

Professor Triffin. To give an answer in two sentences, and coming back to a point which I had forgotten in my answer to you, I agree fully with what Mr. Boarman has said.

It may very well be that if we reached an international agreement on the functioning of the system, it would preclude a guarantee for the financing of our deficits. What does this mean?

It means that if we continue in deficit and are unable to put our house in order, we would have to sacrifice our remaining resource, our dwindling gold stocks, and borrow from the $6 billion which we still have in the IMF. We have $12 billion in gold but $16 billion of liabilities. Well, those $16 billion of liabilities would be transformed into a long-term debt. We would have $12 billion in gold plus $6 billion in the Fund, or $18 billion to take care of our mistakes. Of course, we might see all that dwindle to the point where we would have to go back to controls or to devaluation of the dollar.

Dr. Boarman. If we are going to get our house in order—and I thoroughly agree with you—we are left with the President's proposals and we are left with other options.

One point that occurred to me, as the conversation has been proceeding, is that if we apply generally the exchange controls of the type that the President has suggested, and if we make these more comprehensive, will this not have the effect of seriously restricting the usability of the dollar internationally and, therefore, aggravate the very flight of gold that we're trying to prevent? Don't we have other options here besides the kind of drastic measures that the administration has proposed?

Mr. Goodell. Mr. Janssen?

Mr. Janssen. I wanted to raise one question for the whole panel. It is getting late and I think this could be a quick one, answered best by winking and nodding. There has been a lot of talk of heading into trouble and I wonder if there is anyone on the panel who thinks that if this meeting were reconvened a year from now we would be looking back on some very fundamental changes in the international monetary system?

Professor Triffin. I think there is no doubt of that. The monetary system will not stop dead in its tracks. It will not even evolve in accordance with the mood of the negotiators in Rio in September 1966 and 1967. After all, they did foresee what was going to happen in the following months.

Mr. Goodell. Dr. Piquet?

Dr. Piquet. I should predict that if the difficulties in Vietnam come to an end in this interval, it would change the question slightly. What is the situation going to be after Vietnam? We may well be discussing the dollar shortage problem again.

I believe that the problems of liquidity and gold are all going to be settled by international agreement. There is no danger, in my opinion, of a breakdown in the international monetary system in the immediate future.

I think the big problem is the balance of payments of the United States in the coming year. Now there have been conversations around here among the panelists that give you the impression that we can't do anything for our balance of payments.

Some of the arguments that have been used indicate that the balance of payments cannot be solved by any measures because the minute a country cuts down on its outflow of dollars, presumably it brings about an immediate reduction in the inflow. Well, that simply isn't true.

This is an emergency program. This emergency program is designed to save $3 billion in payments. On the liquidity definition, I think it probably will save $3 billion. On the official settlements definition, it will not save $3 billion because of the reduction of bank credit to Europeans.

The reduction of bank credit to Europeans will simply compel some of the New York banks to send their European borrowers to their London branches. The London branches will be told "you have got to take care of that good European customer. We will give you back some of your dollars we took from you." So there will be a reduction of our loans to Europe but also a reduction of our borrowings from the dollar market.

Now, it is my opinion that the President's program will be effective because such programs can be effective for a year, or for a year and a half. There are other reasons for thinking that the repercussions will not be of the order that some people have suggested. The big point is, if we get this saving for a year, how can we make sure that a permanent improvement in our balance of payments will be secured? We need a stronger balance of payments, but not through controls. Controls are only a device to carry us through an emergency.

The longer range thing has to be a domestic policy on credit, a domestic policy that won't give us too much domestic money creation, a domestic fiscal policy which will make sure that we don't spend too much at home and a wage and price policy which assures us that we will remain competitive in world markets.

Now, if we supplement this action program by real economic measures, then I think that in good time, with the end of the war in Vietnam, with the normal growth of world trade, and above all, with a better understanding of how much of a so-called deficit we can carry without disturbing the world's international monetary system, we'll have a good strong balance of payments without controls.

That is the way I look at the problem.

Mr. GOODELL. Dr. Boarman wishes to pose a question to the panel.

Dr. BOARMAN. We are drawing toward the end of our discussion this morning and we have, it seems to me, discussed a number of options. We mentioned briefly devaluation; we're not considering that.

We have the option of trying to get other countries to help us in terms of creating more international liquidity; and I think there has been agreement that this is not a mechanism which in the long run can cope with a chronic on-going imbalance between the United States and the rest of the world.

We have two other options which are left, namely, either the controls which the President has suggested, or the adjustment of domestic policy, in respect to aggregate spending, fiscal restraint, monetary restraint, and wage and price restraint. Although I take it that Mr. Bernstein would not understand by that that the imposition of wage and price controls on the economy.

Professor BERNSTEIN. I don't want any controls. I want good policies.

Dr. BOARMAN. I agree. Do we have a feeling here, on the panel, that we do have a feasible alternative to the President's program? Is it possible now to cut the spending, to achieve the domestic restraint that would bring the balance of payments around?

Who feels that we can do without these controls by sufficiently restrictive domestic policy which would not precipitate, we hope, deflation and unemployment?

Professor MUNDELL. In my view, I don't think that the restorative measures proposed will in fact improve the balance of payments. It will look as if they are going to improve the balance of payments because when you put a tax on tourists or restrain the export of capital, it will certainly cut into these items. There is no question but that a tax on tourists will mean that fewer tourists will go abroad. It is the effects of the restrictions that create the illusion that they are in fact improving the balance of payments.

In the universities some very serious econometric work has been done in this area. The voluntary foreign credit restrictions program, for example, has been subject to careful analysis, and the upshot of the conclusion of one study, which is coming out in a Brookings book, is that the restrictions had no effect upon the balance of payments. They had the illusory effect, initially, of changing the item to which pressure was applied, but that after taking into account all the items, no effect whatsoever was observable.

I think we greatly exaggerate the impact of these measures. I would say that it is far more preferable to do without these measures than it is to put these measures into effect, and that in the long run (i.e., the next year or two years) the balance of payments will be worse on account of these measures. The effectiveness of aggregate policies, of appropriate monetary and fiscal policies is several times more important than the particular attempts to control one item. I don't need to list the gaps that are involved in these credit restraint programs—the Canada gap, the Panama gap, the substitution effects that work throughout the economy, the effect upon foreign economic policies, etc. When you aggregate these together and combine them with the increased speculation that this leads to with respect to gold, as Professor Haberler pointed out very carefully, we have the beginnings of a concealed devaluation. Once you get to a whole system of controls, what governments typically do—and the British government is the best example of this—is say, "Well, now we need to change the price of gold or we need to change the exchange rate so that we can get rid of all these restrictions that we've built up in the process." This is a policy of 50 or 75 underdeveloped countries with inconvertible currencies and I don't think it is the policy that the United States should follow.

Mr. GOODELL. Gentlemen, we are getting near the end here. It is the normal approach to have ladies go first; in this instance I apologize, Mrs. Jager, you will have the privilege of going last, and maybe that is a good spot to be in.

Mrs. JAGER. I guess it is best that it is last because my question really relates partly to Mr. Madden's comment on the difference between the short-run and the long-run. This is a confusing factor which would seem to preclude the reaching of any policy conclusions by a Congressman, from the advice of the panel.

But even more interesting to me is the combination of psychological and political judgments and also timing judgments on the part of the panel. Doesn't it seem a matter of some importance that the adjustments that most of the panel seem to find necessary in the domestic economy might fall with rather undue weight on certain sectors of this economy; doesn't this seem to you to be an important aspect in this consideration?

In other words, aren't you letting the tail wag the dog almost entirely in your general attitude, that to take care of a long-run problem you consider measures which would result in a pretty strong deflating of this economy?

Mr. GOODELL. Professor Bernstein?

Professor BERNSTEIN. Well, I want to be the first to say that I don't believe deflating would solve our balance of payments problem. Deflating is the one thing which would make sure that demand abroad falls off as much as demand here. This is why I say some people here practically suggest that there are no solutions.

I would say that what I want to get out of this economy is that part of the demand which is clearly excessive, which is inflationary, which is the cause of the rise in prices, which made our exports less competitive, which pulled in the import goods from abroad to fill up the shortage of supply relative to demand that we have been experiencing.

As Mr. Triffin said, in 1964 we had an enormous surplus on goods and services, on goods particularly. By 1966 we had dissipated more than half of it.

Now our good friend, Mr. Piquet, has shown us that in the first three months of 1967 the balance of payments was a little bit better, excluding the bad items—I mean excluding the items that went up, like military spending which he doesn't regard as in the current account. But he didn't, so far as I am concerned, prove that it was any good before it got better, and that is our problem.

We have had inflation and it is, strictly speaking, along with the war, the principal cause of the deficit. Therefore, we have to solve the problem by getting rid of the inflation, not by deflating.

Mr. GOODELL. A distinction between deflation and disinflation?

Professor BERNSTEIN. If you want to use that old-fashioned term,

Mr. GOODELL. Dr. Piquet?

Dr. PIQUET. One word about using the word "deflation" so fast and loose. There is little emphasis here, but not enough, on the necessities of international adjustment through the forces of the market. We did have, as was pointed out, under the old gold standard a tolerable degree of adjustment via trade without deflation. Adjustments do not occur in aggregates; adjustments occur always at the margin.

Now, this leads us into liberal trade policy philosophy. By increasing imports (or exports), we do not necessarily provoke unemployment. There is a shift, there is an adjustment of workers from one line to another, as the AFL–CIO has itself pointed out.

Mr. GOODELL. Ladies and gentlemen, I think we have drawn to the furthest extent now of our time. And I want to say first of all that we are very privileged to have had such a distinguished group of panelists and observers here.

I want you also to know that you've not been talking to yourselves. At one point this morning, before we got the quorum calls, I counted fifty members of Congress in the audience, so hopefully some of this has been absorbed in places where it can do some good.

And we were also privileged to have here the Deputy Assistant Secretary of the Treasury for International Affairs, Mr. John Petty.

Along with the rest of us, as a listener and a learner, I certainly learned a great deal and I thank all of you for taking the time and the effort to be a part of this panel this morning.

The meeting is adjourned.

(Whereupon, at 12:40 o'clock p.m., the meeting was adjourned.)

AFTER THE POUND: WHAT? OR AN INTERNATIONAL MONETARY STANDARD: NEITHER GOLD NOR THE DOLLAR

(By Robert Triffin, Yale University)

SUCCESS OF FAILURE?

The devaluation of the pound might have opened a new era in monetary cooperation. For the first time in history, *meaningful* international consultations determined the new rate, prevented a spiralling of mutually defeating devaluations by other major countries, and elicited from them large credits in support of the new rate. It could have been a great, an unprecedented success in our groping for a new monetary order.

Instead it unleashed an equally unprecedented wave of speculation, throwing even greater doubts than already existed as to the survival of our international monetary system. Why?

MARKET RIPPLES

Market analysts concentrate their guesswork on the day-to-day ripples that might quiet down tomorrow or be the beginnings of a maelstrom. They note the failure of the devaluation to restore so far full confidence in the pound and bring back to London a substantial portion of the short term funds that flew from it in the preceding weeks, months, or years. They see speculative unrest spreading from the pound to other currencies, and particularly to the dollar. Private gold purchases appear to have risen to record levels of possibly $1 billion, or more, in the month following the pound devaluation. Who is to blame? And how long can this last without forcing an official, or unofficial, increase in the price of gold?

CULPRITS OR SCAPEGOATS?

President de Gaulle kindly offers himself as a convenient scapegoat for what happened. He started his gold purchases several years ago, allowed—or stimulated?—press leaks that alarmed speculators, refused to cooperate fully with others in financing the remedies which we favored ourselves to get us out of the hole. Others blame the British for having waited too long, and for having bungled by not closing the exchange market on the day preceding the devaluation rather than on the following Monday. As for the new wave of speculation which rocked the market from December 11th through December 18th, they ascribe it to the unprecedented gate-crashing of the jealously closed club, or Mecca, of central bankers—the Bank for International Settlements—by our Undersecretary of the Treasury, and to rumored U.S. proposals to seek agreement on various ways to close speculators' access to gold at the present price, thus inducing them to scurry before the door was locked in their face.

The new and drastic U.S. balance-of-payments program unveiled on January 1st was obviously timed to ward off the further speculative wave that might have been expected otherwise from the public announcement of the unprecedented gold drain from Fort Knox in December: $295 million in a single month.

TWO BASIC ISSUES

All this makes fascinating copy indeed for the newspapers, but throws little light on the basic issues that will determine the ultimate outcome of the present crisis: the death-throes of the present gold-exchange standard, aggravated and accelerated by the huge and persistent deficits of the two countries whose national currencies serve as international reserves for others, i.e. the United Kingdom, and primarily today the United States.

THE DEATH OF THE GOLD-EXCHANGE STANDARD

The gold-exchange standard is dead or dying, but nothing else has taken its place yet.

It rested uneasily yesterday on two sources of supply for needed increases in the world reserve pool, essential to sustain desirable and feasible rates of expansion in world trade and production: (1) gold, and (2) gold-convertible foreign exchange. Both have totally dried up in recent years.

Gold used to provide three fourths, or more, of global reserve increases. In spite of increasing USSR sales, its contribution dropped to only one fourth in the quinquennium 1960–1964, and has now become negative. Indeed it was already negative before the recent speculative gold rush. In the last twelve months for which estimates are available (July 1966–June 1967), private purchases by industry, jewelers, dentists, hoarders and speculators ($1.7 billion) exceeded the total supplies coming to the market from new gold production ($1.4 billion), the difference being met by a $300 million contraction in official gold holdings. Last month's events will, of course, dig further—probably by $1 billion or more—into the world pool of monetary gold.

Gold-convertible foreign exchange thus provided the lion's share of new reserve increases: sixty-five percent of the total over the years 1960–1964. These foreign exchange reserves are overwhelmingly made up of dollar IOU's. They were at first accepted—or even eagerly looked for—by other countries, because they carried substantial interest-earnings, unavailable of course on gold metal, and could be converted at will into gold by their holders, without any question or embarrassment whatsoever.

This system was killed, several years ago, by our brilliant Undersecretary of the Treasury, Mr. Roosa, when he was forced—for very good reasons indeed—to appeal to "international cooperation" in order to apply the brakes on gold conversions which might topple the system by raiding the gold cellars of Fort Knox. In 1949, these were overflowing with about $25½ billion of gold and another $1½ billion of net claims on the International Monetary Fund, while our gold-convertible debt to foreign central banks barely exceeded $3 billion. In the following years, our net monetary reserves dropped gradually from their 1949 peak ($22.8 billion) to $10.9 billion in 1959 and minus $3.2 billion in June of this year. The net reserves of both reserve centers together—the United States and the United Kingdom—and of the other countries were about equal (approximately $17 billion) in 1949, but the first had dropped by mid-1967 to minus $9 billion or $10 billion, while the second had risen to well over $50 billion.

Sterling, and even the dollar, no longer looked quite "as good as gold," and foreign countries became increasingly reluctant to pile up further—and less and less easily "gold-convertible"—sterling and dollar IOU's. They were more and more inclined instead to convert them into gold, if they could or dared, or in gold-guaranteed claims on the International Monetary Fund. In the last two and half years—from the end of 1964 through mid-1967—they converted the entirety of their current reserve gains ($4.4 billion) and some ($0.2 billion) of their previously accumulated foreign exchange holdings into gold ($2.4 billion) and claims on the IMF ($2.1 billion). Foreign exchange liquidation by developed countries even reached the huge total of $2.8 billion (of which $0.8 billion by France and $2 billion by other countries), but was nearly offset by unprecedented foreign exchange accumulation by the underdeveloped countries.

THE DEBATE ON MONETARY REFORM

Events have thus confirmed dramatically the reluctant and belated recognition by the official negotiators of the Group of Ten and the IMF that neither gold nor gold-convertible foreign exchange could be safely relied upon to sustain indefinitely the world reserve requirements of expanding levels of world trade and production. Indeed, now that both of these traditional sources of reserve increases have become negative, reliance upon them threaten not only to unleash deflationary pressure or mutually defeating trade restrictions on the world economy, but also to destroy the stability of the two currencies which used to prop up the gold-exchange standard.

Four years of arduous negotiations finally succeeded, at the Rio de Janeiro meeting of the IMF last September, in producing a blueprint for the deliberate creation of a truly international reserve asset, in the amounts necessary to supplement vanishing supplies of gold and foreign exchange reserves. This agreement, however, must still be written out in legal form and hatched—ratified—by scores of Congresses and Parliaments before it can come into operation. And when the new bird finally breaks out of its shell, a special provision will still forbid it to fly, or even to walk until the United States and the United Kingdom have succeeded in diminishing substantially—or even eliminated entirely and durably—their huge and persistent reserve deficits.

I ventured to predict at the time that the Rio Agreement would do little—or nothing—therefore, to solve the more immediate problems raised by the storm already raging around the pound sterling, and by the tidal wave of bearish dollar speculation which a sterling devaluation might unleash upon the world. I added optimistically, however, that these forthcoming crises would impel new international rescue operations which might finally force us to deal realistically with the problem which the negotiators had bravely tried to sweep under the carpet, i.e. the relationship of the proposed new reserve asset to the former ones, the role which gold, dollars and sterling would continue to play in future reserve creation, and particularly the inherent vulnerability of the system to sudden or massive conversions from foreign exchange into gold.

The much heralded opposition of views between the United States and France, which had blocked agreement for so long, revolved indeed on this issue. The U.S. wanted basically to discourage the conversion of dollars into gold, but wished also to preserve as far as possible our chances to finance part, at least, of our future deficits through further dollar accumulation by foreign central banks, up to undetermined amounts. As long as we maintain that position, it will be difficult indeed (1) either to exact from European governments precise commitments for the creation and absorption of new reserve assets which might conceivably add to already excessive and inflationary, levels of dollar accumulation, or (2) to erect jointly appropriate safeguards against sudden or massive liquidation into gold of dollar reserves currently accruing to foreign central banks or already accumulated by them over the long years of functioning of the gold-exchange standard.

THE DOLLAR AREA ALTERNATIVE TO INTERNATIONAL AGREEMENT

These financial disagreements have now been compounded and magnified by the political implications of continued dollar accumulation by foreign central banks. Our Secretary of the Treasury called for such accumulation, particularly by the surplus countries of Continental Europe, as an indispensable cooperation for the financing of our direct investments abroad and of the defense of the "free World" not only in Europe, but also in Vietnam. Negotiations aiming at offsetting the foreign exchange costs of the stationing of our troops in Germany ended up, last March, with a German "declaration of intention" promising apparently broader and unlimited dollar accumulation and retention to avoid undesirable disturbances in the gold markets. Substantial increases of foreign exchange reserves since last March, not only in Germany ($172 million through November), but also in Italy ($845 million), Belgium ($307 million), the Netherlands ($274 million), etc., in sharp contrast to previous reductions, suggest that similar bargaining pressures may have been exercised on these countries to bolster up their flagging interest in dollar accumulation and deter them from excessive gold conversions.

We may be slipping unwittingly indeed, by gradual steps whose ultimate outcome is hardly suspected—as was the case for our Vietnam escalation—toward a most radical solution of our balance-of-payments difficulties. Influential banking voices have recently joined the chorus of academic writers calling for a demonetization of that barbarous relic: gold. We could do this unilaterally, by suspending formally gold purchases as well as gold sales, or, more informally, by raising various forms of restrictions—on capital, and even on current account transactions—against countries which insist on cashing their dollars for gold. Many countries might then prefer—according to this reasoning—to finance our deficits through unlimited dollar accumulation, since their refusal to buy and retain the dollar overflows would either expose their industries to severe U.S. restrictions, or to unbearable competition with U.S. producers whose costs would be slashed by the depreciation of the dollar in terms of their own currency.

Other instruments of persuasion could even be brought into play, if necessary: sharp cuts in our foreign aid to some, in our military supplies to others, etc.

The discriminations established by our new balance-of-payments program between three groups of countries might easily indicate a further and major step along this road, as they may induce countries to escape, or alleviate, our restrictions—shifting their status from "hell" to "purgatory" or "heaven"—by agreeing to limit their dollar conversions, or even to sell us gold against further piling-up of dollar IUO's.

There is little doubt that we could easily repeat in this manner the disastrous experience of Britain with her sterling area. We could force even more countries into a dollar area, large enough to absolve us of any future worries about our balance of payments.

At least, for a while! And at the cost of building up a tidal wave which would be certain to engulf, sooner or later, such "dollar imperialism" into a renewal of the divisive and destructive international monetary and economic chaos of the 1930's. Public opinion would soon awaken—or be awakened—to the political implications of such a system, i.e., the forcible financing by foreign central banks and their nationals of whatever deficits we may incur in pursuing policies unilaterally decided by us, even if these policies entered into conflict with their own views of world interests, or of their own national interests.

It is true that we similarly financed ourselves, in the Marshall plan and early NATO days, the huge deficits of the European countries. These deficits, however, were associated with policies on which we all agreed: the reconstruction of a Europe ruined by the second World War, and left as a tempting prey for Stalinist aggression or subversion. It is abundantly clear that many Europeans do not agree today with the policies of our Administration in Vietnam, and that some of them strongly object to what they regard as an excessive penetration, or take-over, of their industries by American capital. They may be wrong, but it would be highly unrealistic to expect them to finance indefinitely policies on which they have not been consulted and with which they may at times deeply disagree.

The ultimate outcome of such short-sighted U.S. policies could only be to arouse sharp political, as well as economic, divisions between the United States and Europe, as well as many other countries. More and more countries would desert, sooner or later, the dollar area, and erect compensatory barriers against the "foreign-exchange dumping" associated with the downward drift of a floating dollar—no longer supported by central bank purchases—in the exchange market. Economic warfare à la 1930's between a new gold bloc and a shrinking dollar-sterling bloc would replace the economic cooperation that has assured our joint prosperity ever since the end of World War II.

ROUNDING UP THE RIO AGREEMENT

The agreement reached at the Hague between the EEC countries, and later expanded into the Rio Agreement of last September, was largely a sane, last minute reaction to the abyss which was opening before the eyes of the negotiators as a result of the unreasonable and incompatible so-called "negotiating positions" previously adopted by France and the United States. Substantial concessions by the French rallied unanimity within the European Economic Community in favor of solutions acceptable to the United States, and far preferable indeed to the "undermining" of the international monetary system alluded to by Secretary Fowler at Pebble Beach, on March 17th, 1967.

Having agreed, however, on the need for a new reserve asset, we should now try to accelerate—or anticipate—its creation, not so much to expand present levels of world liquidity, but to prevent their contraction through flights into gold by either speculators or central banks or both.

The new reserve asset can be made vastly more attractive to central banks, and more acceptable to their politicians and public opinion, than mere sterling or dollar IOU's. Contrary to widespread opinion, it can also be made as safe for them as gold itself.

As long as it is not available, however, for reserve accumulation, and the practical choice for reserve holders remains constricted to either gold or dollars, President de Gaulle will not be alone in preferring gold, especially as long as our absurd and immoral venture in Vietnam perpetuates deficits of several billion dollars a year in our balance of payments.

The most urgent task confronting us at this juncture is not so much to expand immediately the world reserve pool as it is to arrest the contraction now triggered by wild flights into gold by speculators whom central bankers themselves might imitate tomorrow if they finally lost their nerve. The way to do this is not to close the private gold market, merely transferring its activities thereby to black or grey markets as in the late 1940's and early 1950's. It is to warn speculators that central banks no longer need gold as their ultimate reserve asset, are ready to use instead of a new reserve asset jointly created and managed by them, and are therefore able and willing to dump in free gold markets the billions of dollars of sterile gold which they now hold.

This may well indeed correspond to the ultimate objective of the new gold pool plans rumored to have been proposed at Basle by Undersecretary Deming earlier this month. To make such proposals truly negotiable, however, we must stop overplaying our hand as we have done so often, and at such costs, over the last eight years.

We cannot realistically expect to negotiate any agreement that would enable us to elude indefinitely the correction of our persistent balance-of-payments deficit either through bilateral palming-off of further dollar IOU's on foreign central banks, or through large and automatic earmarking in our favor (26 percent) of the new reserve asset proposed at Rio, but which is unlikely to see the light of day as long as our deficits continue on the present scale. We might be forced, like other countries, to accelerate the re-equilibration of our accounts, and to finance our tapering-off deficits through gold losses and recourse to our still huge drawing rights ($5½ billion) on the International Monetary Fund. We can, on the other hand, reasonably expect to negotiate an agreement protecting us against the danger of massive conversions into gold of the huge indebtedness incurred by us over the last half century of functioning of the absurd Monte-Carlo roulette dignified under the name of "gold-exchange standard."

I am deeply convinced, for my part, that the U.S. national interests, as well as those of the world, will be served far better in this way than by protracted delays and ultimate failure of negotiating aims unacceptable to other countries, or by short-sighted attempts to extract unlimited financing from reluctant partners in any "dollar area" scheme, or by the monetary chaos and economic warfare which either of these techniques would be bound to unleash, in the end, upon a world in which we are condemned, and must learn to live together.

THE JANUARY 1 PROGRAM

The new restrictions announced on January 1st are primarily a hurried response to our immediate concern: plug the dramatically widening gold leak from Fort Knox. They may do so in the short run, even though the *net* "improvement" to be expected from them is likely to remain far short of the $3 billion optimistically aimed at. Direct investments financed abroad are exempt from the

ceilings established, but much of this financing will come from foreign funds withdrawn from New York or which would otherwise have been placed in New York. Moreover, our hopes to improve our balance by $3 billion and Britain's hopes to improve its balance by $1.2 billion are unlikely to be matched by an accepted deterioration of $4.2 billion either in Continental Europe, whose surpluses totalled less than $700 million in the first three quarters of last year, or in the rest of the world where they barely reached $350 million. New troubles and spiralling of restrictions are likely to be forced upon other countries by our measures, just as they were forced on us by the aftermath of the British devaluation.

As for our own longer run aims and policies, the new program confirms, but does not resolve, the dilemma highlighted above:

1. It can—and I hope should—be interpreted as a laudable and long overdue attempt to pave the way for a quicker and fuller agreement on a negotiable plan for international monetary reform, by meeting the European objections to our huge and persistent deficits. It even centers our proposed measures on an effort to reduce drastically the splurge of direct investments which some of them have denounced as a "take-over" of their industrial establishment by American capital.

2. The plan could also be interpreted, however, as a further move toward a "dollar area" solution, discriminating in favor of the countries which refrain from converting their dollars into gold—i.e. the underdeveloped countries, the United Kingdom, Canada, Japan, Australia, etc.—and against those, "principally Continental Western Europe," which refuse to finance our deficits in this way.

I suspect that the Administration itself remains deeply divided as to which of these two directions it will take in the forthcoming months. Indeed, it might be forced into the second if the surplus countries of Continental Western Europe failed to respond constructively to the first. An international solution to what is, after all, an international problem will require their cooperation as well as ours. Neither is insured as yet, even though the consequences of the nationalistic alternative favored by some, on both sides of the Atlantic Ocean, would be as disastrous for all in the late 1960's as they proved to be in the early 1930's.

EVOLUTION OF THE U.S. BALANCE OF PAYMENTS, 1964 TO SEPTEMBER 1967

	1964	Yearly rate, January–September 1967	Difference
A. Current account	7.6	4.0	−3.5
B. Minus foreign aid	3.7	4.3	−.6
Change in international "net worth" (A+B)	3.9	−.2	−4.1
A. Net capital assets	7.4	3.7	−3.7
1. U.S. assets	6.5	5.0	−1.5
(a) Direct investment	2.4	2.9	+.5
(b) Portfolio investments	.7	1.2	+.5
(c) U.S. banks' loans	2.5	.7	−1.7
(d) Other	1.0	.3	−.7
2. U.S. liabilities (−)	−.1	−2.3	−2.2
3. Errors and omissions	.9	.9	-------

EVOLUTION OF THE U.S. BALANCE OF PAYMENTS, 1964 TO SEPTEMBER 1967—Continued

	1964	Yearly rate, January–September 1967	Difference
B. Settlements deficit (−)	−3.5	−3.9	−.4
1. Debt prepayments, etc.	−.4	−.3	+.1
2. Reserves and liquidity balance	−3.1	−3.6	−.5
(a) Dollar balances abroad	−1.6	−.7	+.8
(b) Net official reserves	−1.5	−2.9	−1.3

EXPLANATION

1. *The change in the U.S. international "net worth"* (exclusive of reinvested earnings and price changes not recorded in balance-of-payments statistics):

(a) reflects the excess of our current account (primarily trade) surplus over our foreign aid expenditures which finance it in part;

(b) is, in turn, reflected in changes in various U.S. assets and liabilities, classified here under:

(i) assets and liabilities other than those regarded as settlements and entering the various measurements of our so-called "overall" deficit;

(ii) our "settlements deficit," defined here in a way approximating the "balance on regular types of transactions" whose publication has been suspended. This includes:

(a) inter-governmental settlements, related to debt prepayments, military exports, etc. primarily designed to reduce our reserve losses;

(b) changes in our net official reserves (gold, foreign exchange and claims on the IMF, *minus* our liabilities to the IMF and to foreign monetary authorities) and in other foreigners' liquid dollar holdings ("dollar balances"). The distinction recorded here—and in the *Survey of Current Business*—between these two very different components is blurred by the inadequate recording of central banks' Euro-dollar claims, and can be extremely misleading at times.

2. Increases in U.S. assets and decreases in U.S. liabilities appear here as positive—and decreases in assets or increases in liabilities as negative—while the opposite convention is used by balance-of-payments bookkeepers.

BRIEF COMMENTS

1. Information about the disastrous fourth quarter of last year is not yet available, and the estimates for 1967 are for the yearly rates of the first three quarters seasonally adjusted.

2. Instead of increasing by $3.9 billion as in 1964, our international "net worth" was *declining* in 1967 at an annual rate of $200 million. This $4.1 billion reversal must, without any doubt, be ascribed primarily to the direct and indirect impact of the Vietnam war on our economy.

Total costs of the war are currently estimated at about $24 billion a year and expected to rise to about $28 billion in the next fiscal year. Direct foreign exchange costs are estimated (conservatively?) at more than $2 billion. Indirect costs—diversion of export capacity to military production, increased imports, inflationary impact diminishing U.S. competitiveness in world trade, etc.—are difficult to estimate, but may be even higher.

3. This $4.1 billion deterioration in our "net worth" balance has been absorbed primarily ($3.7 billion) by a sharp decline in our capital exports ($1.5 billion) and an even larger increase in our capital imports ($2.2 billion). Both were mostly due to steep increases in interest rates here. Only the capital exports of U.S. residents were affected by the interest-equalization tax and the "voluntary" restraints program. While U.S. banks' loans declined by $1.7 billion (or two-thirds) between these two years, direct and portfolio investments continued to rise, by $1 billion.

4. The remainder of the deterioration of our "net worth" balance ($0.4 billion) was absorbed by our "settlements balance." Our deficit on official settlements (net reserve losses) increased far more, however (by $1.3 billion) owing to the reduced accumulation of dollar balances by foreigners other than monetary authorities and the IMF.

5. Our gold losses remained moderate during the first eleven months of this year ($270 million) but reached a record $981 million in December alone, thus totalling $1251 for the year as a whole, and reducing our "free gold" stock to about $1.4 billion, i.e. an amount that could easily be absorbed in less than a year by future deficit settlements combined with normal money supply increases, to say nothing of another speculative gold rush similar to that of last December.

CONCLUSIONS

1. The removal of the remaining gold cover requirement has become a matter of great urgency, but will not, of course, arrest our huge and persistent deficits.

2. The January 1st program aims at "saving" about $3 billion of foreign expenditures by American residents. A substantial portion of these savings, however, is likely to be offset by:

(a) withdrawals of funds by foreign residents, or reduced investments of foreign funds here, because of:

(i) higher interest rates abroad, as a result of the curtailment of U.S. capital exports;

(ii) purchases of U.S. securities abroad—rather than here—floated by U.S. firms desirous to pursue their direct investment programs (such investments being exempted from the new ceilings when financed by foreign borrowings);

(iii) possibly, though not likely, because of fears of a future extension of U.S. controls to non-residents as well as residents.

(b) the unfavorable impact upon our current account of the U.K. austerity program, of the direct deflationary impact of both the U.S. and U.K. programs (aiming at a $4.2 improvement in their combined balance of payments) upon foreign countries, and of the policy measures which some of them may adopt in order to reduce their consequent reserve losses. The combined overall surplus of all other countries in the first nine months of 1967 was estimated at about $1 billion only, and the U.S. and U.K. measures will unavoidably affect some countries already in a weak balance-of-payments position. Their difficulties, and the measures which they would be impelled to take, would in turn spread to others, as in previous spirals of international deflation and restrictions.

3. The problem calls for two complementary lines of attack, neither which can succeed without the other:

(a) internationally agreed measures urgently needed to prevent a further contraction of existing reserve levels through further liquidation of dollar and sterling reserves into gold metal, and indispensable in the longer run to provide an adequate growth in world reserves through concerted reserve creation and their use for internationally agreed policy objectives;

(b) the early correction of our huge and persistent deficits of the last eighteen years (more than $47 billion), and the recognition that residual deficits should be financed from our own reserves and borrowings from the IMF, or through other multilaterally agreed procedures, rather than through further piling up of dollar balances by increasingly reluctant lenders.

4. The first of these two remedies could be implemented through the strengthening of the existing gold pool (see my proposals in this respect in *Contingency Planning for U.S. International Monetary Policy*, Joint Economic Committee, December 1966, pp. 133–144, brought up to date in the accompanying paper), and the later activation of, and amendments to, the September 1967 Rio Agreement (see my testimony, on November 22, 1967, before the Subcommittee on International Exchange and Payments and the Subcommittee's *Report* of December 6, 1967). International agreement on these short-term and long-term reforms of the present reserve system would, by itself, bring quick and rapid improvements in our balance-of-payments situation. It would protect our dwindling reserves against wanton liquidation of IOU's incurred over many years past. It would discourage the gold bulls and the dollar bears, thus improving—or even reversing—short-term capital outflows from the U.S.

5. This should make it easier for us to finance from our own resources and international borrowings our residual deficits, enabling us to eschew quick-acting, but mutually disastrous, restraints on our capital exports.

Final balance in our international transactions imperatively demands the restoration of our current account surplus to a level adequate to the financing of the capital exports to be expected from the richest country, and most productive economy in the world. This is unlikely to be achieved, however, as long as we devote a disproportionate share of our resources to an insane policy in South-East Asia, whose main result so far is to serve the interests of Mao-Tse Tung, and to create deepening divisions not only between us and our Western Allies, but also, tragically, within our own country.

Gold, Dollars, and the Balance of Payments

(By Edward M. Bernstein)

In a new year day message to the nation, President Johnson announced a very severe program to restore the U.S. balance of payments. The new program is urgent because of the threat to the dollar. The strength of the dollar depends on the strength of our payments position.

The United States has had a difficult balance of payments problem for the past ten years. Essentially this means that the earnings from our trade surplus and foreign investments have not been sufficient to pay for our foreign investments and the aid and overseas military expenditures of the Government. Every President since Eisenhower has taken some action to strengthen the balance of payments. Despite this, only a moderate and temporary improvement was achieved. In the past two years the problem has become more acute—partly because of the costs of the Vietnam war, partly because of the inflation of 1965–66.

The devaluation of sterling weakened confidence in currencies generally and in the dollar particularly. Speculation reached fever pitch in the gold markets of London, Zurich and Paris. There was imminent danger of a breakdown of the international monetary system. The speculation was brought to an end through the cooperative action of the countries in the gold pool, but only after several hundred million dollars had come out of our gold reserves.

So long as other countries keep acquiring a surfeit of dollars, there is danger of a renewed flight into gold. Unless we restore the strength of the dollar, which is one of the pillars of the international monetary system, it will be impossible to avoid widespread monetary disorders. The remarkable prosperity of the postwar period might then end in a disastrous world-wide deflation as it did in the 1930's.

These are the facts and the fears that underline the President's action program. The program imposes a reduction of $1 billion in U.S. direct investment abroad. It requires a return of $500 million to this country through a reduction of bank loans to continental Europe. It envisages a reduction of nonessential travel outside the Western Hemisphere. It includes further restraints on Government spending abroad. Finally, it proposes measures to encourage a larger increase in U.S. exports which must be the principal means of restoring our long-run payments position.

The action program will entail hardships for the U.S. economy and for the world economy. There are people who believe that all this is unnecessary. Some of them seem to think that our difficulties are due to wicked foreigners who insist on converting dollars into gold. Others think that the balance of payments can be restored painlessly by letting the dollar depreciate in a free exchange market. Unfortunately, there are no easy remedies for balance of payments problems.

The outflow of gold is a consequence, not a cause of our difficulties. We cannot solve the payments problem by the ingenious device of saying that we will sell gold, but we won't buy it back. No foreign country is selling gold to us now, except as a friendly gesture, and none will sell gold to us in the future unless they run short of dollars. It is true that foreign central banks cannot continue to add indefinitely to their gold reserves except by cannibalizing our gold reserves. This is the real gold problem. The solution is to create new reserve assets, not to force a unilateral demonetization of gold. In the meantime, we can keep our gold if we bring down the dollars we pay out to foreigners to the amount they want to spend and invest here.

The view that it would be painless to restore our balance of payments by letting the dollar depreciate in a free market is an illusion. All that a depreciation of the dollar would do is to allocate the effects of the reduction in U.S. foreign spending in a different way. In this country, it would place the greatest burden of adjustment on the consumers of import goods—through higher prices and smaller supplies. Abroad, it would place the greatest burden of adjustment on the countries that depend on exports to us. Canada, Japan, and the United Kingdom, which have balance of payments problems of their own, would find their position intolerable. They would have no alternative except to let their currencies depreciate too. Even some of the surplus countries of Europe would feel the depressing effects of a reduction of their exports to us. In order to maintain production and employment, they would probably let their currencies go down to the previous dollar rate. In the end, a depreciation of the dollar would bring improvement in the balance of payments in the wrong accounts and from the wrong countries at the cost of serious monetary and economic disruption.

To put it plainly, there will be some hardship from a reduction of U.S. payments by $3 billion no matter how it is done. The action program minimizes the impact on the world economy. Except for the proposed tax on tourist travel, it does not restrict any trade in goods and services. Even the restraints on capital outflow are designed to avoid adverse repercussionary effects on the world economy.

The severest restrictions are on direct investment in continental Europe. Many of these countries have a balance of payments surplus and large reserves. They can absorb the balance of payments effects and they can offset any adverse impact on their economy through expansionary domestic policies. The restriction on direct investment in other developed countries (the United Kingdom, Canada, Japan and Australia) and in the oil-producing countries of the Middle East is relatively moderate. Even so, it will cause difficulties for some of the hard-pressed countries. In the less-developed countries, U.S. direct investment can grow this year by a generous 10 per cent. The restriction on bank credit to foreigners is virtually all on the developed countries of continental Europe. If they adjust their credit policies to offset reduced borrowing from this country, there will be no adverse effect on production and trade.

The action program is an emergency program. It should be a temporary program. Our first job is to see that it succeeds. That requires, above all, avoiding renewed inflation by enacting the temporary tax surcharge. Beyond that, we must strengthen our long-run competitive position by holding down prices and costs. Then, when the Vietnam war is over, we shall be able to balance our payments without controls. The world needs a strong and stable dollar. That means a strong and stable dollar without controls.

The New Action Program on the U.S. Balance of Payments

January 18, 1968

(By Edward M. Bernstein)

Summary and Conclusions

In a new year's message to the nation, President Johnson announced a new action program to improve the balance of payments by $3 billion in 1968.

The regulations on direct investment limit capital transfers plus reinvested earnings in the less developed countries to 110 per cent of the 1965–66 average in these countries for each direct investor. For the United Kingdom, Canada, Japan, and Australia, and for the oil-producing countries outside the Western Hemisphere, capital transfers plus reinvested earnings are limited to 65 per cent of the 1965–66 average in these countries for each direct investor. In the other highly developed countries, mainly continental Europe except Finland and Greece, there is a moratorium on capital transfers, but each direct investor may reinvest earnings up to 35 per cent of his 1965–66 direct investment (capital transfers plus reinvested earnings) in these countries, provided this does not reduce remitted earnings below the 1964–66 average.

The limitations on direct investment will not create balance of payments problems for the surplus countries of continental Europe, but will cause difficulty for some others. The limitations will also be burdensome for the United Kingdom, Canada, Japan and Australia. There is no reason to expect the limitations to cause balance of payments difficulties in the less developed countries. On the other hand, there will be problems for U.S. foreign investors and for some foreign countries unless the level of plant and equipment expenditures of U.S. affiliates can be maintained at an appropriate level through funds borrowed in Europe. The limitations on direct investment are expected to result in a reduction of $1 billion in U.S. capital transfers from U.S. companies.

The new Federal Reserve restrictions on bank credit require no relending of long-terms credits repaid by developed countries of continental Europe and a reduction of 40 per cent in outstanding short-term credits to these countries. Nonbank financial institutions must reduce their outstanding foreign credits by 5 per cent. There are additional requirements for the return of liquid assets both by nonbank financial institutions and by direct investors. The return of funds through these restrictions is estimated at $500 million.

The President has called for a reduction in non-essential travel outside the Western Hemisphere designed to reduce the "travel deficit" by $500 million. The target reduction in U.S. Government expenditures abroad is $500 million. The United States is also discussing with the Common Market countries the difficulties caused to U.S. trade by the rebates on exports and border charges on imports equivalent to their value-added tax.

In order to assure the success of the new program, domestic fiscal and credit policy must hold down excessive aggregate expenditure and restore the stability of prices and costs. The President has said that the enactment of a tax surcharge is the first order of business before Congress. He has also called for a new voluntary program to avoid a rise in prices and an excessive rise in wages. New price-wage guideposts are being considered.

Dealing with the Payments Deficit

On January 1st, President Johnson delivered a Message to the Nation on the Balance of Payments. The essence of this message was that the U.S. balance of payments must be restored quickly in order to safeguard the U.S. economy and to prevent a breakdown of the international monetary system. The new action program presented by the President is a severe one. The objective is to achieve an improvement of $3 billion in the balance of payments in 1968.

The need for more effective measures to restore the U.S. payments position has been evident for some time. A more rigorous voluntary program had been instituted prior to the devaluation of sterling. In the first three quarters of 1967, the balance of payments was somewhat worse than it had been in the same period of 1966, omitting special transactions in both years. The modest increase in the trade balance was more than offset by increased military expenditures in Vietnam and by larger capital outflow. The failure of the trade balance to increase by more than $500 million in 1967 was particularly disappointing. Despite the slowdown, the U.S. economy continued on a high plateau, with an increase of imports, while several other leading industrial countries were in a recession, thus holding down the growth of world trade and U.S. exports.

The devaluation of sterling in November 1967 resulted in a sharp change in the payments situation. The United Kingdom had to sell some of its dollar investments to replenish its reserves. Other foreign funds flowed out of the United States to continental Europe. Two bursts of speculation in gold necessitated large support operations by the gold pool, and after the withdrawal of France the U.S. share in the pool increased from 50 to 59 per cent. U.S. net gold sales to foreign countries, which were only $77 million in the first three quarters of 1967, rose substantially and necessitated the withdrawal of about $1 billion from the gold certificate fund in the last quarter. The program is proof that the United States intends to defend the dollar and the $35-an-ounce price of gold.

Mandatory Control of Direct Investment

Under emergency financial powers, President Johnson has issued an Executive Order authorizing mandatory controls of direct investment and requiring the repatriation of earnings of U.S. foreign direct investment enterprises. The administration of the order has been delegated to the Secretary of Commerce.[1] The Secretary has issued Foreign Direct Investment Regulations governing direct investment of all enterprises except banks and financial institutions which are subject to the Federal Reserve program of foreign credit restraint.

U.S. direct investment in all countries will be limited on the basis of the 1965–66 average level of each company's direct investment. The regulations divide all countries into three groups with different limitations. The repatriation requirement is the same for all countries. Each direct investor is required to transfer to the United States from its share of the earnings of all its foreign affiliates an amount equal to the greater of (1) the same percentage of its share of total earnings as it repatriated on an average during 1964–66 or (2) so much of its share of earnings as may exceed the limits set for capital transfers in each group. Moreover, short-term financial assets abroad held other than in direct investments are required to be reduced to the average level of 1965 and 1966.

Limitations on schedule C countries

The strictest limitation on direct investment is on Schedule C countries—South Africa and continental Europe, except Greece and Finland. The regulations place a "moratorium" on transfers of capital to these countries in the form of new funds from the United States. However, a direct investor may reinvest annually in these countries up to 35 per cent of the average of his total investment (transfers and reinvested earnings) during 1965 and 1966, provided this does not reduce remitted earnings to a smaller percentage of his share of direct investment earnings than the 1964–66 average.

1. CAPITAL TRANSFER FOR DIRECT INVESTMENT, SCHEDULE C, 1965–66

[In millions of dollars]

	1965	1966
Common Market	857	1,140
Belgium and Luxembourg	117	122
France	152	93
Germany	359	614
Italy	158	150
Netherlands	71	161
Other specified countries	293	236
Denmark	22	24
Norway	18	12
Spain	54	109
Sweden	47	58
Switzerland	151	33
Other continental Europe[1]	12	45
South Africa	31	21
Total	1,193	1,442

[1] Includes countries such as Austria, Portugal, and Turkey in schedule C, and other countries such as Finland, Greece, and Ireland not in schedule C.

Source: Survey of Current Business, September 1967, p. 42.

The limitations on direct investment apply separately to each direct investor, although transfers between countries in Schedule C are permitted. Capital outflows for direct investment in this group amounted to nearly $1.2 billion in 1965 and about $1.4 billion in 1966. The 1967 data are not yet available, but the outflow to continental Europe in the first three quarters was $847 million and will probably be somewhat less for the year than in 1966. It should be noted that the figures include funds borrowed by corporations domiciled in the United States through the issue of their securities abroad. The use of such funds for direct investment in all foreign countries was $52 million in 1965, $445 million in 1966, and $225 million in the first three yuarters of 1967.

Although U.S. companies will not be able to remit new funds from the United States to continental Europe, except Greece and Finland, they will be able to reinvest part of their earnings to finance direct investment. The earnings of U.S. direct investment enterprises in these countries averaged about $680 million a year in 1964–66. Their reinvested earnings in this period averaged $210 million a year. The income remitted to the United States averaged $445 million a year. In South Africa, earnings averaged about $104 million a year, remitted income about $65 million a year and reinvested earnings about $35 million a year in 1964–66. The difference between the sum of remitted income and reinvested earnings, compared with total earnings, is mainly accounted for by the foreign withholding tax on income remitted to the United States. In some instances, direct investment participation through second and tertiary companies may affect the relationship between earnings, remittances and reinvested earning.

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[1] *Federal Register*, Vol. 33, No. 1, January 3, 1968, pp. 47–53.

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2. EARNINGS, INCOME, AND REINVESTED EARNINGS, SCHEDULE C, 1964–66

[In millions of dollars]

	Earnings			Income			Reinvested earnings		
	1964	1965	1966	1964	1965	1966	1964	1965	1966
Common Market	398	395	435	275	366	316	100	−3	105
Belgium and Luxembourg	53	56	52	34	35	35	14	16	13
France	82	79	88	27	42	36	52	32	50
Germany	211	217	208	178	236	178	18	−42	17
Italy	19	−4	39	23	28	31	−5	−33	9
Netherlands	33	46	48	13	25	35	21	25	16
Other specified countries	195	211	218	76	102	118	124	112	104
Denmark	6	6	5	8	5	7		3	1
Norway	7	6	−1	5	1	−3	3	5	3
Spain	11	27	31	7	10	12	4	17	19
Sweden	20	15	16	16	18	20	4	−4	−4
Switzerland	151	157	167	40	68	82	113	91	85
Other continental Europe [1]	44	67	75	26	31	40	17	36	34
South Africa	87	101	124	46	78	71	38	18	48
Total	724	773	852	424	576	545	279	164	291

[1] Includes countries such as Austria, Portugal, and Turkey in schedule C, and other countries such as Finland, Greece, and Ireland not in schedule C.

Source: Survey of Current Business, September 1966 and September 1967, p. 43.

There are striking differences in the practice of U.S. companies on the retention of earnings in Schedule C countries. In Germany, Italy, and Sweden reinvested earnings were negative in 1964–66. Probably for tax reasons, U.S. enterprises in these countries transferred their entire earnings to the United States and then returned as new funds that part of the earnings they needed for reinvestment. In France, Sweden, and the Netherlands, on the other hand, reinvested earnings were a very large part of the total earnings attributable to U.S. enterprises. In a few countries, notably Switzerland and South Africa, reinvested earnings exceeded 35 per cent of the 1965–66 average of total new investment (reinvested earnings plus transfers for direct investment). In France, reinvested earnings were probably just short of 35 per cent of the 1965–66 average of total new investment. For the group as a whole, reinvested earnings averaged 31 per cent of total earnings in 1964–66 and were less than 35 per cent of total new investment. As some companies will have a greater than average obligation to remit earnings, because of the 35 per cent limitation on new investment, actual remittances will have to be more than 70 per cent of earnings in this group.

Limitations on schedule B countries

Schedule B includes a number of high income countries, such as Australia, Canada, Ireland, Japan, New Zealand and the United Kingdom, as well as most oil-producing countries, such as Iran, Iraq, Kuwait, Libya, Qatar, and Saudi Arabia. Hong Kong, Bermuda and the Bahamas are also in this group. Some of these countries are highly dependent on a capital inflow for economic growth which cannot be adequately met from sources other than the United States. Others depend on U.S. capital inflow in order to avoid serious damage to their balance of payments. The regulations limit the capital inflow for each direct investor in these countries to 65 per cent of the average of his new investment from capital transfers and reinvested earnings in 1965–66.

Direct investment in the Schedule B countries is very large in the aggregate. In Canada alone, capital transfers for direct investment averaged $1 billion a year in 1965–66. In the other Schedule B countries, capital transfers averaged close to $700 million in 1965–66 with half of the total for direct investment in the United Kingdom. In the first three quarters of 1967, capital transfers in Schedule B countries were probably just under $1 billion, mainly because of a sharp decline in direct investment in Canada.

3.—CAPITAL TRANSFERS FOR DIRECT INVESTMENT, SCHEDULE B, 1965–66

[In millions of dollars]

	1965	1966
Australia	136	147
Canada	912	1,087
Japan	19	31
United Kingdom	317	384
Middle East and Libya [1]	266	79
Total	1,650	1,728

[1] Includes some countries not in schedule B.

Source: Survey of Current Business, September 1967, p. 42.

A very substantial part of the earnings of direct investment enterprises was retained for reinvestment. The earnings attributable to U.S. direct investment enterprises in Schedule B countries averaged nearly $3 billion a year in 1964–66. Of this amount, $2.1 billion was remitted as income to the United States and $900 million was reinvested. In Canada alone, earnings of U.S. enterprises averaged nearly $1.2 billion a year in 1964–66, remitted income averaged about $700 million a year, and reinvested earnings averaged over $500 million a year. The oil-producing countries averaged nearly $1.1 billion a year in earnings in 1964–66 and remitted almost all of it to the United States. For the group as a whole, remitted income averaged 73 percent of earnings in 1964–66.

4. EARNINGS, INCOME, AND REINVESTED EARNINGS OF U.S. ENTERPRISES, 1964–66

[In million of dollars]

	Earnings			Income			Reinvested earnings		
	1964	1965	1966	1964	1965	1966	1964	1965	1966
Australia	121	126	143	54	52	54	64	72	89
Canada	1,106	1,209	1,240	634	703	766	500	540	539
Japan	54	91	91	31	47	43	35	49	49
United Kingdom	473	504	427	263	270	251	167	242	190
Middle East and Libya [1]	1,071	1,072	1,146	1,088	1,062	1,129	16	63	102
Total	2,825	3,002	3,047	2,070	2,134	2,243	782	966	969

[1] Includes some countries not in schedule B.

Source: Survey of Current Business, September 1966, p. 35 and September 1967, p. 43.

Limitations on schedule A countries

All other countries are grouped together in Schedule A. They include Latin America and the less developed countries of Asia and Africa (excluding the oil-producing countries of the Middle East and Libya). For the countries in this group, allowable transfers of new capital, when added to reinvested earnings, may not exceed in any year 110 per cent of the direct investor's average investment in the Schedule A countries in 1965–66. Capital transfers to all of these countries averaged less than $500 million a year in 1965–66. Except for Latin America and other Western Hemisphere countries, capital transfers to Schedule A countries are usually very small and were only $158 million in 1966, making no deduction for negative investment (Table 5, page 7). In 1967, virtually no new capital transfers went into direct investment in the Schedule A countries of Asia and Africa.

The major source of funds for direct investment in the less developed countries, particularly the Latin American Republics, is the reinvested earnings of the subsidiaries and branches of U.S. enterprises in these regions. In 1964–66, the earnings of U.S. affiliates in all Schedule A countries averaged slightly more than $1.5 billion a year. The remitted income averaged about $1,170 million and reinvested earnings averaged about $355 million a year (Table 6). In Venezuela, virtually all of the earnings of U.S. enterprises were remitted as income.

5. CAPITAL TRANSFERS FOR DIRECT INVESTMENT, SCHEDULE A, 1965–66

[In millions of dollars]

	1965	1966
Mexico	99	16
Brazil	−6	85
Venezuela	−93	−48
Other Latin American Republics	176	109
Other Western Hemisphere [1]	95	114
Africa [2]	139	76
India	8	−10
Philippine Republic	30	19
Other Far East [3]	126	44
Total	574	405

[1] Includes Bermuda and the Bahamas in schedule B.
[2] Excludes Libya in schedule B and Republic of South Africa in schedule C.
[3] Includes Hong Kong and excludes Japan which are in schedule B.

Source: Survey of Current Business, September 1967, p. 42.

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6. EARNINGS, INCOME, AND REINVESTED EARNINGS, SCHEDULE A, 1964–66

[In millions of dollars]

	Earnings			Income			Reinvested earnings		
	1964	1965	1966	1964	1965	1966	1964	1965	1966
Mexico	92	96	109	61	70	60	34	33	49
Brazil	58	101	122	5	19	33	59	84	85
Venezuela	547	497	456	521	475	438	27	23	20
Other Latin American Republics	398	466	574	301	305	431	96	166	145
Other Western Hemisphere [1]	149	160	158	116	126	148	34	39	41
Africa [2]	1	44	21	3	23	2	−1	25	23
India	23	30	3	12	14	8	7	12	−8
Philippine Republic	47	48	53	28	23	26	14	23	24
Other Far East [3]	84	91	102	77	119	70	7	−27	32
Total	1,399	1,533	1,598	1,124	1,174	1,216	277	378	411

[1] Includes Bermuda and the Bahamas in schedule B.
[2] Excludes Libya in schedule B and Republic of South Africa in schedule C.
[3] Includes Hong Kong and excludes Japan which are in schedule B.

Source: Survey of Current Business, September 1966, p. 35, and September 1967, p. 43.

INCIDENCE OF THE REGULATIONS ON DIRECT INVESTMENT

The impact of the regulations on the balance of payments of individual countries cannot be determined from their historical experience. The regulations apply to each group of countries as a whole, and a direct investor may move funds from one country to another in the same group. Transfers between countries not in the same group are permitted from those in Schedule C to those in Schedules A and B, and from those in Schedule B to those in Schedule A, provided "that the amount of the transfer, taken together with other authorized transfers of such direct investor, does not exceed in any year the limits authorized with respect to such direct investor . . . [in each separate Schedule]." Thus, the regulations on transfers and reinvested earnings set a theoretical limit on direct investment for each Schedule as a whole, but the practical limit may be less, as some direct investors may not be able to invest to the amount of the theoretical limit. This is true of investors with affiliates in only a few countries and particularly those operating in continental Europe with a relatively high repatriation requirement.

7.—APPROXIMATE EFFECT OF NEW REGULATIONS ON DIRECT INVESTMENT [1]

[In millions of dollars]

	New funds, 1966	Reinvested earnings, 1966	Total direct investment, 1966	Maximum under regulations [2]	Indicated reduction from 1966 [2]
Schedule A	405	411	816	972	+156
Schedule B	1,728	969	2,697	1,726	−971
Schedule C	1,442	291	1,733	291	−1,442
Funds borrowed abroad	−445		−445		+445
All countries	3,130	1,671	4,801	2,989	−1,812
Allowance for lower direct investment in 1967, approximately					400
Allowance for direct investment not covered by regulations and for special authorizations, approximately					400
Indicated reduction from 1967 level of investment by direct investors					−1,000

[1] Does not include international shipping companies incorporated abroad.
[2] Assumes that 1968 earnings will permit reinvestment at the 1966 level.

The regulations as they stand would require a reduction in direct investment through transfers of new funds and reinvestment of earnings of about $1.8 billion from the 1966 level. Compared with 1967, however, the reduction would be about $1.4 billion because direct investment transfers (new funds) amounted to $2.0 billion in the first three quarters of 1967 compared with $2.4 billion in the same period of 1966. Funds borrowed abroad and included in U.S. transfers, however, were also less in 1967 than in 1966. The reduction in direct investment will be less than shown in Table 7 because allowance must be made for funds borrowed by a foreign affiliate from U.S. financial institutions. This is treated as direct investment but is not a transfer by a direct investor. Allowance must also be made for exclusions from the regulations—banks and financial institutions subject to Federal Reserve guidelines, and direct investment of less than $100,000 a year. Most important, special authorizations can be given for investment in excess of the limits, particularly for work in progress and for legally binding commitments. The estimated 1968 reduction of $1 billion in direct investment, as measured by the 1967 balance of payments, makes allowance for exclusions and special authorizations.

The developed countries of continental Europe would have the greatest reduction in receipts from U.S. direct investment. The moratorium on transfers of new funds would mean a reduction of nearly $1 billion from the 1966 level but considerably less from the 1967 level, assuming that the continental European countries are the sole source of the foreign funds borrowed by U.S. corporations for direct investment. Many of them can absorb the balance of payments effects of the sharp decline in U.S. direct investment without great difficulty.

Direct investment in the Schedule B countries would be reduced by about $1 billion from the 1966 level and by about $550 million from the 1967 level, before other allowances. If the reduction of direct investment were proportionate in all countries, the greatest burden would be on the United Kingdom because of its serious payments problem. In Canada, with easy access to U.S. money and capital markets, the adverse effect on the balance of payments may not be great. The problem created for Australia's balance of payments by the limitation on direct investment is more difficult, but it may be met to some extent by transfers of funds from other countries in Schedules B or C or by special authorizations, particularly for projects already under way. For the less developed countries generally, the regulations on direct investment are generous and cannot create balance of payments difficulties.

8.—SOURCES OF FUNDS OF DIRECT INVESTMENT ENTERPRISES, 1965

[Dollar amounts in millions]

	Manufacturing	Mining and smelting	Petroleum	Total
Funds from the United States	$1,369	$124	$997	$2,490
Reinvested earnings	1,174	301	−4	1,471
Direct investment	2,543	425	993	3,961
Depreciation and depletion	1,865	278	1,247	3,390
Funds obtained abroad	2,437	260	881	3,578
Unidentified sources	157	16	145	318
Total	7,002	979	3,266	11,247
Ratio of direct investment (1+2) to total, percent	36.3	43.4	30.4	35.2

Source: Survey of Current Business, January 1967, p. 28.

The limitations on direct investment will create investment problems for the U.S. direct investors and for the foreign countries in which they operate. If U.S. affiliates in Schedules C and B countries had to depend solely on the limited amount of new direct investment permitted under the regulations, they might be unable to finance any expansion of their operations. In fact, U.S. affiliates can use their depreciation and depletion allowances and funds obtained abroad. These sources are much larger than transfers from the United States and reinvested earnings. In 1965, for example, U.S. affiliates in all areas obtained 65 per cent of the $11.2 billion they used to acquire plant and equipment, inventories and other assets from depreciation and depletion allowances, credits abroad, and unidentified sources. U.S. affiliates will become even more dependent on foreign financing for the normal expansion of their operations. If U.S. affiliates can borrow long-term through issues of their securities (with the guarantee of parent companies if permitted) and if they have somewhat greater access to local credits, the scale of new investment of U.S. enterprises in Europe, Canada, the United Kingdom, Australia, and Japan need not be seriously curtailed. This would require an accommodating credit policy in Europe.

Investment by the petroleum companies, and to some extent by mining companies, presents a special problem for foreign countries and for U.S. direct investment enterprises. The amount of foreign investment by petroleum and mining companies varies sharply from year to year, depending upon exploration and development of new fields. No formula could take adequate account of the need for new investment funds that could emerge unexpectedly when new oil fields or new mines are opened. Inevitably, such cases will require special authorization.

BANKS AND FINANCIAL INSTITUTIONS

The President has delegated to the Federal Reserve Board standby authority to invoke mandatory controls on transfers by any bank or other financial institution, including authority to require the repatriation of funds held abroad, if the Board should regard this as necessary or desirable. So far, the Federal Reserve Board has decided to regulate the foreign transactions of banks and other financial institutions through voluntary controls. It has, however, issued new guidelines requiring a severe restriction of outstanding foreign credits of banks and of covered foreign assets of other financial institutions.

The November 16, 1967 guideline established a 1968 ceiling for outstanding foreign credits of large banks with considerable foreign claims at 109 per cent of their 1964 base (the amount of foreign credits outstanding at the end of that year). The new ceiling for 1968 is 103 per cent of the 1964 base. For other banks, generally smaller ones with limited foreign credits outstanding, the 1968 ceiling had previously been set at 2 per cent of their total assets at the end of 1966. The new ceiling for 1968 is their 1967 ceiling plus one-third of the addition that had been envisaged in the original guidelines.

More important, banks are asked to reduce outstanding long-term loans to developed countries of continental Western Europe by not renewing such loans at maturity and by not relending repayments to residents of those countries. The guidelines request further that short-term loans to developed countries of continental Western Europe be reduced during 1968 by 40 per cent of the amount outstanding on December 31, 1967 at a rate not less than 10 percentage points in each quarter. The ceiling for outstanding foreign credits for each bank will be reduced by the reduction in its term loans to developed countries of Western Europe and additionally each quarter by 10 per cent of the amount of short-term credits to the developed countries of Western Europe outstanding at the end of 1967.

9. OUTSTANDING CLAIMS ON EUROPE REPORTED BY BANKS IN THE UNITED STATES [1]

[In millions of dollars]

	Oct. 31, 1967, short term	Sept. 30, 1967, long term
Austria	10	15
Belgium	72	74
Denmark	36	18
France	58	46
Germany	198	122
Italy	78	118
Netherlands	31	2
Norway	51	146
Portugal	24	66
Spain	56	53
Sweden	71	47
Switzerland	117	11
Other Europe	86	25
Total	890	745

[1] Does not include United Kingdom, Greece, Finland, or Eastern Europe.

Source: Federal Reserve Bulletin, December 1967, p. 2151; Treasury Bulletin, Nov. 1967, p. 105.

The new guidelines will necessitate a reduction of about $300 million in outstanding short-term credits to continental Western Europe at a regular quarterly rate during 1968. They will also result in a reduction of nearly $300 million in outstanding long-term loans, the amount repaid in 1967. The new guidelines will leave some room for increasing bank credits to other countries in 1968, perhaps by about $150 million. Foreign credits extended within the guidelines will have to give priority to export financing and to loans to less developed countries. The contraction will be especially large in short-term credits for Germany and Switzerland and in long-term loans to Norway, Germany and Italy.

Under the new guidelines, nonbank financial institutions (insurance companies, trust companies, mutual savings banks, etc.) are requested to reduce their end of 1967 holdings of foreign assets covered by the program by 5 per cent during 1968. Holdings of liquid funds abroad will be reduced to zero or the minimum working balance required for their foreign business, even if this entails a decline of more than 5 per cent in foreign assets. The amount involved cannot be large, perhaps a reduction of $50 million in covered assets.

The reduction of bank credits to Europe will result in a great increase of demand for Eurodollar credits and for credit from the banks of continental Europe. Some European customers of American banks may try to secure loans from the American branches of the same banks in Europe; and the head offices in this country may find it necessary to repay Eurodollars previously borrowed from their branches. No doubt some foreign funds will be withdrawn from this country to meet the increased demand for credit in Europe. The improvement in the reserve settlements balance may be much less than the $500 million improvement in the liquidity balance.

The pressure on the Eurodollar market from the reduction of U.S. bank credits to Europe will be intensified by the withdrawal of liquid assets by U.S. firms. The short-term foreign claims on Europe of U.S. nonbanking concerns amounted to $1,157 million at the end of June 1967. About half of the claims were on the United Kingdom, a further indication that they included a considerable amount of liquid assets. Some of these funds are temporary investments of the proceeds of securities issued by U.S. companies for financing their direct investments abroad. It is difficult to see how such funds can be returned to the United States without disrupting plans for financing direct investment that may already be in process. Nevertheless, there will be some liquid assets that will have to be returned to the United States, placing further pressure on the Eurodollar market.

FOREIGN TRAVEL

President Johnson's message on the balance of payments calls for a reduction of $500 million in the "travel deficit" by deferring for the next two years nonessential travel outside the Western Hemisphere. The emphasis on reducing travel expenditures cannot be justified merely by the "travel deficit." The view that no account in the balance of payments should have a large excess of payments contradicts the principles underlying the freer trade and payments policy of the postwar period. The case for a reduction in U.S. travel expenditures rests on the urgency of solving the payments problem and the importance of having the general public share in the sacrifices that must be made for this purpose.

Expenditures of U.S. travellers in foreign countries amounted to $2.4 billion in 1965 and $2.7 billion in 1966. In the first three quarters of 1967, such expenditures amounted to $2.62 billion, about $460 million more than in the same period of 1966, most of which was in Canada. For the year as a whole U.S. foreign travel expenditures were about $3.2 billion in 1967. To this should be added passenger fares paid to foreign carriers which amounted to $720 million in 1965, $755 million in 1966, and about $800 million in 1967. Thus, in the balance of payments, foreign travel accounted for payments of about $4 billion in 1967.

The restriction of travel expenditures is very difficult for the United States because there is no altogether satifactory means of administering such limitations. With the ready acceptability of dollar notes and dollar checks, it would be very difficult to set a maximum sum that each traveller could spend abroad. The alternative of a graduated expenditure tax would require a far-reaching innovation in the tax system. The simplest device would be to impose a ticket tax on travel outside the Western Hemisphere, although this might not achieve the desired reduction of travel expenditures.

In 1966, U.S. travel expenditures outside the Western Hemisphere amounted to $1,045 million and in 1967 they were over $1.1 billion. Payments to foreign carriers (about $800 million in 1967) must have been very largely to European airlines. Even a precipitous fall in travel to Europe, Africa, and Asia could not reduce foreign travel and passenger transportation payments by $500 million in 1968, as some U.S. travel would be diverted to the Western Hemisphere. The best hope for reducing the "travel deficit" by $500 million in 1968 is to supplement a moderate reduction of U.S. travel in Europe with the return of a normal level of U.S. travel in Canada (now that Expo is over) and a more-than-normal increase in receipts from foreign travel in conjunction with the Olympic Games in Mexico.

10. U.S. EXPENDITURES FOR TRAVEL IN FOREIGN COUNTRIES, 1965–67

[In millions of dollars]

	1965	1966	1st 3 quarters 1966	1st 3 quarters 1967
Canada	600	678	571	925
Mexico	540	575	701	740
Other Western Hemisphere	324	360		
United Kingdom	142	167	------	------
France	125	116	------	------
Italy	152	153	------	------
Switzerland	53	60	------	------
Germany	79	86	------	------
Austria	27	36	------	------
Denmark	23	26	------	------
Sweden	14	13	------	------
Norway	16	14	------	------
Netherlands	24	26	------	------
Belgium-Luxembourg	13	13	------	------
Spain	51	53	------	------
Greece	31	34	------	------
Other Europe	56	61	------	------
Total Europe	806	858	735	777
Israel	31	35	------	------
Japan	60	62	------	------
Australia-New Zealand	15	18	------	------
All other	62	71	------	------
Total all other countries	168	186	155	178
Total expenditures in foreign countries	2,438	2,657	2,162	2,620

Source: Survey of Current Business, June 1967, p. 14; March 1967, pp. 26–31; and December 1967, p. 29.

GOVERNMENT EXPENDITURES

The Government's overseas expenditures are very large, reflecting the wide international commitments of the United States. These expenditures have increased rapidly in recent years in response to the intensification of the war in Vietnam. In 1966, the foreign payments on U.S. Government transactions (other than military grants of goods and services) amounted to $8.7 billion. In the first three quarters of 1967, such payments were $7.7 billion, an increase of $1,073 million from the corresponding period of 1966.

U.S. Government payments abroad are not responsive to economic policy in the same way as private transactions. That is because they are mainly designed to achieve military,

diplomatic and aid objectives. The policy of the Government has been to minimize the balance of payments effects of such expenditures through the tying of aid and through greater reliance on U.S. goods and services to meet the needs of overseas forces. In the case of military expenditures, the U.S. Government has emphasized burden-sharing through offsetting purchases of military equipment in the United States by foreign countries and through investment in U.S. securities (Government and other) which can be treated as capital inflow in the liquidity definition of the balance of payments.

These measures have held down the payments deficit, although not by as much as is sometimes assumed. The new program contemplates a further saving of $500 million on Government payments. The number of U.S. civilians working overseas will be cut. The foreign exchange impact of personal spending by U.S. forces and their dependents in Europe will be further reduced. Negotiations will be initiated with the NATO allies for offsetting purchases of defense goods and investment in long-term U.S. securities. Similar discussions will be held with other countries in which the United States has armed forces. The tying of aid is already very stringent and the President recently ordered a further reduction of $100 million in the foreign exchange costs of the aid program.

INCREASING U.S. EXPORTS

In the long run, the elimination of the U.S. payments deficit, without depending on restrictions, will require a substantial increase in the trade balance. The achievement of a sufficiently large trade surplus will depend primarily on a high rate of growth of world trade and the strengthening of the U.S. competitive position. At present, however, the value-added tax in the Common Market, with its tax rebates for exports and its border charges on imports, creates serious handicaps for U.S. trade throughout the world.

These tax rebates and border charges are permitted under the GATT rules. Nevertheless, the economic principles underlying such action are open to question. They assume that indirect taxes (excise and sales taxes) are incorporated in prices, while direct taxes (income and profits taxes) do not affect prices. In a country in which a substantial portion of the tax revenue is derived from indirect taxes, it is very unlikely that all of the tax is incorporated in prices. On the other hand, in a country in which tax rates on profits (Federal and state income taxes) are well over 50 per cent, it is very unlikely that none of the tax is passed on in the form of higher prices of goods and services. If this conclusion is correct, the tax rebates for exports and border charges on imports in countries using a value-added tax provide a bounty to exports and place a penalty on imports.

The inequity of such a rule would be apparent if one country used indirect taxes exclusively and another country used direct taxes exclusively. In the first country, exports would be rebated the full amount of the indirect taxes and they would bear no part of the cost of operating the Government, either in the country in which they are produced or in the country in which they are sold. On the other hand, in the second country, exports would pay their full share of the cost of operating the Government in the country in which they are produced and would then be required through border charges to bear a proportionate share of the cost of operating the Government in the country in which they are sold. In the first country export goods would be completely exempt from taxes, while in the second country export goods would be taxed doubly. These questions have been studied by the OECD. Their economists are aware that absolute distinctions cannot be made between the incidence of direct and indirect taxes.

In his balance of payments message, President Johnson said that discussions have been initiated with the Common Market countries which "will examine proposals for prompt cooperative action among all parties to minimize the disadvantages to our trade which arise from differences among national tax systems. We are also preparing legislative measures in this area whose scope and nature will depend upon the outcome of these consultations." Even in the United States there are some indirect taxes on goods, services and property which under the GATT rules would justify tax rebates on U.S. exports and border charges on U.S. imports. If the United States were to follow this policy, other countries would have to do the same in order to avoid an adverse effect on their trade.

The United States is undertaking a program to promote the sale of U.S. goods overseas. One aspect of this program is the formation of joint export associations through which smaller corporations can join together to sell their products abroad. The President will also ask Congress to earmark $500 million of the Export-Import Bank authorization to provide better export insurance, expand guarantees for export financing, and broaden the scope of Government financing of exports. Finally, through a more liberal rediscount system, the Export-Import Bank will encourage commercial banks to provide more generous help to business firms to finance an increase in their exports.

DOMESTIC POLICIES TO STRENGTHEN THE BALANCE OF PAYMENTS

The action program is designed to improve the balance of payments by $3 billion. The impact on other countries of such an enormous shift in the world pattern of payments will be moderated by several factors. In the first place, the improvement is in terms of the liquidity definition, involving in part a simultaneous reduction in U.S. bank liabilities and bank assets. On a reserve transactions basis, the payments deficit would be reduced by somewhat less than $3 billion. Furthermore, there is a once-for-all aspect in some phases of the program, such as the reduction in bank credits to Europe and in the return of liquid assets from abroad. Finally, the incidence of the program will be mainly on high-income countries with a strong balance of payments and with large reserves. The repercussionary effects on the world economy will thus be minimized as far as can reasonably be done.

It must be recognized that any large and sudden change in the U.S. balance of payments must have some restrictive effects on the world economy. That is inherent in the elimination of the U.S. deficit. The restrictive effects would be much greater, and perhaps dangerous, if the same improvement in the U.S. balance of payments were attempted through severe deflation. Because the greater part of the improvement is achieved by reduced capital outflow, the impact on production and employment in other countries will be much less than if there had been a reduction in U.S. imports of goods and services. Nevertheless, even a reduction of capital outflow will to some extent affect the level of economic activity in other countries—particularly those with a balance of payments problem. The repercussionary effects on the world economy can be kept relatively small, if the surplus countries of Europe follow expansionary policies and make available a larger supply of loanable funds without a sharp rise in interest rates.

Now that the program has been announced, it is of the utmost importance that it succeed. Time and again the United States has introduced measures to achieve a substantial reduction of the payments deficit. Despite this, the overall balance of payments showed only modest improvement until 1965 and in the past two years deteriorated further. While there is no difficulty in explaining why this happened, there is the danger that repeated failure will ultimately be interpreted as an inability of the United States to restore its balance of payments. This time there must be no mistake. The action program must succeed. Domestic policies should be designed to assure its success.

The persistence of the deficit is primarily attributable to the Vietnam war, the inflation of 1965–66, and the resultant rise in prices and costs which is still continuing. The best way of avoiding another round of inflation is through a strong fiscal policy. The President has emphasized this in his balance of payments message. "No business before the returning Congress will be more urgent than this: To enact the anti-inflation tax which I have sought for almost year. Coupled with our expenditure controls and appropriate monetary policy, this will help to stem the inflationary pressures which now threaten our economic prosperity and our trade surplus."

Despite the slowdown of the economy in 1967, prices of manufactured goods rose by 3 per cent and labor costs per unit of output in manufacturing rose by 5 per cent, partly because the increase of productivity was held down by the lower level of industrial production. The continued rise of prices in a period of moderate demand is a belated adjustment to the inflation of 1965–66 which disrupted appropriate price, cost and income relationships. This happened in 1967 and it will happen again in 1968. The objective now must be to restore monetary stability by avoiding renewed inflationary pressures this year, by gradually moderating the rise in wages, and by holding down the rise in manufacturing costs through a greater increase of productivity. If the U.S. economy is to operate at a high level of production and employment without inflationary pressures, it is essential to have price-wage restraint. The key to this is voluntary adherence to price-wage guideposts that will keep the wholesale price level of manufactured goods stable and will relate the rise of wages to the increase of average productivity in manufacturing. A country with a balance of payments problem cannot afford to see the prices of its export goods rise to an uncompetitive level. To maintain stable and competitive export prices, it cannot afford a larger rise in wages than the increase of productivity in its export industries.

THE PRESIDENT'S BALANCE-OF-PAYMENTS PROPOSALS

(Letter to New York Times by Prof. Gottfried Haberler, January 9, 1968)

The latest measures to correct the deficit in the balance of payments are a further big step into the morass of specific controls, into what used to be called the "Schachtian" system, named after its inventor, the Nazi economic wizard Hjalmar Schacht.

To prevent American tourists from going outside the Western Hemisphere is not only a shocking infringement on individual rights, but gives the worst possible example. It flagrantly contradicts the often repeated declarations for freer international trade which were solemnly reaffirmed earlier this year in connection with the successful temination of the Kennedy Round negotiations for tariff reductions.

What economic sense does it make to refuse tariff protection to the steel, automobile and other industries when the American tourist industry receives sky-high protection and the airlines and aircraft industries are hard hit in the process? Has tourism a comparative advantage over steel and textiles? Is it more important to have more ski slopes, gambling casinos and other tourist attractions than more steel mills and textile plants?

The worst feature is the arbitrary discrimination between the Western Hemisphere and the rest of the world, which add a strong touch of economic warfare to the proposed measures. What economic sense does it make to tax tourists going to Africa, but not those going to Latin America? Why should Italy and Great Britain be hit and Canada favored?

General nondiscriminatory payments restrictions could perhaps be justified as a temporary measure if something decisive were done at the same time to correct the fundamental disequilibrium. But nothing of this sort has been proposed. On the contrary, the Federal Reserve continues to pump money at a record rate into the economy. Hardly a week passes without the President signing into law new programs costing billions of dollars, criticizing Congress at the same time for not spending more.

If inflation is not stopped and the financial house put in order, a devaluation of the dollar becomes unavoidable. An open devaluation, preferably in the form of a floating rate, would be far better than one disguised in a multitude of haphazard, discriminatory taxes and controls of which the existing and presently proposed batch is only the beginning.

The U.S. Balance-of-Payments Deficit: Ailment or Symptom?

(By Howard S. Piquet) [1]

Most of those who have expressed agreement with the President's action and proposals to narrow the deficit in the U.S. balance of payments have deplored the fact that some such action "had to be taken". All have expressed hope that the limitations on U.S. private foreign investment and on foreign travel will be temporary and will be removed as soon as there is substantial improvement in the international accounts.

Restriction of the outflow of capital and of funds on the part of American tourists has the same kind of effect on the international accounts as would an across-the-board restriction of imports. Ever since 1934 the United States has exercised its leadership to bring about reductions of trade barriers throughout the world and to maintain an unrestricted payments system. The Trade Agreements Acts, commencing in 1934 and culminating in the Trade Expansion Act of 1962 and the Kennedy Round, were accompanied by strong support of the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF). Naturally, there is grave concern that the restrictive measures that have just been adopted and proposed are in clear contradiction of this policy and that, once adopted, they will become more permanent than temporary.

Even experts in international economics give the impression of disagreeing, not only with respect to the "balance-of-payments problem," but also with respect to the nature of the problem itslf. Some of the disagreement appears to arise from failure to distinguish betwen financial (including fiscal) and monetary phenomena.

Economic problems often involve unseen, subtle forces and relationships as opposed to the seen and the obvious. There is always danger of concentrating attention on symptoms instead of on fundamental ailments.

Unfortunately, "monetary" and "financial" are not clean-cut, mutually-exclusive categories, one reason being that, although only the State can create "money," once created it serves as the basis for private credit which performs the same functions as money. Furthermore, when Government debt (a financial phenomenon) is monetized, the money supply (a monetary phenomenon) is increased.

If the United States were "just another country" its continuing large balance-of-payments deficits could not be tolerated. They would bring about weakness in the foreign exchange value of the dollar and result in a loss of monetary reserves (gold) which would necessitate restrictionist domestic economic policies. This was the condition of Western Europe at the close of World War II.

However, the United States is not "just another country." Ever since World War II it has been used by other countries as a central banker, performing functions of financial intermediation. Which means that it has been exchanging its short-term liquid liabilities for the long-run liabilities of other countries and their nationals. It is not necessary for a banker, or any one else engaged in the business of lending, to keep his monetary inflows and outflows always in balance. What is essential is that he maintain sufficient reserves to maintain confidence in his ability to meet the demands of his creditors. In the short-hand of the day this is "liquidity."

There can be little doubt about the international financial integrity of the United States. At the end of 1966 the obligations of Americans to foreigners, including governments and central banks, totaled $60 billion, while American claims against foreigners totaled $112 billion. The country's liquid reserve (gold) of some $12.5 billion equals approximately 40 percent of its total outstanding liquid liabilities. If the analogy of central banking is applicable this is a pretty healthy reserve.

There has been easy acceptance by the Administration, by many members of Congress, and by the press of the assertion that the only way to solve the "problem" is to bring the plusses and the minuses in the international accounts into closer balance with each other, at least down to the 1965–1966 deficit level of $1.4 billion. The fact that certain Europeans have been urging that we do this does not mean that the restrictive balance-of-payments measures that have been taken or proposed are the only, or even a logical, solution of the "problem."

We must make sure, before taking major action, that we understand clearly the nature of the problem that we are trying to solve. It is doubtful whether confidence in the dollar depends primarily upon the attainment of balance between the total inflow and the total outflow of funds across our national boundaries. The heart of the problem is maintenance of confidence in the integrity of the dollar, which is a *monetary* problem having heavy psychological overtones.

I find it difficult to admit that there has been any substantial lessening of confidence in the dollar in view of the fact that the short-term liabilities of U.S. banks to foreigners have been increasing rather than decreasing and, even more significant, the fact that Euro-dollars in circulation are estimated to have expanded to $15 billion. These are dollars that circulate freely outside of the United States without any controls by government whatsoever. If foreigners were losing confidence in the U.S. dollar would they be expanding their Euro-dollar holdings and operations? [In this connection see the article in the *Wall Street Journal* of January 15, 1968].

If the problem is one of maintaining confidence in the dollar there is serious doubt as to whether restricting the outflow of U.S. investment capital and limiting foreign travel (which are financial transactions) are on target. We seem to be trying to cure symptoms rather than the ailment giving rise to the symptoms.

On the basis of a comparison of balance-of-payments statistics for the first three quarters of 1967 with the first three quarters of 1966, there is a strong presumption that the large outflow of funds in 1967 [figures for which have not yet been released by the Department of Commerce] was speculative in nature, roughly similar to the dollar outflow during the fourth quarter of 1960. This time, the immediate occasion appears to have been devaluation of the British pound, which induced speculators to anticipate that the dollar was next in line. The President has made it clear that the United States is determined to maintain convertibility of the dollar into gold at the ratio of $1.00 to 1/35th of an ounce of gold, by asking Congress to remove the 25 percent gold backing against Federal Reserve notes, thereby making it clear to the world that the country's entire gold stock, and not only the $2.5 billion of "free gold" over and above the amount presently being maintained as backing for Federal Reserve notes, will be available to redeem dollars.

If confidence in the dollar is in danger of being impaired by speculation would it not be more logical to cure it by direct means rather than to penalize such "normal" financial transactions as foreign investment and tourist expenditures—that have shown no substantial increase (certainly not during the first three quarters of 1967) comparable to the increase in the over-all deficit for 1967?

As long as the United States not only redeems dollars in gold at the rate of 1/35th of an ounce of gold per dollar, but also guarantees that it stands ready, at all times, to purchase all gold presented to it at $35 per ounce, is it not to be expected that speculators, whenever they feel there is a chance of the United States devaluing the dollar in terms of gold, will buy gold and hold it for the rise? If the price of gold is increased they will make a handsome profit. If its price does not increase, all that they lose is the interest cost of holding the gold becasue they can return it at any time to the U.S. Treasury in exchange for dollars. This is not true speculation; it is "one-way street" speculation. The speculators can gain but they cannot lose. Since 1962 proposals have been made that the United States abandon its "guarantee" to buy all gold presented to it at the fixed price of $35 per ounce. Such action would appear to be more pertinent than limiting the outflow of private investment and restricting travel by Americans.

The most important deterrent of all against dollar speculation is avoidance of accelerating inflation. This can be done only by hitting hard at its source. Regardless of cost-push and demand-pull explanations, the truth is that inflation arises from the overissuance of money by government. The price rises that ensue result from attempts by individuals and groups to catch up with the erosion of the value of the monetary unit that has already occurred by the fact of overissue. Inflation can be stopped only by putting an end to the continuing monetization of the Federal debt. If the United States will demonstrate its determination to keep its own financial house in order confidence in the dollar will remain unimpaired and speculative drives against the dollar will cease. Under such circumstances there would be reason to believe that the international dollar-exchange standard can continue to function satisfactorily for some time to come, regardless of when, or whether, the newly-devised Special Drawing Rights are activated.

Library of Congress, Legislative Reference Service, Restricting Private Direct Investment Abroad To Narrow the Balance-of-Payments Deficit

(By Howard S. Piquet, senior specialist in international economics, January 8, 1968)

INTRODUCTION

The United States has been incurring deficits in its international accounts every year since 1950, with the sole exception of 1957. During the five-year period 1962–1966 the deficit averaged $2.1 billion a year, compared with $3.4 billion a year during the period 1958–1961. In 1966 it was $1.4 billion.

During the first three-quarters of 1967 the deficit was running at the annual rate of $2.2 billion. The outflow of gold, however, had declined to $158 million, which was about one-third the 1966 rate.

On the basis of these figures the expectation was that, although the payments balance had deteriorated somewhat since 1966, the deficit was still smaller than it was in 1963 and 1964 and was far removed from the $3.9 billion deficit of 1960.

However, at his press conference on January 1, 1968 the President announced that he was taking extraordinary measures to bring about balance in the international accounts because of the great deterioration in the country's balance of payments position in the fourth quarter of 1967.[1] He said that the deficit for the full year 1967 was between $3.5 and $4.0 billion.

PRESIDENTIAL ANNOUNCEMENT OF JANUARY 1, 1968

A continuing deficit of this magnitude, according to the President, cannot be tolerated because it would endanger the strength of the entire free world economy, thereby threatening our own unprecedented prosperity. The actions that he has taken and proposed are predicated on the assumption that the strength of the dollar abroad depends on Americans earning abroad about as many dollars as they spend abroad. Vigorous action, he said, is necessary to bring the international accounts into equilibrium in 1968.

He announced the imposition of mandatory restrictions on direct investments abroad by American individuals and corporations and requested a series of other programs, legislative and voluntary, to narrow the payments gap.

Those who support the President's position maintain that, had the balance-of-payments statistics for the 4th quarter of 1967 been released without an accompanying announcement of corrective action, the result would have been to precipitate speculation against the dollar and to expose it to the risk of loss of confidence.

In introducing his new program the President made it clear that "the first line of defense of the dollar is the strength of the American economy". He went on to stress the importance of Congressional enactment of an antiinflation tax and of the exercise of the utmost responsibility on the part of business and labor in reaching wage-price decisions. He directed the Secretaries of Commerce and Labor and the Chairman of the Council of Economic Advisers to work with leaders of business and labor in an endeavor to make more effective the voluntary program of wage-price restraint.

The Administration's new program consists of four temporary measures and three permanent, or long-term, measures.

The temporary measures affect American direct investments abroad, foreign lending by American financial institutions, travel abroad by Americans, and U.S. Government expenditures overseas. The measures affecting direct investments are mandatory and become effective immediately, whereas the others require enabling action, either by Congress or by governmental agencies.

The long-term measures are aimed at increasing U.S. merchandise exports, at modifying non-tariff trade barriers, and at stimulating investment and travel by foreigners in the United States.

TEMPORARY MEASURES

1. *Direct foreign investment.* The President stated that, although the existing voluntary program to moderate the outward flow of direct long-term capital has been reasonably successful, the curtailment that is now necessary is beyond the reach of any voluntary program. He therefore invoked his authority, under Section 95A of the Banking Act, to establish a mandatory program to restrain new direct investments abroad.

The objective of this mandatory program is to reduce the balance-of-payments deficit by at least $1 billion in 1968.

2. *Lending by financial institutions.* The President announced that he had requested the Federal Reserve Board to tighten its program for restraining foreign lending by banks and other financial institutions, with the objective of reducing the balance-of-payments deficit by another $500 million. It is anticipated that the reduction can be achieved without harming the financing of U.S. exports and without jeopardizing the availability of funds to the less-developed countries.

He announced that he has given the Federal Reserve Board stand-by authority to invoke mandatory controls should such action become necessary.

3. *Curtailment of foreign travel by Americans.* The American people are asked to defer for two years all non-essential travel outside the Western Hemisphere for the purpose of reducing the net travel deficit to $500 million (from its $2 billion level in 1967). The President has asked the Secretary of the Treasury to explore with the appropriate Congressional committees legislation to achieve this objective.

4. *Government expenditures overseas.* Although the United States cannot forego its essential commitments abroad, the President went on to say that every step must be taken to reduce their impact on the balance of payments without endangering the Nation's security. He has directed the Secretary of State to initiate negotiations with our NATO allies to minimize the foreign exchange costs of keeping American troops in Europe, through purchase in the United States of more defense needs and by increased investment on the part of our NATO allies in long-term U.S. securities. He also instructed the Director of the Budget to find ways for reducing the number of American civilians working overseas. The Secretary of Defense is asked to find ways to reduce the foreign exchange impact of personal spending by U.S. troops and their dependents in Europe.

LONG-TERM MEASURES

1. *Increase U.S. exports.* The President announced his intention to ask Congress (a) to support an intensified 5-year, $200 million Commerce Department program to promote the sale of American goods overseas and (b) to earmark $500 million of the Export-Import Bank authorization to provide more adequate export insurance, to expand guarantees for export-financing, and to broaden the scope of Government financing of exports.

2. *Non-tariff trade barriers.* He announced the initiation of negotiations with foreign countries, particularly those having balance-of-payments surpluses, with the objective of inducing them to minimize the disadvantages to U.S. exports which arise from differences between national tax systems and other types of non-tariff trade barriers. His expectation is that an improvement of $500 million in the balance of payments can be realized.

3. *Foreign investment and foreign travel in the U.S.* The flow of foreign funds into the United States, he says, can be achieved by an intensified program to attract larger investment by foreigners in U.S. corporate securities and by a program designed to attract more foreign visitors to the United States. A special task force is already at work on this problem.

The remainder of this memorandum is devoted to the mandatory program for curtailing direct private U.S. investments abroad.

REGULATIONS WITH RESPECT TO DIRECT FOREIGN INVESTMENT

The new regulations provide three basic limitations on new direct foreign investment by American individuals and corporations which own, or acquire, an interest of 10 percent or more of the voting power, or capital, of a foreign business venture. The limitations are imposed on the direct investor's dealings with *each* of the ventures in which it has such an interest. The regulations provide for the following:

1. *Annual limits on the amounts of new direct investment,* which vary according to country, as follows—

In the less-developed countries transfers of new capital, when added to re-invested earnings, may not exceed in any year 110 percent of the direct investor's average investments in these countries in 1965–66.

With respect to Canada, Japan, Australia, the United Kingdom, and the oil-producing countries (countries in which a high level of capital inflow is essential for the maintenance of economic growth and financial stability) new direct investments, together with re-invested earnings, may not exceed 65 percent of the average of investments in these countries in 1965–1966.

With respect to all other countries (including continental western Europe except Greece and Finland) there is to be a moratorium on new direct investment. However, an investor may re-invest annually into his ventures in these countries up to 35 percent of the average of his total investment during 1965 and 1966.

2. *Repatriation requirements.* It is required that each investor repatriate from his share of the earnings of all his foreign business ventures amounts equal to the greater of: (a) the same percentage of his share of total earnings from these three groups as he repatriated during 1964–65, or (b) so much of his share of earnings as may exceed the limits of capital transfers in each group.

With respect to the continental European countries, where there is to be a moratorium on capital transfers, earnings in excess of 35 percent of historical investment in 1965 and 1966 must be repatriated.

Furthermore, short-term financial assets abroad held other than in direct investments are required to be reduced to the average level of 1965 and 1966.

3. *Authorization.* Specific authorizations will be required for any transactions subject to regulations and not falling within the targets indicated. An Office of Foreign Direct Investments is being created within the U.S. Department of Commerce to administer the new regulations. It will have power to issue specific authorizations. A special staff is being assembled for the purpose.

SIGNIFICANCE OF THE NEW DIRECT INVESTMENT CONTROLS

Although the short-run effect of curtailing the outflow of new U.S. direct investment abroad will be to narrow the overall U.S. balance-of-payments deficit, the longer-run effect will be to increase it. The outflow of U.S. funds for investment abroad, the inflow of earnings on existing investments, and U.S. merchandise exports are all structurally interrelated. It is almost impossible to take action with respect to any single variable for the purpose of diminishing the balance-of-payments deficit without affecting one or more other variables.

The immediate effect of new long-term capital investment by Americans abroad on the balance of payments is similar to an increase of merchandise imports. The intermediate and longer-run effects, however, are of greater significance than the short-run

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[1] Senior Specialist in International Economics, Legislative Reference Service of the Library of Congress. The views expressed herein are his own and are not to be attributed to the Library of Congress.

[1] Official figures for the fourth quarter of 1967 released on February 15 showed a deficit of $7.3 billion at an annual rate and a deficit for 1967 of $3.6 billion, nearly triple the 1966 deficit.

effects, because foreign investments yield continuing income to Americans.

Shortly after investment funds flow abroad there is a tendency for some of them to return to the United States as foreign affiliates of U.S. firms import equipment and supplies from the United States for their own use. According to the U.S. Department of Commerce, exports to such affiliates in 1964 amounted to $6.3 billion and accounted for 25 percent of total U.S. exports.

In the longer run there is a tendency for funds to flow back to the investing country in the form of earnings on investment. This inward flow of funds has an effect on the balance of payments similar to that of increased exports and, if continued over a considerable period of time, will result in increased outward payments (as would a steady increase of exports) usually in the form of increased imports. A country that engages in large-scale foreign investment over a considerable period of time can expect that eventually its merchandise imports will tend to increase, relative to its merchandise exports. This is because the investing country receives returns on its investments, the anticipation of which was the reason for investing in the first place. This was the position of the United Kingdom during the latter part of the nineteenth century. Current earnings on the large British foreign investments that had been made throughout the earlier part of the century enabled Britons to pay for the country's substantial excess of merchandise imports over merchandise exports.

Foreign investment is also advantageous to borrowers because it facilitates economic development and expansion. Economic development of the less-developed areas of the world for some time has been an important objective of U.S. foreign policy.

The outflow of funds for direct investment between 1954 and 1966 was approximately $1.9 billion a year, while returns on existing investment, in the form of dividends, branch profits, interest, etc., averaged $3.2 billion a year. Expressed as cumulative totals, the outflow of funds for new direct investment over the 13-year period amounted to $24.8 billion, while earnings on outstanding direct foreign investments over the same period amounted to $41.7 billion (see table).

NEW DIRECT PRIVATE FOREIGN INVESTMENT AND INCOME FROM OUTSTANDING DIRECT FOREIGN INVESTMENTS, 1954-66

[In billions]

Year	New U.S. direct investment abroad	Earnings received on direct investments abroad	Net effect on balance of payments
1954	-$0.7	+$1.9	+$1.2
1955	-.8	+2.1	+1.3
1956	-2.0	+2.4	+.4
1957	-2.4	+2.5	+.1
1958	-1.2	+2.4	+1.2
1959	-1.4	+2.6	+1.2
1960	-1.7	+2.8	+1.1
1961	-1.6	+3.2	+1.6
1962	-1.7	+3.6	+1.9
1963	-2.0	+3.8	+1.8
1964	-2.4	+4.4	+2.0
1965	-3.4	+4.9	+1.5
1966	-3.5	+5.1	+1.6
Total	-24.8	+41.7	+16.9

Source: Department of Commerce, Survey of Current Business.

These figures do not include undistributed earnings of subsidiaries, which do not affect the balance of payments because they are not transferred internationally.

Total earnings on U.S. direct investments abroad amounted to $5.1 billion in 1966 and were second in importance, on the receipts side of the balance of international payments, only to the favorable balance on merchandise trade.

It is estimated that the book value of all U.S. direct investments abroad amounted to $54.6 billion at the end of 1966, which was more than 4½ times larger than in 1950. Such investments are much larger than total direct investments by foreigners in the United States, which are estimated at about $9 billion.

There can be little doubt that the new policy will succeed in narrowing the country's balance-of-payments deficit. There is considerable difference of opinion, however, regarding the long-run desirability and effectiveness of such a policy. Private capital investments constitutes a net plus, rather than a net minus, in the country's balance of payments because, in due course, it returns more funds in the form of current income than the total of funds paid out currently in the form of new investment.

INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES

The excess of American investments abroad over foreign investments in the United States is large and has been increasing. In 1950 U.S. foreign investments and claims on foreigners totaled $31.5 billion, while foreign investments and claims on the United States totaled $17.6 billion, an excess of almost $14 billion on the plus side. By 1966 American foreign investments and claims on foreigners had increased to $111.9 billion while foreign investments in the United States increased to $60.4 billion, a favorable balance of $51.5 billion. In the 16 years period 1950–66 the excess of American claims against foreigners over foreign claims against Americans increased by 270 percent.

INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES, 1950, 1963, AND 1966 (END OF YEAR)

[In billions of dollars]

Types of investment	1950	1963	1966
U.S. investments and claims on foreigners[1]	31.5	88.2	111.9
Private investments and claims	19.0	66.4	86.2
Long term	17.5	58.3	75.6
Direct	(11.8)	(40.6)	(54.6)
Short-term assets and claims	1.5	8.1	10.7
U.S. Government credits and claims	12.5	21.8	25.6
Long-term credits and claims	10.8	17.1	21.2
Foreign currencies and short-term claims	.3	3.4	2.8
IMF gold tranche position and convertible foreign currencies	1.4	1.2	1.6
Foreign assets and investments in the United States	17.6	51.5	60.4
Long term	8.0	22.8	27.0
(Direct)	(3.4)	(7.9)	(9.1)
Short-term assets and U.S. Government obligations	9.6	28.7	33.4
Private obligations	(6.5)	(14.9)	(20.8)
U.S. Government obligations	(3.2)	(13.8)	(12.6)
Excess, U.S. investments abroad over foreign investments in the United States	+13.9	+36.7	+51.5

[1] Not including gold holdings.

Source: U.S. Department of Commerce, Survey of Current Business, September 1967.

Whereas over 85 percent of American claims against foreigners are long term in nature, over 55 percent of all foreign claims against Americans are short term (see table).

It remains to be seen whether the United States is entering a new phase in its long-term international financial position. If there is a substantial and prolonged increase in the movement of American capital abroad, relative to foreign capital invested in the United States, it is to be expected that eventually there will be a changed relationship between merchandise exports and merchandise imports, with the latter expanding in relation to the former as the income from existing investments abroad comes to exceed new capital outflow, allowing for payments in the form of military expenditures and foreign aid.

DEVALUATION OF THE BRITISH POUND AND ITS LIKELY EFFECTS ON BRITISH AND AMERICAN CONSUMERS

(By Howard S. Piquet, senior specialist in international economics, the Library of Congress, Legislative Reference Service, December 8, 1967)

MEANING OF "DEVALUATION"

In years past sovereigns used to enhance their revenues by debasing the coinage of the realm, either by clipping coins or by melting them down and re-issuing them in lighter weight. Today, when gold coins no longer circulate, a country devalues its money standard when it equates it to a smaller quantity of gold.

When the United Kingdom devalued the pound on November 18, 1967 it changed its nominal weight from 0.08 ounces of gold to 0.06857 ounces. Since the pound is not freely convertible into gold this meant only that the par value of the pound sterling, relative to the U.S. dollar (which on the books of the International Monetary Fund is equal to gold at the fixed price of $35 per ounce) was reduced from $2.80 to $2.40. This change in par value was accomplished after consultation with the United States and other countries and with the concurrence of the International Monetary Fund.

This was not the first time in recent years that the British pound had been devalued. From 1821 to 1931 its par value was $4.8667 and throughout most of this period the pound was freely convertible into gold. In 1931 the United Kingdom abandoned the gold standard and allowed the pound to fluctuate freely. It finally found its level at $4.03 (a 17 percent devaluation) where it remained until 1949 when it was devalued to $2.80 (a 30 percent devaluation). The devaluation of November 1967 from $2.80 to $2.40 was by 14.3 percent.

Prior to World War I when the United Kingdom, the United States and other important countries were on a free gold standard, the par values of their monetary units reflected their relative weights in pure gold. Thus, the fact that the par value of the pound was $4.8667 meant that the pound was 4.8667 times as heavy as the U.S. dollar. At that time gold was valued at $20.67 per ounce.

The United States devalued the dollar in 1934, thereby raising the price of gold from $20.67 per ounce to $35 per ounce, a devaluation of 41 percent. The dollar has remained at 1/35th per ounce since that time.

France devalued its franc four times in recent years from 19.3 cents (US) to 4 cents (US) in 1926, when she went off the gold standard. In 1928 she returned to the gold standard with the franc valued at 3.92 cents (US).

In 1936 France again devalued to about 4.6 cents (US)—higher in terms of cents than in 1928 because, meanwhile, the U.S. had devalued the dollar. In the 1949 devaluations the franc was devalued by about 30 percent.

The next French devaluation was in 1958 when the franc was reduced 15 percent relative to U.S. dollars. In 1960 the Government introduced the "heavy franc", equal to 100 of the old francs and thus worth about 20 cents (US), close to the historic value of the franc prior to World War I.

EXCHANGE RATES AND INTERNATIONAL FINANCIAL EQUILIBRIUM

Under the free gold standard, which prevailed prior to 1914, the money of a country could remain at parity only as long as the external demand for it equaled its external

supply. Thus, if Britons continued over an extended period of time to spend more funds abroad than they received from other countries the value of the pound would fall relative to other currencies. The extent to which pounds (or any other gold currency) could depreciate was limited by the cost of shipping gold between countries (about 2 cents per pound sterling). The pound could not fall by more than two cents, however, because as soon as it reached $4.8467 it became more advantageous for the British to ship gold than to suffer a foreign exchange loss.

Conversely, if Britons were selling more goods abroad than they were buying in other countries, there would be a shortage of pounds in the foreign exchange market, and the exchange value of the pound would rise. If the rise exceeded 2 cents (i.e. if it rose to $4.8867) gold would be shipped into Britain.

Because gold served as the basis for credit expansion, a loss of gold by Britain would cause prices in that country to decline, while its acquisition by other countries would cause prices therein to rise. Because it is more advantageous to sell in a market where prices are high than in a country where they are low, British exports would increase relative to its imports. There was a tendency, therefore, for earnings from abroad and payments to foreigners to come into balance with each other and for foreign exchange rates to remain close to parity (the physical weight of the gold pound measured in terms of the weight of the gold dollar, *viz:* 4.8667).

The exchange rate mechanism, under the free gold standard, was the most important bridge between national economies. Abandonment of the gold standard by all countries, including the United States, together with the adoption my most countries of policies to insulate national economies against each other, made it possible for exchange rates to vary much more widely than was possible under the free gold standard.

Theoretically, even without gold, freely fluctuating (flexible) foreign exchange rates can bring about increases in exports or imports, as the prices of imports change in relation to other prices. Thus, if imports into the United Kingdom increase, relative to its exports, the supply of pounds will increase in the foreign exchange market, and the value of the pound, in terms of other currencies, will fall. As the pound cheapens it becomes profitable for Britons to export certain goods to the United States which it had not been profitable for them to export before because foreigners can now obtain more sterling for their own currency than before. The two currencies (pounds and dollars) would be brought into line with each other as prices in the two countries (including not only prices of merchandise, but also the price of labor and the price of capital, i.e. wages and interest rates) adapt to each other.

Since the close of World War II there has been no disposition on the part of any major country to allow its economy to adapt, in this manner, to the economies of other countries. Under the terms of the International Monetary Fund Agreement of 1944, par values of currencies are maintained at fixed parities, stated in terms of gold but, in practice, in terms of the U.S. dollar.

Although some flexibility is allowed whereby exchange rates can vary within a few cents each side of parity, the breaking of the direct connection between gold and prices in all countries has rendered these slight variations in exchange rates insufficient to bring about the adjustment of national economies to each other. Furthermore, practically all countries now pursue policies of full employment, controlled interest rates, and other restrictions designed to insulate them against competitive merchandise imports and against the outflow of too much capital.

For these reasons, a persistent excess of the international supply of a country's money, in terms of the money of other countries, gives rise to policies on the part of that country to support its value by financial operations and other controls. If the country is not successful in doing this it will lose its monetary reserves (gold, if it has any, and its holding of other convertible currencies) and find itself in a position where it can no longer import goods from other countries. To the extent that imports are necessary for the continued survival of the economy of the country, a persistently adverse movement in its foreign exchange rate can result in severe economic depression.

WHY DID BRITAIN DEVALUE?

Since the close of World War II Britain has found it increasingly difficult to keep its commodity exports and other foreign earnings at a level sufficiently high to enable it to earn the foreign currencies needed to purchase the imports that are essential to the continued health of its economy. Notwithstanding the success of the Marshall Plan, Britain and a number of other countries found it necessary to devalue their currencies, relative to the U.S. dollar, in the fall of 1949.

Since 1949 it has been necessary, from time to time, for other countries to come to Britain's assistance by making sizeable loans to enable the British to maintain the pound at its $2.80 parity. Britain's problem is one of fundamental economic weakness. Whatever the causes—loss of Empire, failure of industry to modernize, a too-ready willingness to adopt social security and welfare measures that are not supportable by the country's productivity, or too rapidly rising wages—the British economy has not been producing enough goods at costs low enough to enable it to export enough to pay for its imports.

Finally, in November 1967 the British Government decided that it would be to no avail to try to shore up the pound any longer, at $2.80, through borrowing operations. After consultation with other countries and with the International Monetary Fund, it was decided that a 14.3 percent devaluation would be sufficient to enable Britain to increase production and exports. If prices and wages are allowed to rise, however, to an extent that will interfere with exports, even the devalued pound of $2.40 will not be sustainable. It is this uncertainty regarding the future that has been inducing speculators to sell pounds short, in the expectation that there will be further devaluation. Although some of the countries whose economies are most intimately tied to that of the United Kingdom (Ireland, Denmark, Israel, New Zealand, Hong Kong, Spain and Bermuda) also devalued, the United States, Canada, and the EEC countries have stated that they will not devalue their currencies. If all countries were to devalue to the same degree, of course, the relationships among their currencies would be restored to what they were before the original devaluation.

WILL THE UNITED STATES DEVALUE THE DOLLAR?

The United States is in the unique position of being the only country whose currency is convertible (by foreigners) into gold. It is also in the unique position of being the world's international banker, with its dollar serving both as the world's principal vehicle currency and its principal reserve currency.

The fact that the United States continues to incur a deficit in its balance of international payments is a by-product of that fact that it is serving the world as financial intermediary. It can do this because of the great size of its economy and its unprecedented economic strength. The fact that the United States owes approximately $30 billion to foreigners, in terms of short-term liabilities, and has about $13 billion in gold that can be used to pay those who wish to convert their dollar claims into gold,[1] does not mean that the United States is threatened by bankruptcy. Its claims against foreigners—mostly long-term claims to be sure—total well over $100 billion. Like any bank, the United States is engaged in the business of exchanging its own short-term liabilities for the long-term liabilities of its clients. The United States did not seek this position. Other countries themselves decided to use the dollar in place of gold because the dollar is not only as good as gold, but is better than gold, inasmuch as those who have dollars on deposit receive interest thereon, while the gold that they hold is non-interest bearing.

The world today is on a gold-exchange standard, the foreign exchange being the U.S. dollar. As long as confidence in the dollar is maintained there is no reason to expect that there will be a financial collapse. In final analysis, the value of the dollar—internationally as well as domestically—rests upon its purchasing power. As long as the United States succeeds in avoiding run-away inflation there is no reason why the dollar-exchange standard cannot continue in successful operation for many years to come. This is not to say, however, that the United States should be unwilling to cooperate with other countries when, and if, they desire to create some form of international monetary standard to take the place of the dollar.

It is conceivable, of course, that other countries might, by concerted effort, convert their short-term deposits in American banks into gold and drain the United States of its entire gold stock. The effect of this would be to diminish foreign reserves to the extent that they use dollars rather than gold. It is unlikely that other countries will do this, but if they should, the chances are pretty good that, as long as the purchasing power of the dollar is maintained, the world would continue to use dollars. It is conceivable that gold would decline drastically in value and that dollars, unredeemable in gold, would become the world's standard currency. Economists and bankers do not all agree on this point, although an increasing number of economists maintain that the world is no longer on a gold standard, but rather on a U.S. dollar standard.

Because the U.S. dollar is the only currency that is directly convertible into gold, and because it is the currency which is equated to gold in the International Monetary Fund Agreement, the only meaning that attaches to "devaluation", in the case of the United States, would be a decrease in the value of the dollar relative to gold, that is, an increase in the price of gold.

There is no reason why the United States should devalue the dollar. If it were to devalue it by one-half (that is, raise the buying price of gold from $35 per ounce to $70 per ounce) the action would be followed by similar devaluations on the part of other countries by an equivalent amount so that, as indicated above, the value of the dollar, relative to the values of other currencies, would remain the same. In consequence, dollar devaluation would not increase U.S. exports relative to U.S. imports, and would have little, if any, effect on the U.S. balance of international payments. The only beneficiaries would be the world's principal gold producers (South Africa, the Soviet Union, Canada) and countries that have a propensity to hoard gold (such as France).

Although an increase in the price of gold would increase the liquidity of the international payments system temporarily, there is nothing inherent in the process that would cure the basic difficulties of the system. It would not be long before the problem of persistent deficits and surpluses reappeared and the world would again be confronted by the problem of having to create still more liquidity and compelled to devalue again. Moreover, division of the gold stock into a larger number of currency units than before

[1] About $10 billion of this gold is presently held as a 25 percent legal reserve against outstanding Federal Reserve notes, a requirement that can be suspended for temporary periods.

would increase the supply of money and be inflationary.

If the United States were to decrease the quantity of gold that it is willing to give in exchange for its present I.O.U.'s (dollars), not withstanding previous assurances that it would pay at the rate of $35 per ounce, there would be no assurance that it might not repeat the process again and again. To introduce such uncertainty into the world's credit system would be a sure way to wreck it.

EFFECT OF THE BRITISH DEVALUATION

(a) On the British economy

1. Since the pound is now slightly cheaper, relative to most other currencies, there will be an increase in British exports to countries that have not devalued. The result will be to enable Britain to secure an improvement in its balance of payments position of at least 500 million pounds annually ($1.2 billion at the new parity).

2. For the same reason, there will be a curtailment of British imports since it will require more pounds than before to purchase a given quantity of imported merchandise. The price of imports is important to Britain which depends heavily upon them for its economic life. The British Government has stated its determination to limit price increases and to ensure that, where higher import costs make price increases inevitable, they do not lead to larger wage claims.

3. One of the domestic measures taken to support the devaluation of the pound is an increase in the Bank Rate(roughly the British equivalent of the U.S. rediscount rate) from 6½ percent to 8 percent, its highest level since World War I. Banks are to limit their advances to borrowers which, together with other domestic supporting measures, is intended to reduce demand at home and to meet the threat of inflation.

4. Government expenditures are to be cut by the equivalent of $960 million, including defense spending and capital investment in nationalized industries.

5. The corporation tax is to be increased from 40 percent to 42½ percent.

(b) On British consumers

1. In the absence of devaluation it is estimated that personal consumption in Britain would have increased by 3 percent a year, thereby stimulating imports and aggravating the country's balance-of-payments deficit. It is expected that devaluation and supporting policies will divert this 3 percent increase from domestic consumption into increased exports.

2. Because of the increased bank rate, other rates of interest will also rise, thereby making it more difficult for British consumers to borrow.

3. For the same reason, British savers will be in a position to demand higher returns on their personal institutional savings.

4. The down payment on automobiles is increased to 33⅓ percent and the repayment period reduced to 27 months.

5. There will be a stricter "incomes policy," which means that there will be greater resistance to rising wages. Such efforts at restructuring British industry are deemed to be necessary to enable Britain to exploit the opportunity she now has to eliminate her persistent balance-of-payments deficit. The Government hopes for an export-led economic growth that will not be deflationary and that will not retard production.

6. As exports increase it is hoped that industry will need more labor and that unemployment will fall.

7. It will be more difficult for Britons to travel abroad than before the devaluation. Hotel accommodations abroad in countries that have not devalued their currencies will cost more in terms of pounds, and the money left over for spending will be worth less abroad because of the devaluation. It is likely that, before long, there will be an increase in international air fares. For the immediate present, however, air tickets may be purchased in Britain at the old prices.

(c) On the U.S. economy

1. It is to be expected that there will be a decrease in U.S. exports to the United Kingdom and other countries that have devalued their currencies. This does not mean, however, that all U.S. exports will be directly affected. In 1966 U.S. exports to the United Kingdom totaled $1.7 billion and to all the countries that have devalued (as of Nov. 30) a little over $3.1 billion, which represents only slightly more than 10 percent of total U.S. exports.

The U.S. exports to the United Kingdom that will be most directly affected are machinery and transport equipment, other manufactured goods, and food (including grains).

2. It is to be expected that there will be an increase in imports into the United States from the United Kingdom and other countries that have devalued their currencies. Here, too, the effect will not bear directly on all U.S. imports. Imports from the United Kingdom in 1966 totaled $1.8 billion and from all the countries devaluing slightly less than $3 billion, or about 11½ percent of total U.S. imports. The imports from the United Kingdom that will be most directly affected are machinery and transport equipment, alcoholic beverages (mostly Scotch whiskey) and such manufactured goods as iron and steel, textiles, clothing, and musical instruments.

3. To prevent an outflow of U.S. funds to Britain to take advantage of increased rates of interest there, the Federal Reserve System has increased the U.S. rediscount rate to 4½ percent. This will be followed by an upping of other interest rates.

4. The dollar value of U.S. foreign investments in Britain will suffer not only from the devaluation but also from higher tax rates on profits and other new austerity measures. It is probable that industries in the United Kingdom producing for export will be favored over those producing for the domestic British market. Producers of automobiles and machinery probably will be favored over retailers and service organizations.

(d) On U.S. consumers

1. Many imported goods from the United Kingdom, such as automobiles and woolens, should be somewhat cheaper than before.[2] For example, a woolen sweater priced at 10 pounds could cost $24 instead of $28, and a British automobile priced at 1,000 pounds could cost $2,400 instead of $2,800 (on a net basis).

2. Higher interest rates will increase the cost of home mortgages and other installment purchases, such as automobiles and consumer hardware items.

3. For the same reason, savers should receive higher rates of return on their savings in Savings and Loan Associations and other savings institutions as the increased rediscount rate is reflected throughout the interest rate structure.

4. Increased taxes and cuts in Government spending would demonstrate to world central banks that the United States is determined to get its domestic budget under control. If this reasoning prevails, it is likely that there will be increases in taxes.

5. Travel for Americans in Britain and other countries that have devalued will be cheaper than before the devaluation because holders of dollars will get more in foreign currency for their travelers cheques.

6. Air fares for Americans will remain constant for a time, but may be increased after the "standstill agreement" among the airlines expires. However, Americans in Britain will be able to purchase air transportation, for a time at least, with sterling. In the United States, however, tickets must be purchased with dollars.

[2] In some cases it may be possible for producers of certain British exports to increase their selling prices, in terms of pounds, thereby negating this effect of the devaluation.

SUMMARY STATEMENT OF REMARKS TO THE HOUSE REPUBLICAN CONFERENCE ON THE PRESIDENT'S BALANCE-OF-PAYMENTS PROGRAM, JANUARY 24, 1968

(By Robert A. Mundell)

THE GOLD CRISIS

My position on the recent measures advanced by the Administration to improve the balance of payments can be summarized as follows:

1. They will not improve the U.S. balance of payments.

2. They will weaken the dollar in the long run and seriously undermine U.S. financial leadership.

3. There are better alternatives.

1. The measures are expected to improve the U.S. balance of payments. However, they could improve, worsen, or leave unchanged the balance of payments, depending on (a) the definition of the balance of payments used and (b) the monetary-fiscal measures with which they are combined. They can improve the tourist account and the direct investment account, but this is not the same as the aggregative accounts as a whole.

2. Whatever the initial effects on the foreign investment and travel accounts, the impact on the remainder of the total balance will be negative. This is because of (a) evasion of the restrictions through loopholes, (b) substitution of other forms of foreign assets affected by the measures, (c) reduction in the inflow of foreign capital, (d) reduction in the trade balance surplus, (e) disguised capital exports through the under-invoicing of exports and the over-invoicing of imports, and (f) reduction of export supply because of the full-capacity state of the U.S. economy. All these effects can be predicted on the basis of economic theory and empirical studies of similar measures like the IET and the VFCRP.

3. The long-run effects are certain to be negative. To the extent that demand for foreign goods and assets is reduced, foreign central banks will take action to protect their own balance of payments. Correction of the U.S. balance of payments is contingent upon worsening foreign balances, and the U.S. does not have direct control over foreign balances.

At best, the U.S. can bring deflationary pressure to bear on the world economy, but this is an extremely risky course at the present time.

4. The measures would bear heavily on Canada and Japan, despite the asserted attempt to exempt these countries from the controls; they may even contribute to devaluation of these currencies even though no fundamental disequilibrium exists in the case of either the dollar or the yen.

5. Control measures that are partial will not be successful. The experience of countries with inconvertible currencies in the past has been that controls have to be progressively tightened and ultimately lead to de facto, followed by de jure, devaluation. This has been a common syndrome throughout Latin America, post-war Europe, and the Communist countries. But controls for the U.S. are even more difficult; first, because the U.S. does not have the experienced bureaucracy and police force trained to implement them, and second, because of the loopholes connected with the Canadian and Mexican borders and the huge flow of air and sea travelers.

6. Controls have other grave risks, and involve a flight from recorded to unrecorded transactions and from bank deposits to cash. They are inequitable because they penalize the honest.

7. The measures will accelerate the withdrawal of foreign-owned capital in the U.S. For the first time in recent U.S. history, there has arisen fear of potential blocking of accounts, especially in the event of a crisis. This negative effect on the accounts could alone be sufficient to cancel any positive effects on the accounts directly affected.

8. The argument that the restrictions on capital exports would reduce U.S. competition for European assets and thereby lower their price has a measure of validity. In this sense the measures could be looked upon as a means, like optimum tariffs, of exploiting the national monopoly power of the U.S. financial community over other countries. By preventing competitve bidding, the U.S. can lower the price of European assets, but if this is the subtle reasoning behind the measures, it is a shabby example of hypocrisy for the world's leading power.

9. It would be a mistake to infer by its silence that the U.S. business community supports these measures. Any acquiescence to the controls is based on the special interests of lobbies hoping for special exemptions and fearful of reprisals if they do react publicly against the government's policy.

10. The measures would weaken the U.S. dollar by reducing its usefulness as a world currency. Both private holders and central banks will withdraw balances they fear may be blocked. Central banks may attempt to "get gold while it lasts." The measures create a "sauve que peut" attitude.

11. The controls will have pernicious effects. They are offensive to the U.S. system of free enterprise. They were advanced in the mistaken belief that the U.S. has no better alternative to confront the crisis which confronts it. If that is so, it would involve an open admission that the French have taken the initiative out of U.S. hands. But this is a mistake. The crisis is partly the making of the U.S. authorities themselves. The U.S. has followed the wrong course in its balance of payments policy and needs to alter direction. The U.S. should abandon its defeatist attitude and take positive steps to reassert its financial leadership.

To this end, I would recommend that the U.S. take into account the following principles:

(a) The way to increase demand for dollars is to make dollars more desirable. Thus (i) eliminate the interest equalization tax, (ii) eliminate the "voluntary" foreign credit restraint program, (iii) reject the current measures, (iv) abandon all other measures that have mistakenly been imposed for "balance of payments" reasons, and (v) restrain inflation in the U.S. even if it means an increase in taxes or higher interest rates. A more restrictive financial policy is needed in the U.S. even for domestic reasons.

(b) Solve the gold problem directly, instead of worsening it by weakening the dollar as a freely usable world currency.

The first recommendations speak for themselves. The second requires a decision, which must be made very soon, between (i) cooperative solutions and (ii) a unilateral solution.

There are two cooperative solutions. One is for the major central banks to commit their gold stocks to stabilize the free market price of gold. With over 25,000 tons of it among them and yearly private supply (and demand) in the neighborhood of 1,000 tons, this involves no risk whatsoever for the next five or ten years. The formula I suggest (as I did in 1965) is for the gold pool to issue gold-pool certificates in exchange for the gold of the major powers. The major countries would then use gold-pool certificates for reserves instead of gold. When gold is fed to the market from stocks, (interest-bearing) dollars (or other convertible currencies) would be received in exchange; when gold is taken from the market, the dollars or other convertible currencies are given back to it. The certificates would initially have 100 per cent gold reserves behind them, but there would be no harm in letting the reserve ratio drop to 70 or 80 per cent over the years. Over time the certificates would acquire the status of international money. The lower the reserve ratio, the more interest the certificates could pay.

The other cooperative solution is a uniform reduction in the par value of all currencies (an increase in the price of gold). This would be a wasteful solution, and it would involve inequitable transfers to Russia and France. I would prefer this to the proposed controls, but regard it as definitely worse than the gold-pool certificate plan, and worse than the unilateral solution.

The unilateral solution is for the U.S. to get out of the gold market, at least over the next two years. The commitment to keep dollars convertible into gold for the monetary purposes of foreigners is no longer necessary for the U.S., nor is it in the national interest. It is a service the U.S. provides to other financial nations so that they can justify internally, their policies of keeping their currencies fixed to the dollar and holding international reserves in the form of dollars. It is in the U.S. interest to provide this service only as long as other nations want to use it and enable the U.S. to perform it. If that is the case, the other nations will agree to a cooperative solution. If it is not the case, the U.S. should get out of the gold market and stop paying a very high cost for the sake of providing a service other nations no longer want. (Despite the fact that France has attempted to wreck the present system, she still uses the service by pegging her currency to the U.S. dollar.)

Freeing the gold price does not mean abandoning the role of the U.S. dollar as a world currency. On the contrary, it would enhance this role if combined with the elimination of restrictive balance of payments measures. It is doubtful that the world shares the discontent of the Continenal Powers with the way the U.S. has run the dollar exchange standard. There is simply no viable alternative to it at the present time. The question of compensation may not even arise. But it would not be hard to handle; my suggestion would be to compensate those countries who no longer intend to hold dollars or peg their currencies to the dollar.

THE DOLLAR AND GOLD

(By Prof. Robert A. Mundell, University of Chicago, taken from "Man and Economics," by Robert A. Mundell, McGraw-Hill Book Co., New York, 1968)

The international monetary system has been in trouble in one way or another for half a century. Prior to 1914 the major nations alternated between gold and silver and bimetallic standards, but since 1870 gold had ruled the roost. Gold was the anonymous monarch in a world of creative nationalism, and it counted for more than a mere medium of exchange and contract; it symbolized internationalism and the rule of international law. Like any sovereign it had its detractors, but these were inconsequential as long as sterling, the power behind the throne, was accorded the respect due the currency of the greatest financial power. National currencies were equal, but sterling was more equal than the others.

The use of a national money as an international reserve asset is not, of course, a new phenomenon; it goes back to Biblical times and was widespread during the Renaissance and the eighteenth cenutry. During the nineteenth century, when the pound sterling was fixed to gold, many central banks outside as well as inside the British Empire held sterling balances in London banks, usually at the Bank of England, to provide a national reserve. The Bank of England, "the Old Lady of Threadneedle Street," managed the system so that when it lost gold, bank rate (the rate charged by the Bank of England on loans) would be raised and a tightness would develop in the London money market, spreading into a general scarcity of liquidity for all those who had stakes in the London capital market.

The London capital market was a world market, with borrowers and lenders placing and taking up loans and capital-market issues through the facilities that the financial center of the empire had developed. When money was scarce in London, it would tend to become scarce all over the world, and a general reduction in world expenditures would take place; when money was easy in London, interest rates all over the world tended to be low. The Bank of England, through its use of bank rate, was the "price leader" in the world monetary system. For a century the bank managed to keep sterling convertible into gold on the basis of an incredibly small gold reserve, by today's standards, relying on confidence in the stability of sterling and the power of London to attract gold through the use of bank rate when it was needed. As Walter Bagehot, the English economist and journalist who wrote *Lombard Street*, said, "8 per cent will bring gold from the moon."

In rough outline, here is how what should probably be called the gold-sterling-exchange standard worked in the world as a whole. Whenever a peripheral country ran short of gold (that is, whenever it had a balance-of-payments deficit), it would allow money-market conditions to tighten (as they would automatically unless the monetary effect of the gold loss were offset by an expansion of domestic credit), thereby attracting capital and curtailing expenditure; and when it had excess gold, it would allow money-market conditions to ease, with the opposite effect. As we have seen, the Bank of England followed the same policy, but since the London capital market was huge in relation to other centers, the Bank of England in effect dominated all others and affected world interest rates and expenditures. Thus whenever the Bank of England was short of gold, world interest rates would be high, and whenever the Bank of England had excess gold, world interest rates would be low. London was the channel through which gold production and hoarding was fed into the world financial system and determined, along with banking operations in the London market, the world price level.

The First World War changed all that. Besides shattering the illusions of a generation brought up to expect continuity and progress as the patrimony of the greatest organized culture the world has ever known, the European "civil war" destroyed the fabric of the international order—an order that was symbolized, in the economic sphere, by the mutual harmony of interests binding trading nations together. The international gold standard broke down completely at the outbreak of war all over the world except the United States, while the agony of the prolonged war and the bitterness it had stamped on an entire generation set the stage for the ill-conceived Treaty of Versailles.

Neither political nor monetary order could be restored on the old basis. America had remained on gold during the war, and on America was laid the heavy responsibility of picking up the pieces. After the war ended, Benjamin Strong, the Governor of the New York Federal Reserve Bank, and Montague Norman, the Governor of the Bank of England (the so-called mystery man of high finance), made valiant attempts to reinstate the old system and spent many fateful hours together reorganizing the currencies of Europe, later joined by Moreau, the Governor of the Bank of France. This team did in the middle twenties what the IMF was to do after the Second World War.

Alas for the welfare of the world, the system had been rebuilt upon sand. Currencies had depreciated in terms of goods, and Britain's fatal error of 1925 (when Churchill was Chancellor of the Exchequer) in going back to the old prewar parity left not only the pound but also the gold base of the international monetary system in jeopardy. The weakness might have been revealed in any event, but the undervaluation of the franc after 1926 sealed the fate of the pound and the international system. The system collapsed in 1931 when Britain, whose balance-of-payments position had been undermined by deflation in the United States, abandoned gold in the wake of the chain reaction initiated by the failure of the big Viennese bank, the Credit Anstalt. All the king's horses could not put the system together again. Some hope for the system was rekindled after United States devaluation in 1934, when the price of gold was raised to $35 an ounce, but by that time the world depression had become deep, economic nationalism was on the march, and the disease of totalitarianism had spread all over the southern, middle, and eastern parts of the European Continent.

The post-Second World War system built up at Bretton Woods, where the United Nations set up the International Monetary Fund and the World Bank, was an attempt to correct the mistakes of the interwar period by "humanizing" the gold standard. But the IMF was not strong enough in experience, reputation, or resources to replace the authority of the major financial countries, especially, now, the United States. The real power behind the IMF system became the United States, and its instrument was the dollar.

In a technical sense and in fact, the United States became the center of the international monetary system. First, the United States became the sole country pegging its currency to gold; in this sense the dollar became the *key currency*. Second, and partly because of the first event, other countries pegged their currencies to the dollar, either directly or through the pound, franc, or escudo; in this sense the dollar became the primary *intervention currency*. Third, dollars became increasingly used as an international asset for central banks; in this sense the dollar became the primary *reserve currency*. Fourth, the dollar became increasingly used for trading operations as a currency of contract; in this sense the dollar became the primary *vehicle currency* (along with the pound). Fifth, and finally, the dollar was increasingly used as the *currency of quotation;* in this sense the dollar became the main currency used as *unit of account*. In these five roles the dollar became the currency that was more equal than any other just as sterling was in the nineteenth century.

After the war no one doubted the strength of the dollar, and dollars were accumulated by central banks as being more useful than gold because of the interest that could be earned and because the dollar was the currency of intervention in the exchange market. As postwar recovery proceeded, the European countries developed the balance-of-payments surpluses needed to rebuild their reserves. The surpluses were taken out in both dollars and gold as no one doubted the ability of the United States to convert dollars into gold. But in 1958, after the European currencies had become convertible and much stronger, the United States balance-of-payments deficit, which in the early fifties had averaged $1 billion, jumped to $3 billion. Awareness of the implications for convertibility of the dollar became apparent, and central banks took a closer look at their portfolios. Since 1958 the United States has run a deficit of over $2 billion of which, on the average, about half was taken in gold and half in dollars. But many central banks held dollars merely because they did not want to embarrass the United States. Involuntary dollar holdings mounted until France led the way to a "declaration of independence." After the spring of 1965 France began converting its entire surplus into gold, and other countries became increasingly reluctant to expand their holdings of United States dollars. In effect, the world monetary system appeared to be moving back to the gold standard.

Thus we see that since the Second World War the world economy has been moving toward a system which, in some respects, is similar to that of the nineteenth-century gold-standard system, with the dollar, New York, and the Federal Reserve System replacing sterling, London, and the Bank of England. However, the present system is complicated by a Federal Reserve policy that is more ambiguous than the Bank of England used to have. The present system makes use of numerous restrictions and prohibitions, and there is a greater self-consciousness on the part of foreign central banks about the advantages to be gained from a system which relies heavily on the dollar and United States monetary policy.

Let us put these complications aside for a moment, however, and concentrate on some of the institutional features through which the system works. First of all, the United States government forbids its own citizens to hold gold, so that there is no legal gold market in the United States; the center of the world's gold market is London (which, however, is not open to the British public, since the British government also forbids its citizens from holding gold). But the United States is still the main determinant of the market price of gold, since the United States Treasury will sell or buy gold for dollars at $35 an ounce for monetary purposes to foreign central banks. This means, in effect, that the London private-market gold price cannot differ from $35 an ounce by much more than the cost of shipping gold from the United States to London.

Let us see how the gold market works. New gold production, of somewhat more than $1 billion worth a year (the main producer is South Africa, with Russia and Canada of considerably less importance) is marketed through London. Producers sell gold in London. Consumers buy it. Usually the supply exceeds the demand, and the Bank of England takes up the excess gold, paying for it with dollars; it then replenishes its dollar holdings by selling the gold to the United States Treasury or to other central banks. (The Bank of England manages the recently developed "gold pool," by which demand for new gold by other major central banks is managed collectively.) But when the private demand for gold exceeds the supply, the Bank of England sells gold from its own reserve in exchange for dollars and then presents the dollars for conversion to gold at the United States Treasury. Thus United States gold losses or gains are directly dependent on whether there is an excess demand or excess supply of gold in the London market. They also depend on whether other central banks want to keep less or more of their reserves in dollars or gold. United States gold losses over any period of time are thus composed of the excess of private demand for gold over its supply in the private gold market and the excess of dollar holdings of foreign central banks. Russian sales or purchases have to be included in private demands or supplies.

The most important causes of fluctuations in the United States gold stocks, apart from changes in the flow of gold from the mines, are the following:

1. *Russian gold sales.* When the Russians have a poor wheat harvest, they ship gold to London to get dollars to pay for wheat imports, but when their harvest is good, they prefer to add their domestic production of gold to their gold stocks. Thus the United States gold stock goes up when the Russian wheat crop is bad, and down (or up by less) when it is good.

2. *Private hoarding.* When there is an increase or decrease in the speculative demand for gold or in the demand for its use in industry and the arts, the United States gold stock goes correspondingly down or up.

3. *Central bank conversions.* When the other central banks want to alter the composition of their reserves and shift from dollars into gold, the United States suffers a gold loss; and when they want to increase their holdings of dollars at the expense of gold, the United States has a gold gain.

4. *A deficit in the United States balance of payments.* When the United States monetary system creates more money than Americans or private foreign residents want to hold, the flow of dollars offered on foreign-exchange markets abroad expands either directly or indirectly after first raising United States prices or lowering United States interest rates. Since foreign central banks keep their exchange rates fixed to the dollar, they have to buy up the excess dollars on the exchange markets, dollars which they convert into gold at the United States Treasury. A lax United States monetary policy therefore induces gold losses, while a restrictive (or not excessively expansive) one induces gold gains.

The first three factors affecting the United States gold stock tend to be rather volatile and suggest that the Federal Reserve System cannot follow as simple or convenient a set of rules for monetary policy as those adopted by the Bank of England in the nineteenth century, tightening the monetary policy when there is a gold loss and easing it when there is a gold gain. If the Federal Reserve followed such a rule uncritically, United States monetary policy would be dictated in part by the whims of foreign central banks and private gold hoarders and by Russian wheat harvests. Such a policy on the part of the Federal Reserve System would not be in the interests of the United States or indeed in the interests of the world community as a whole.

This is the justification, in part, for the United States practice of sterilizing gold movements, preventing them, in the first instance, from having an impact on outstanding dollar liabilities. But the process of sterilization is, in fact, probably carried too far. As noted above, gold losses may be due to a deficit in the United States balance of payments arising from excessive credit expansion in the United States. If gold losses arising from excess credit creation in the United States are sterilized, the disequilibrium is perpetuated with no compensating gains.

If the United States authorities did not sterilize the initial gold outflow, gold would eventually come back to the United States in the process of transferring in goods, through a balance-of-payments surplus, the financial transfer implied by the capital movement. It is sometimes argued, however, that unless the authorities sterilize the gold outflow, deflation or unemployment in the United States will result. But there is no reason for deflation or unemployment to result from the transfer process. If no sterilization took place in either the United States or Britain, the British would spend more on all goods, including American goods, while the Americans would spend less on all goods, including British goods. The change in *spending* is not the same as a change in income or employment, and indeed the shift in the international pattern of expenditure could induce inflationary pressure in the United States rather than deflationary pressure.

It is sometimes argued that because the United States is a large country, with only a small proportion of internationally traded goods, the decrease in United States spending on American goods will be large, causing a net fall in spending on American goods and bringing about recession. But the conclusion does not follow because, for precisely the reason the decrease in United States spending on home goods will be high, the increase in foreign spending on United States goods will be high also.

It may next be argued that in all countries, including the United States, many goods are not traded at all, so that there will be a large drop in United States spending on domestic goods and export goods without any corresponding increase in spending by foreigners on United States domestic goods. But because the United States is large, a given change in spending, spread over a wide range of goods, needs to reduce demand only a little in any one sector of the economy, so that price changes also need only be minor. Price changes undoubtedly occur after any disturbance, but international disturbances in a large country with a small international sector are likely to be correspondingly small.

It is partly because of the adoption of this faulty technique of automatic sterilization, based on unsound theory as well as practice, that Britain, the United States, and a few other countries that have followed their bad example have managed to maintain and perpetuate balance-of-payments disequilibriums over a long period of time, to the discomfort of the inhabitants of these countries and at the social cost of the remainder of the world community. The harm is not restricted to a persistent weakness of the pound sterling, and an incipient weakness of the dollar, but extends to the measures adopted in their defense. These measures have included prohibitions on imports, hidden export bounties, altered military-procurement plans, taxes on capital exports, new laws forbidding private gold purchases, and arm-twisting "gentlemen's agreements" with banks. In the case of America these measures have created in the minds of many observers the sorry spectacle of a superpower, a democracy, creating on the basis of a wrong theory and faulty practice, an artificially weak currency, imitating measures invented in Nazi Germany and perpetuated all over Europe in the years following the end of the Second World War. The situation is made more ironic by the fact that America led the battle against those very measures when they were imposed in Europe where to a large extent they have now been abandoned.

Until recently the continental European position has been that the United States should correct its deficit and then make an agreement on international monetary reforms, probably through creating a new reserve asset, while the United States position has been to talk about reform before correcting the deficit. In a formal sense the major countries including the United States have now decided to go ahead with reform, but it is of the kind likely to paper over the cracks in the wallpaper rather than undertake any real replastering.

The case for reform of the system is a strong one, if the rest of the world is unwilling to continue to use the dollar to the extent it formerly did, but it is not clear that the central banks can or will agree on the ingredients constituting an improvement in the world monetary system. Many Europeans have become bitter about the intrusion of American capital into Europe and its buying up European factories—purchases which the Europeans themselves have financed by holding on to dollars needed to lubricate the flow of trade. In another vein they argue that the dollar holdings of the European countries have helped finance the Vietnam war, of which they disapprove. Against this some American economists have insisted that the inadequate capital markets in Europe—inadequate because of Europe's own restrictions—have left European companies no recourse but to use the dollar as a financial intermediary between lenders and borrowers. The dollar is so entrenched, so strong, and so useful that its use will, like the English language, spread over the world—not a very comforting thought to the new nationalism developing on the Continent of Europe.

[The] resentment of American financial expansion is not shared by all Europeans, many of whom see great advantages in American capital investments as a medium by which the technology gap between Europe and America can be reduced. But from the standpoint of the world's monetary system, the United States answer to the bitterness is a simple one:

"The error in such thinking
Ignores the common ground
That the dollar is a cancer
No cure yet found."

It is in this antagonistic milieu that the managers of the system—the central bankers and the finance ministers—have reached an impasse on the fundamental reform that is necessary. The stability of the system depends entirely on their ability to agree, yet the ingredients for agreement are not present.

The weak link in the present system is the threatened instability in the price of gold, since the United States cannot continue to sell gold and at the same time preserve confidence in the dollar. At present, events are moving on a collision course, which in the absence of cooperation will result in a sporadic and uncontrolled increase in the price of gold. It would be far better to raise the price of gold by agreement than to have this decision forced on the world through the inability of the major powers to cooperate.

Yet it is surely clear that an increase in the price of gold is at best a second best course. The way out, the path of stability, lies in agreement among the main European countries, Japan, and the United States that they need to preserve the present dollar price of gold and will commit their gold reserves to that end. After all, if there can be no agreement on a new system, it is better to make do with the one we now have than to allow the forces of instability to disrupt the unprecedented expansion of industry and trade that has been the outstanding feature of the postwar world economy.

Were the central banks to agree on this, there would have to be a balance of responsibility between the United States, at the center of the system, and the other major countries. A gentlemen's agreement is really necessary while basic reform is being worked out—or at least talked about. Europe and Japan must be willing to alter the composition of their reserves to the extent necessary to preserve the present dollar price of gold. To make Europe's commitment worthwhile, the United States, on its part, would have to be willing and able to preserve the stability of its economy and take international interests into account.

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The Balance of Payments and International Monetary Reform

(By Dr. Patrick M. Boarman)

For the past decade and a half, American payments to other countries have regularly, exceeded other countries' payments to us, except in 1957 when the Suez crisis raised demand for American exports and produced a small surplus (of about $500 million). From 1951 to 1958, U.S. balance of payments deficits were moderate, averaging about $1 billion a year, and were considered desirable as contributing needed reserves to the rest of the world then suffering from a "dollar shortage".

After 1958, the deficits became a cause of concern as they increased in size, assumed a chronic character, and were accompanied by substantial declines in the monetary gold reserves of the U.S. The cumulative total of such deficits between the end of 1960 and the end of 1967 was $17.2 billion. In the same period, the gold reserves of the U.S. fell by some $6 billion to an historic low of approximately $12 billion (they were about $23 billion in 1957). This represents a drain of national monetary reserves of a magnitude and speed which is unique in the annals of the international monetary system.

COMPLACENCY OF THE ADMINISTRATION

The ongoing payments deficits and gold hemorrhaging of the United States have placed in serious jeopardy the country's ability to meet its political, military, and economic commitments as leader of the Free World. The Republican Party attaches the highest priority to the task of bringing our international accounts into equilibrium. This can be accomplished only when we recognize that the radical changes which have occurred in the rest of the developed world since 1950—increased competitiveness, technological progress, and effective policies of stabilization—require compensating internal adjustments in our economy. What is required before all else both for our internal and our external health is a return to fiscal and monetary discipline.

Complacency has marked the Administration's attitude toward the balance of payments crisis and the impression has been created that balance of payments equilibrium cannot be expected as long as the Vietnam war continues. This is an extremely dangerous course and will tend to erode whatever international confidence in the dollar still remains. Continued doubts about its ability to serve as the keystone of the existing international monetary system could lead to a collapse of the system. Indeed, the possibility of such a worldwide monetary disaster has figured prominently in many objective studies of the current situation by leading experts.

SHORT-TERM LIABILITIES EXCEED RESERVES

The elements of crisis are present in these facts: against the U.S. reserve of about $12 billion in gold stands a grand total of approximately $30 billion in short-term liabilities to foreigners—$14.5 billion of them convertible at once on demand into gold by foreign official agencies. In effect, such demands, if presented simultaneously, would render the U.S. internationally bankrupt. Hopefully, this catastrophe will not occur. But the actual deterioration of the international economic position of the U.S. is disturbing enough.

The American reserve position is further aggravated by the existing requirement that at least 25 percent of the Federal Reserve notes outstanding be backed by gold. When allowance is made for this reserve requirement amounting to about $10 billion, only $2 billion in free gold is available to meet the vastly greater sum of our international liabilities.

THE ROLE OF GOLD

It is true that the gold cover for domestic currency can be abrogated as it was in 1965 in respect to the deposits of the Federal Reserve System. Then as now, however, such a step serves merely as a palliative and has no real effect on the basic causes of the balance of payments difficulties of the nation. Indeed, by removing the immediate pressure on the reserve position, it tends to prolong the fundamental disequilibrium in the nation's international economic relationships. The alleged purpose of abandoning the gold backing requirement is to forestall a run on our gold by making the whole gold stock available now. But foreigners are certain to be more impressed by the ability of the U.S. to hold the line against inflationary pressures at home, thus making gold outflows unnecessary, than by its willingness to pay out its entire gold reserve to back up an internationally depreciating dollar.

Because the dollar serves, together with gold, as a principal component of the international reserves of the rest of the world, doubts about its future have measurably increased the fragility of existing monetary arrangements. World reserves are normally increased each year by additions to monetary gold stocks from new production. In the last few years, however, virtually the entire world output of gold has been absorbed privately, with one-third of the total being purchased by industry and two-thirds by hoarders. The private absorption of gold was $1.5 billion in 1966, of which $1 billion was purchased by hoarders speculating on a devaluation of the dollar in terms of gold. New gold production, including sales from the USSR, was $90 million *less* than the amount privately absorbed with the result that the monetary gold stocks of the world actually declined in 1966, the first such decline in modern monetary history.

DECLINE OF U.S. TRADE SURPLUS

A particular cause of concern in view of the developments here described has been the significant deterioration of the United States balance of trade. The U.S. has traditionally counted on its large surplus on trade to offset the large outflows of capital from this country, both on private and governmental account. But the trade surplus fell from its high of almost $7 billion at the close of 1964 to less than $4 billion in 1966. The worsening of the trade balance was due not only to Vietnam-caused increases in imports (which increased 10 percent more rapidly than exports) but to inflationary pressures in the domestic economy which raised private demands for resources which normally would have been exported. The weakness of the trade balance raises the possibility of a larger balance of payments deficit in the immediate future and therewith of the emergence of a new and more critical turn in the U.S. position in the world economy.

VOLUNTARY RESTRAINT OF CAPITAL OUTFLOWS

The essence of the U.S. problem is that the imperatives of the balance of payments—the need to bring domestic costs, prices, and incomes into harmonious relationships with those prevailing in the countries with which we trade—are not permitted to interfere with the ideological and political imperatives of easy money policies, expanded spending programs, and chronic budget deficits. The official U.S. position appears to be: it is not our policies which should adjust to the needs of the balance of payments, but the balance of payments which should adjust to our policies. Accordingly, the major response of the Administration to the balance of payments crisis has not been to reduce domestic inflationary pressures but rather to clamp controls on the movement of private capital out of the United States.

The so-called "guidelines" promulgated by the Administration for capital lending abroad are the counterpart in our international affairs of the "guideposts" concept in the domestic economy. Both substitute government fiat for the forces of the market; both conflict violently with the principles of freedom of enterprise and efficient allocation of economic resources.

The techniques the Administration proposes for overcoming international disequilibrium are but a throwback to the solutions used in the 1930's—the era of "international laissez-faire." The nations simply retreated from the international economy so that they could pursue autonomous domestic policies and they secured this retreat with the armor of exchange controls, quotas, and bilateral trade agreements. Balance of payments crises were avoided but at the heavy cost of almost total disintegration of the international economy.

A RETREAT FROM PRINCIPLE

The United States, which led the way after World War II in freeing the international economy of its shackles, is now perversely retreating from its own principles. It enthusiastically supports tariff cutting under "Kennedy rounds" while adamantly resisting the internal discipline—in monetary and fiscal matters—that international trade requires.

It couples demands for "liberalization" of trade in goods and services, hypocritically, with programs to deliberalize capital movements. The restrictions on capital outflows are, in effect, a form of exchange control, while the interest equalization tax on the sale of a foreign securities in the U.S. is a disguised form of selective devaluation of the dollar. These are exceedingly drastic and, in the end, self-defeating interferences with the fundamental freedoms of Americans to carry on legitimate business activity wherever they may choose. But they are the predictable response of an Administration which seeks to avoid at all costs the modification of domestic objectives in the interest of achieving international equilibrium.

SELF-DEFEATING CONTROLS

In spite of the Administration's imposition of controls on capital movements, the deficit in the balance of payments has persisted. It amounted to $1.3 billion in 1965, $1.4 billion in 1966, and the estimated deficit for 1967 is in the $4 billion zone. It now is clear that preoccupation with the attainment of short-run balance between receipts and payments by arbitrarily restricting activity in specific sectors, e.g., cutting back on capital outflows, can actually provoke new disequilibrium. This is because items in the balance of payments are closely interrelated; "corrections" in one item cannot be made without producing counterbalancing changes in other items.

To illustrate, exports of money capital by American corporations to their foreign subsidiaries tend to increase U.S. merchandise exports because foreign affiliates of American firms import large quantities of merchandise and services from the U.S. for their own use. The U.S. Department of Commerce has estimated that merchandise exports by American firms to their foreign affiliates in 1964 amounted to 25 percent of total U.S. exports in that year. Moreover, there is evidence that current cutbacks in U.S. long-term investment abroad will sacrifice future net inflows on such investments. Total U.S. direct investments abroad are already so large that the return of funds to the United States in the form of dividends and profits exceed the outflow of new investment. In 1966 the return on existing direct foreign investments was $4.1 billion compared with new direct investment abroad in that year of $3.4 billion.

Similarly, the cutbacks in U.S. bank lending abroad—which were significant contributions to the reduction in the balance of payments deficit at the time they occurred—have been largely offset by declines in foreign deposits in the U.S. Denied credit facilities in the U.S., foreign holders of dollar deposits in American banks have drawn them down instead. Again, "voluntary" prohibitions on U.S. industrial investment abroad have caused American firms to borrow abroad; this has helped measurably to push up interest rates abroad relative to the U.S., thus cancelling out in part efforts to stem capital outflows by raising interest rates here.

In sum, restrictions of investment outflows, while of help in the short run, may be moving the economy of the U.S. even farther away from balance of payments equilibrium in the long run. Instead of narrowing the deficit, they tend to widen it. This is because none of these measures is a substitute for removing a chief cause of the deficits, viz., the absence of fiscal restraint and monetary discipline within the U.S. It is, moreover, certain that the continued reliance on guidelines and similar controls will seriously prejudice the role of the U.S. as world banker, provoke retaliatory measures in other countries, and thus ultimately force a return to the economic nationalism of the unlamented 1930s.

LONDON MONETARY AGREEMENT—AN ILLUSION OF STRENGTH

Spokesmen of the Administration would have it believed that the balance of payments difficulties of the United States are the outgrowth of deficiencies in the international monetary system. Statements adverting to the seriousness of the U.S. position have been coupled with emphasis on the need for reform of the international monetary system. The widely hailed London Monetary Agreement of 1967 providing for the creation of a new form of international reserve to supplement gold and dollars is expected to resolve our difficulties. In fact, these "special drawing rights or SDR's—which are simple bookkeeping entries supported by the prestige of the International Monetary Fund—are additional lines of credit extended by the surplus countries to the deficit countries.

The power to apply the provisions of the new agreement lies in the hands of the Common Market countries who are in surplus and who represent only 18 percent of the votes in the IMF. The other 82 percent are deficit countries, including chiefly the U.S., Great Britain, and the underdeveloped countries. It is clear that the deficit countries—the only ones in need of more "international liquidity"—would like to see early creation of substantial amounts of SDRs. The steady decline in U.S. gold stocks has moved the Administration to engage in desperate maneuvering to discover new means of covering its chronic payments deficits.

But the surplus countries are understandably determined not to supply resources for that purpose. Neither the amount of new reserves to be created nor when they are to be paid have been agreed upon, nor is any decision on these matters likely to be forthcoming until the U.S. has ended its deficit.

THE KEY ROLE OF THE DOLLAR

The claims made by the Administration that the London accord represents "one of the great days in the history of international financial cooperation" appear vastly exaggerated. The evidence suggests that it is not the international monetary system that is in need of reform so much as the U.S. dollar, and that it is the shaky position of the dollar which puts the international monetary system in a precarious position.

If the U.S. fails to bring its international accounts into balance and if, as a result, a devaluation of the dollar in terms of gold becomes necessary, the consequence may well be a world-wide liquidity panic as all nations rush to acquire gold or attempt to prevent loss of their own gold. Naive hopes that gold can be eliminated as a component of internaional reserves founder on the ages-old and universal preference for the metal as the one medium of international exchange which is beyond the control of any single nation or group of nations.

The continued primacy of gold as international money makes it unlikely that the International Monetary Fund, even with the potential new resources established under the London agreement, would be able to prevent a crisis precipitated by collapse of confidence in the dollar. The IMF was designed to provide stop-gap aid to countries with temporary short-falls in their balances of payments. It was not designed and it is not able to cope with the prolonged cumulative deficits of the sort the U.S. has been experiencing. When it is recalled that a prior devaluation of a key currency—the devaluation of the British pound in 1931—triggered an international liquidity crisis and brought on world-wide

deflation and depression, the ominous character of the ongoing international deficits of the U.S. is revealed.

INTERNATIONAL LIQUIDITY AND TRADE

As long as the U.S. continues in the deficit position its plea for the establishment of a mechanism to produce "paper gold" must remain suspect; in fact, its motives in this respect have been all too transparent. But the urgency of the case for an increase in "international liquidity" remains dubious for more fundamental reasons. The historical record shows that there is no necessary relationship between the growth of world trade and th growth of world montary reserves. On the contrary, both magnitudes would appear to develop in a completely unrelated way. In past periods, world trade has decreased substantially in value while world reserves have rapidly increased. At other times, for example in the post World War II period, world trade have advanced far more rapidly than the growth in reserves.

It is significant that prior to 1914 when nations allowed their internal economies to adjust to changes in the international economy, the term "shortage of international liquidity" was unheard of. It is a fact that Great Britain, the leading trading nation of the nineteenth century, supported a vast network of trade and payments on a miniscule reserve; nor did the relatively small size of the British reserve prevent her trade and that of the whole world from undergoing extremely rapid growth in this period. The equilibrating forces at work under the gold standard reduced the need for reserves to a minimum.

THE PHANTOM OF "WORLD LIQUIDITY"

The basic error of the "liquidity shortage" thesis is its confusion of internal with external liquidity. But the two are quite different in origin and in effect. An internal contraction or expansion of liquidity relative to physical product can normally be expected to induce a contraction or expansion of demand and of economic activity generally. Conversely, an increasing volume of business and trade cannot be supported without an increasing volume of credit and cash.

The function of *international reserves*, however, is *not* to consummate international transactions. These are, on the contrary, financed by ordinary commercial credit supplied by exporters or importers, or in some cases by international institutions. Of such commercial credit, there is in individual countries normally no shortage, or internal credit policy can be adjusted to make up for any untoward tightness of funds. In contrast, international reserves are required to finance only the inevitable differences between the value of a country's total imports and its total exports; their purpose is not to finance trade itself but net trade imbalances.

The alleged shortage of liquidity is not a general illness afflicting the world because of the failure of growth in gold stocks and dollar reserves to keep pace with the growth in world trade; it is a surfeit of dollars, indeed, which is the contemporary international malaise. Since the exchange reserves of one country are always the exchange deficiencies of another country, a liquidity problem emerges only in respect to some countries, viz., those with chronically unbalanced balances of payments. If all nations' imports and exports on current and capital account exactly balanced, no international movement of cash would be required at all. While this hypothetical situation is hardly likely to be realized, the principle is clear: surpluses and deficits (excesses or deficiencies of "international liquidity") arise in specific countries as the product of their individual policies and not in the world at large. No "world state" exists of which it could be said that it is short of "world liquidity."

DANGERS OF "PAPER GOLD"

Thus, the problematical aspects of Administration supported schemes to overcome the alleged illiquidity of the world by creating a new reserve unit is seen to lie in the fact that the deficit countries—the only ones who would require such artificial reserves—would in effect be allowed to obtain *carte blanche* for further deficits. It would be the surplus countries which would be required to exchange real goods for "paper gold" and hence to bear the burden of the continuous import of inflation to which such a perpetual motion machine would give rise.

It is conceded that there must be enough international liquidity to provide the time required for nations to make the internal adjustments called for by their balance of payments situation. But there must not be an endless supply of liquidity; liquidity must be permitted to run out for only this ultimate restraint is capable of inducing the domestic economic and fiscal discipline which is the necessary condition of continued participation by each country in the international division of labor.

Under the guise of a noble and seemingly disinterested appeal for more international liquidity for a liquidity-starved world, the incumbent Administration is in reality seeking to continue adamantly with the economic status quo at home, come what may in the shape of balance of payments difficulties. The plea in truth is not for more liquidity for "the world", but for the United States; it is a plea for more cash with which the Administration can continue in its "guns and butter" policies.

Under the circumstances, it is not surprising that the surplus countries are resisting American attempts to have them accept "paper gold" in exchange for their real goods and services. The surplus countries see no reason for admitting the inflations being exported to them—via the balance of payments—by the deficit countries as long as the deficit countries refuse to admit some deflation or even to moderate their own internal inflationary processes.

THE NEED FOR DISCIPLINE AT HOME

Neither paper gold, nor "Special Drawing Rights," nor flexible rates of exchange, nor any other devices no matter how sophisticated, can dispense a deficit nation such as the United States from the adjustments of its internal economy needed to achieve external equilibrium. Chronic deficits in the balance of payments, or a continuously depreciating currency, are the result of a country's attempt to live beyond its means at home while seeking, through trade, to induce other countries to pick up the tab for the difference. This is a situation which will yield a shortage of international liquidity for the deficit country under any international monetary system.

The times are over in which the prestige and power of the dollar could compel the surplus nations to give up their own vital interests—in particular, their concern for the avoidance of inflation—against their own better judgment. In international monetary affairs, the power of decision has passed humilitatingly from our hands. We can regain it only by returning to monetary discipline and fiscal sanity at home.

U.S. GOVERNMENT PRINTING OFFICE: 1968

CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
April 2, 1968

President Johnson now has a singular opportunity to begin putting this Nation's fiscal house in order.

Having decided against an attempt to seek reelection, he is free to act without regard to political considerations. He is in perfect position to launch the "austerity program" he recently declared is urgently needed in this country.

I ask that the President reconsider the position he took on management of our fiscal affairs in his address to the Nation on radio and television Sunday night. In that speech he indicated that he will simply sit back and wait for Congress to make reductions in his budget for fiscal 1969.

If the fiscal situation at the federal level is as critical as the President and his advisers have painted it, then the country cannot wait for Congress to act.

I urge instead that the President immediately outline and implement the austerity program he recently declared to be so necessary if the United States is to maintain any semblance of prosperity. This means the President should impose immediate lower spending limitations on each department and agency.

The President on his own can order a sweeping hold-down in all federal spending unrelated to the Vietnam War. In view of the fact he will not be seeking reelection, he should have no difficulty in imposing a ceiling on federal spending immediately--a ceiling which would remain in effect at least throughout the rest of his term in office.

President Johnson has sought to eliminate some of the divisiveness in this country over Vietnam by removing himself as a candidate for reelection. Let him now act to slow inflation and the continuing deterioration in the value of the dollar by cutting his own budget. He would be doing the American people a great service.

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25 July 1968

U. S. HOUSE OF REPRESENTATIVES REPUBLICAN POLICY COMMITTEE

REP. JOHN J. RHODES, (R.-ARIZ.) CHAIRMAN • 1616 LONGWORTH HOUSE OFFICE BUILDING • TELEPHONE 225-6168

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HOUSE REPUBLICAN POLICY COMMITTEE OPPOSES H.R. 15890 - A BILL THAT WOULD AUTHORIZE 428 ADDITIONAL SUPERGRADE POSITIONS.

The House Republican Policy Committee is opposed to H.R. 15890. This bill would authorize 428 additional supergrade positions (GS-16, 17 and 18) in the Executive Branch.

There are at the present time a total of 9,320 supergrade posts (or their equivalent) in the Executive Branch. These positions pay between $22,835 and $28,000 per year. The addition of 428 such posts (365 to a general pool and 63 to specific agencies) would increase the Federal payroll by at least $10 million a year. Moreover, a promotion to a supergrade usually creates a chain reaction of at least a dozen promotions or new appointments in the lower grades, each of which requires additional Federal expenditures.

Out of the total of 9,320 supergrade positions now in existence, Congress establishes numerical ceilings affecting only about one-half. There are no limitations on the remainder. Since 1961 there has been a total increase of over 4,000 supergrade positions. This large increase is in direct conflict with the Congressional policy that was established in Public Law 87-367.

One year ago the bill submitted by the Administration provided for an increase of 245 supergrade jobs in the "general quota pool" under the jurisdiction of the Civil Service Commission and 63 supergrades for certain specified agencies. At that time, the Chairman of the Commission, John W. Macy, Jr., testified, "The 245 that we are proposing at the present time represent the Commission's best judgment as to the number that are needed for the foreseeable future." Now in just one short year, the needs of the Commission's general quota pool have increased from 245 to 365 supergrade positions. Moreover, of the 365 general pool supergrade positions, 100 would be held

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in reserve for future use.

This legislation has been recommended by the Johnson-Humphrey Administration despite the fact that we are in a fiscal crisis that has placed in jeopardy the financial structure of this Country. It would substantially expand the elite corps of the Federal bureaucracy even though in an effort to meet this crisis, a 10 percent surtax has been imposed on the American Taxpayer and the Administration has been ordered to cut $6 billion in 1969 budget expenditures and reduce the Federal payroll by 250,000 permanent positions.

The proposed legislation is economy in reverse. It is a flagrant example of a Bureaucracy out of control determined to make its own rules and march to its own music. If this legislation is adopted, top paying jobs could be awarded in the waning days of a thoroughly discredited administration to key political appointees and cronies. We urge that H.R. 15890 be defeated.

U. S. HOUSE OF REPRESENTATIVES REPUBLICAN POLICY COMMITTEE

REP. JOHN J. RHODES, (R.-ARIZ.) CHAIRMAN • 1616 LONGWORTH HOUSE OFFICE BUILDING • TELEPHONE 225-6168

91st Congress
First Session

March 11, 1969
Statement Number 4

STATEMENT ON INCREASE OF THE PRESENT FEDERAL BORROWING AUTHORITY

The House Republican Policy Committee urges the establishment of the federal debt ceiling in the amount of $365 billion, and the provision of an additional temporary borrowing authority of $12 billion to be available until June 30, 1970, to accommodate seasonal financing peaks during the present calendar year.

A projection of seasonal requirements indicates that the present borrowing authority limitation will be clearly inadequate in the last quarter of this calendar year. Even the financing requirements for April, 1969, will present most serious strains on prudent financial management. An increase in the current debt ceiling to accommodate immediate obligations is urgently needed.

The debt ceiling will require real expenditure restraint by the Executive Branch and the Congress. Present debt projections indicate that the proposed new ceiling will necessitate a review of the ceiling next year, thus affording a further opportunity for appraisal of the budgetary and expenditure activities of the Executive Branch and the Congress.

The Nixon Administration is currently reevaluating all federal programs for the purpose of effecting significant economies. It is hoped that this reevaluation will provide substantial reduction in federal spending.

We urge the Administration and the Congress to exert every reasonable effort toward striking a true balance between the income of the Government and its expenditures so that further increases in the debt limit will not be required.

CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR RELEASE ON RECEIPT--
April 24, 1969

Remarks by Rep. Gerald R. Ford, R-Mich., Republican Leader, U.S. House of Reps., Placed in the Body of the Congressional Record of Thursday, April 24, 1969.

Mr. Speaker, I ask unanimous consent to proceed for one minute and to revise and extend my remarks.

Mr. Speaker, on April 21 the President of the United States sent the Congress a message urging repeal of the 7 per cent investment tax credit effective as of that date.

On that same day I endorsed President Nixon's call for repeal of the investment tax credit for several reasons but primarily because I believe such action is necessary to curb inflation and thus shield the American people from the repeated blows of price escalation.

Yesterday I was shocked to learn that the cost of living had jumped eight-tenths of one per cent during March, a rate of price rise which runs to nearly 10 per cent on an annual basis.

Mr. Speaker, as the proverb in the greatest book ever written so wisely warned: "As ye sow, so shall ye reap." We are today continuing to suffer from the inflationary policies of the past three years and the failure of the Johnson Administration to take timely action against inflationary pressures that surfaced as early as late 1965. Now the battle against inflation is infinitely more difficult to win.

Mr. Speaker, the sharp cost of living jump in March strengthens my earlier judgment that the Congress should respond as quickly as possible to President Nixon's call for repeal of the investment tax credit.

Although it is possible to read too much into one month's cost-of-living index figures, the warning signal in the March data is unmistakable.

To me it says that the fiscal and monetary measures already taken by the Administration and by the Federal Reserve Board to slow down the economy and bring inflation under control are inadequate for the task.

There is always risk involved in actions taken to dampen down the economy. But we must take such risks, carefully and judiciously, if we are to bring inflation under control.

The impact of investment tax credit repeal will not be felt in the economy immediately. When it does register, cutting the income tax surcharge in half next Jan. 1 as proposed by President Nixon will probably be needed as a stimulus to the economy.

We must win the fight against inflation, for it weighs most heavily upon the poor. And runaway inflation would inevitably be followed by a deep recession and heavy unemployment.

I hope the members of this House will support the President in his efforts to repeal the investment tax credit.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

January 27, 1970

Remarks on floor of House of Representatives by Rep. Gerald R. Ford

Mr. Speaker:

I am sure all of us here listened to the President's talk on television last night with great interest.

It was in my opinion a forthright and convincing speech.

It was a speech that recognized the value of and the need for not only educational programs, but other social programs also.

But it was a speech that also made absolutely clear what the real issue is and what it is not.

Certainly, the issue is not a debate on the merits of education or on whether federal funds should be spent on education.

Certainly the issue is not one of whether or not we should have an impacted aid program, although there is no doubt that that program needs extensive reform.

The issue was simply: inflation and the duty of the President as the national leader to control it.

In the President's mind and I'm sure in the minds of most of us here, inflation is the overriding domestic issue at this time.

This being so, the President recognizes that it is his duty and his obligation to take the necessary steps to bring it under control.

One of these steps is to keep federal spending under federal income. This, too the President is determined to do. That is why we have a balanced budget this year and why we will have one next year. That is why the President has vetoed the HEW appropriations bill. And that is why those who recognize the overriding need to control inflation will vote to sustain that veto.

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U. S. HOUSE OF REPRESENTATIVES **REPUBLICAN POLICY** COMMITTEE

REP. JOHN J. RHODES, (R.-ARIZ.) CHAIRMAN • 1616 LONGWORTH HOUSE OFFICE BUILDING • TELEPHONE 225-6168

91st Congress
Second Session

January 27, 1970
Statement Number 1

HOUSE REPUBLICAN POLICY STATEMENT
ON
SUPPORT OF VETO OF LABOR-HEW APPROPRIATIONS BILL

The House Republican Policy Committee supports President Nixon's veto of the Labor-HEW appropriations bill.

The bill provides new obligational authority for FY 1970 in the amount of 19.7 billion, and appropriates $1.26 billion more than was requested by the President. Such an increase, at this period in history, is clearly inflationary.

The President is making every effort to control an inflation which has reached an annual rate of more than six percent. The necessary tools to control the ever-rising cost of living must be provided by the Congress. It cannot be expected that rising costs be curbed when the Congress votes large, unbudgeted sums which make such control impossible.

Unless inflation is halted, all government programs, including those for education, will suffer. Even more importantly, if inflation continues to run rampant, it will be to the detriment of all Americans, especially those on the lowest rung of the economic ladder. We cannot in good conscience add to the cost-of-living crisis of the old, the sick, the disabled and others on low or fixed incomes.

A major portion of the $1.26 billion increase provides mandatory grants requiring the Administration to allocate funds regardless of real need or of its inflationary effect; a significant portion of the $1.26 billion increase provides

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lower priority items which can be postponed without lessening the quality of American education.

As President Nixon stated in his veto message, the HEW FY 1970 appropriation represents "the wrong amount for the wrong programs at the wrong time". Much of the add-on merely increases spending for existing educational programs without providing sorely-needed reforms to improve the quality of those programs and to use most beneficially and equitably each dollar appropriated.

In supporting the President's veto we wish to emphasize that neither he nor we oppose the expenditure of adequate funds to meet today's bona fide educational needs. Within the framework of a balanced budget the President proposed record-high expenditures for education in FY 1970, 13% above those of last year. We support these increases.

We do not believe, however, that the addition of a $1.26 billion spending program, late in this fiscal year and late in this academic year, at the expense of a balanced budget, can bring true benefit to education. Persistent inflation can and has proved education's worst enemy. And, despite the measures taken by this Administration to curb inflation, the cost of living has risen three percent since the HEW appropriations bill was first considered by the House of Representatives last July. Thus the economic picture is entirely different than it was when this bill was initially voted upon.

In the past decade the free spenders in the Executive Department, with the agreement of Congress, created federal deficits of $57 billion. The increased cost of living which such deficits have brought to all Americans, is all too well known.

Inflation is largely psychological. People who make management decisions still are thinking in terms of further inflation, because they are not yet convinced that this Congress has the courage to make the hard decisions necessary to stem the inflationary tide. This vote will be a clear signal to them, and to the World--America, through its Congress, either will or will not "bite the bullet". The effect of overriding the President's veto would, therefore, be to encourage inflation, and further increase the cost of living to all Americans.

The House Republican Policy Committee urges support of President Nixon's veto.

CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

FOR IMMEDIATE RELEASE

January 28, 1970

Statement of Rep. Gerald R. Ford (R-Mich.), House Republican Leader

Once again the House of Representatives, speaking for the American people, has upheld the President of the United States and the highest interest of the country.

President Nixon's search for a just peace in VietNam was overwhelmingly sustained by the House on a non-partisan basis. Today we demonstrated that in domestic affairs, the Republicans in the House can sustain President Nixon on a partisan basis, if need be.

I am deeply gratified that substantially more than the constitutional number of 145 House votes to sustain a Presidential veto were cast by House Republicans. I am also profoundly pleased that so many Democrats put the soundness of the dollar and the future of the nation ahead of narrow partisanship in joining to support President Nixon on this critical issue.

I am sure this victory for every American in the field of fiscal responsibility will be followed promptly by a joint effort on the part of the President and the Congress to support all our important health and education programs adequately for the balance of this fiscal year.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

FOR IMMEDIATE RELEASE

February 2, 1970

Statement of Rep. Gerald R. Ford (R-Mich.), House Republican Leader

President Nixon's proposed balanced budget and his economic message are marked by courage and candor.

It is particularly gratifying that the President proposes to achieve a budget surplus without new or additional Federal taxes.

He is moving deliberately and decisively to slow down and stop the ravages of inflation as he is to slow down and stop the ravages of Vietnam. Both are difficult and dangerous situations still, but years of drift have been checked and we are now moving in new directions.

I have not examined the new budget recommendations in detail, but I have great confidence in the Secretary of Defense and in the other Cabinet Officers who have been called upon to make sharp cuts in their departmental costs for the coming fiscal year. The Congress will, as always, have an opportunity to study, adjust and finally work its will on the President's proposed budget, but the House has just demonstrated that we can sustain his promised veto of inflationary increases. The American people will support such prudent concern for their savings, the buying power of their earnings, and their tax dollars.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR RELEASE AT 12 NOON WEDNESDAY--
February 25, 1970

Remarks by Rep. Gerald R. Ford, R-Mich., Minority Leader, U.S. House of Representatives, to be placed in the Congressional Record of Wednesday, Feb. 25, 1970.

Mr. Speaker: Last Thursday the House Majority Leader placed in the Congressional Record a statement in which he castigated the Nixon Administration for the inflation President Nixon inherited from the previous Democratic administration.

This is the height of irony, Mr. Speaker -- that the Democratic floor leader in the House should seek to blame the Nixon Administration for the inflation today that is directly due to the policies of the previous Democratic Administration.

The gentleman from Oklahoma knows as well as does anyone else in this chamber that the inflation from which we continue to suffer began in 1965 and gathered speed because of excessive and often irresponsible federal spending and the uncoordinated monetary policies in the years immediately thereafter -- years when both the White House and the Congress were controlled by the Democratic Party.

The Democratic floor leader would have the American people believe that their economic lot has suddenly worsened, has deteriorated because a Republican President now sits in the White House.

The truth is that the Democrats, because of irresponsible fiscal policies, brought on inflation which a Republican President now is forced to combat, with all of the painful consequences attending such efforts.

The truth is that the real earnings of the non-farm worker in the private sector rose hardly at all in the Democratic years of 1965, 1966, 1967 and 1968 -- the years when then President Lyndon Johnson said we could have both guns and butter.

Figures I have just obtained from the Department of Labor's Bureau of Labor Statistics show that a non-farm worker's rise in gross weekly earnings between January 1965 and January 1969 were almost completely eaten up by increases in consumer prices and by income and Social Security tax increases.

The gross weekly earnings of this worker rose 19 per cent during this period -- from $92.64 a week to $110.25.

But what happened to those weekly earnings as a result of price increases and the rise in taxes? The advance in earnings almost vanished.

(more)

The Consumer Price Index jumped from 108.9 in January 1965 to 124.1 in January 1969, a 14 per cent rise. When a non-farm worker's gross weekly earnings were adjusted for price increases, he showed an increase in real earnings of only 4.4 per cent in that 4-year period under the Democrats.

Add to that the increase in income and Social Security taxes, and the non-farm worker's real weekly earnings drop to $77.90 a week -- an increase in real earnings of only 0.7 per cent in four years!

That is what the American worker has to show for all of his years of struggle during the previous Democratic Administration -- a rise of 0.7 per cent in real weekly earnings. This is less than a one per cent increase in purchasing power, not much help for a growing or expanding family.

The Democratic floor leader has unfairly attacked the Nixon Administration for its efforts to combat the inflation brought on by the previous Administration, a Democratic Administration which committed 540,000 military personnel to Vietnam and refused to pay for that war, an administration which ran up federal deficits totalling $45 billion.

He should be candid enough to tell the workers of America that the Nation is plagued by Democratic inflation -- that the Nixon Administration is finding it extremely difficult to fight that Democratic inflation because it was permitted to gain momentum while the Democrats controlled both the White House and the Congress -- that Democrats currently are not cooperating with the President in his efforts to fight Democratic inflation but are seeking to make political capital out of those efforts.

It of course is naive to expect some Democrats to make such admissions, although I must say that Sen. Edmund Muskie was frank enough to state in a recent Christian Science Monitor interview that President Nixon had inherited his problems from the previous Democratic Administration.

So we are not really being naive today. We are simply making a plea for candor. And we would also express the hope that the Democrats would stop playing politics with the people's pocketbook.

President Nixon is making a constructive effort to solve the inherited problem of inflation. He is seeking to build a strong peacetime economy that will provide jobs and industrial growth for a better America. He deserves better from the opposition party than political sabotage.

# # #

Distribution: Full

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR RELEASE AT 12 NOON WEDNESDAY--
February 25, 1970

Remarks by Rep. Gerald R. Ford, R-Mich., Minority Leader, U.S. House of Representatives, to be placed in the Congressional Record of Wednesday, Feb. 25, 1970.

Mr. Speaker: Last Thursday the House Majority Leader placed in the Congressional Record a statement in which he castigated the Nixon Administration for the inflation President Nixon inherited from the previous Democratic administration.

This is the height of irony, Mr. Speaker -- that the Democratic floor leader in the House should seek to blame the Nixon Administration for the inflation today that is directly due to the policies of the previous Democratic Administration.

The gentleman from Oklahoma knows as well as does anyone else in this chamber that the inflation from which we continue to suffer began in 1965 and gathered speed because of excessive and often irresponsible federal spending and the uncoordinated monetary policies in the years immediately thereafter -- years when both the White House and the Congress were controlled by the Democratic Party.

The Democratic floor leader would have the American people believe that their economic lot has suddenly worsened, has deteriorated because a Republican President now sits in the White House.

The truth is that the Democrats, because of irresponsible fiscal policies, brought on inflation which a Republican President now is forced to combat, with all of the painful consequences attending such efforts.

The truth is that the real earnings of the non-farm worker in the private sector rose hardly at all in the Democratic years of 1965, 1966, 1967 and 1968 -- the years when then President Lyndon Johnson said we could have both guns and butter.

Figures I have just obtained from the Department of Labor's Bureau of Labor Statistics show that a non-farm worker's rise in gross weekly earnings between January 1965 and January 1969 were almost completely eaten up by increases in consumer prices and by income and Social Security tax increases.

The gross weekly earnings of this worker rose 19 per cent during this period -- from $92.64 a week to $110.25.

But what happened to those weekly earnings as a result of price increases and the rise in taxes? The advance in earnings almost vanished.

(more)

The Consumer Price Index jumped from 108.9 in January 1965 to 124.1 in January 1969, a 14 per cent rise. When a non-farm worker's gross weekly earnings were adjusted for price increases, he showed an increase in real earnings of only 4.4 per cent in that 4-year period under the Democrats.

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He should be candid enough to tell the workers of America that the Nation is plagued by Democratic inflation -- that the Nixon Administration is finding it extremely difficult to fight that Democratic inflation because it was permitted to gain momentum while the Democrats controlled both the White House and the Congress -- that Democrats currently are not cooperating with the President in his efforts to fight Democratic inflation but are seeking to make political capital out of those efforts.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
March 11, 1970

Remarks by Rep. Gerald R. Ford, R-Mich., placed in the Congressional Record of Wednesday, March 11, 1970.

Mr. Speaker: On Monday the distinguished Majority Leader of the House informed us that because the unemployment rate rose to 4.2 per cent in January he had concluded this Nation is in the grip of a recession.

This is a most interesting observation, Mr. Speaker, particularly if you look at the unemployment rates for the years 1961 through 1965, when Democrats were in control of both the White House and the Congress.

A look at the unemployment rates for those years tells us that the Majority Leader is making statements that are indefensible. Apparently he is trying to talk us into a recession.

If he is not trying to talk us into a recession, then he would have to assert that the United States suffered through a five-year recession in the last decade -- because in all of those years the unemployment rate exceeded the current rate of 4.2 per cent.

In 1961, the unemployment rate was a shocking 6.7 per cent. In 1962, it was 5.5 per cent. In 1963, it was 5.7; in 1964, 5.2; and in 1965, 4.5.

In 1966, the unemployment rate dropped to 3.8, less than 4 per cent, and it has remained below 4 per cent until recently.

Now to what can we attribute this drop to less than 4 per cent in unemployment -- a most welcome decline if viewed as a bit of data unrelated to other economic factors.

One does not have to hold a doctor's degree in economics to recognize that the sharp decline in unemployment in 1966 coincided with a sharp surge in the economy triggered by the Vietnam War.

Conclusion -- the only valid conclusion -- is that we have been experiencing a false prosperity generated by a war into which we were led by the previous administration.

That same false prosperity generated inflationary pressures which steadily pushed up the cost of living for every man, woman and child in America. And, as

(more)

former President Johnson said in his last Economic Report, transmitted to the Congress in January 1969: "The problems of rising prices and wages remain intense as 1969 begins."

The Majority Leader now talks of a recession. In fact, he flatly asserts that "we are in a recession" because the uenmployment rate has risen to 4.2 per cent. Would he also say then that the years 1961 through 1965 were recession years?

The Majority Leader talks at the same time of "Nixon inflation," and yet Lyndon Johnson in his 1969 Economic Report freely admitted that "the first significant break in relative price stability occurred early in 1965" and added that "more pervasive inflationary pressures started in the second half of 1965 when the military buildup in Vietnam began." Mr. Johnson went on to say: "Higher costs had been built into the economy during 1965 and 1966, and when the economy picked up speed in the second half of 1967, prices and wages again accelerated." "Union settlements," he said, "which had lagged in the initial stage of the advance, rose especially sharply in late 1967 and in 1968." And at that point Mr. Johnson stated that price and wage increases remained a severe problem at the beginning of 1969.

Mr. Speaker, President Nixon and others of us are fighting the inflation which was allowed to gather momentum under the previous Democratic administration. One of the unfortunate consequences of that fight is that we are in a temporary slowdown and unemployment has risen.

Mr. Speaker, rather than talking us into a recession it would better behoove the Majority Leader to lend his support to the fight against inflation. He knows full well that it has been necessary to cool off the economy in an effort to slow the rise in prices. He knows full well that a rise in unemployment is an unfortunate but inevitable result of that cooling off.

The Majority Leader has been seeking to blame the present Administration for the sins of the previous Democratic administration. This kind of "politicking" is bad for the entire country. And I doubt it is good politics because the American people know that our inflation problems were inherited from a Democratic Administration, and our fellow citizens also know that the Nixon Administration has made sound decisions which will avoid a recession, slow down inflation and preclude unacceptable unemployment.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
June 17, 1970

Remarks by Rep. Gerald R. Ford, R-Mich., on the floor of the U.S. House of Representatives, Wednesday, June 17, 1970.

Mr. Speaker: President Nixon has laid it on the line in the battle against inflation. He has--to the benefit of the Nation--told the American people just what the situation is and what he will do to deal with it and, just as importantly, what he will not do. This is the kind of guidance the country needs at what I consider to be a most crucial juncture in our fight against inflation.

I am pleased that the President will appoint a National Commission on Productivity and that he has directed the Council of Economic Advisers to prepare a periodic Inflation Alert. This now becomes the key to achieving price stability. It focuses attention on the area which is central to progress toward price stability--improvements in productivity. We cannot lick inflation of the cost-push variety without gains in productivity. So this problem is paramount at this time.

The President has also laid it on the line in urging the Congress not to grant him powers he has said he will not use but to move ahead quickly to pass constructive, meaningful legislation sorely needed in this time of economic transition.

Congress should act with purposeful determination to give the President the program he has requested--stronger unemployment insurance, the Manpower Training Act, a $50 million supplemental appropriation to provide summer jobs for students, insurance to protect small investors against brokerage house failures, a cost-of-living tie with Social Security, the Emergency Home Finance Act, the means to stimulate loans to small businesses at lower interest rates, and emergency assistance to financially-distressed railroads.

As the President so plainly and pertinently said, this is no time to play politics with the economy of this country. It is a time that demands the utmost display of responsibility on the part of business, labor and government. Above all, it is a time for affirmative action--action of the kind described by the President, action that will move this country toward a genuine prosperity based on a peacetime economy and the price stability that keeps more dollars in the pockets of the American working man.

I commend the President for his most timely statement and urge that the Congress join with him in successfully moving this country from a wartime to a peacetime economy. The problems are big enough for all of us to have a piece of the action.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
July 7, 1970

Statement by Rep. Gerald R. Ford, Republican Leader, U.S. House of Representatives

Leaders of the Democratic Party would have the American people believe that we have "a sick economy, a very sick economy," to use the words employed on television last night by Democratic National Chairman Lawrence F. O'Brien.

This is sick talk. This is playing politics with the people's pocketbook. This is the big lie technique, aimed at scaring the American people for political gain. It is simply not borne out by the facts.

The facts are that the economy is not only sound but growing. The facts are that we can expect real economic growth at an annual rate of 3 per cent to develop over the next six months. The facts are that the economy has turned the corner from Democrat wartime inflation toward Republican price stability and peacetime prosperity.

Sen. Edmund Muskie, D-Me., last night suggested we should now impose wage and price controls to halt inflation. Yet the overwhelming majority of economists in this country, without regard for political affiliation, have repeatedly stated that wage and price controls simply do not work. You do not solve the problem of inflation simply by decreeing that prices be frozen for a time. During World War II we had strict price controls, with an enormous bureaucracy to enforce them, and the Consumer Price Index still rose an average of 3.5 per cent.

As I said earlier, we have turned the corner toward price stability and a new period of healthy economic growth. The Nixon Administration, by judiciously and firmly applying appropriate monetary and fiscal policies, has managed to avoid both a deep recession and a new inflationary surge.

Inflation has been slowing, particularly in wholesale prices where it has dwindled to a 1.4 per cent rate during the second quarter. Inflation ran to more than 5 per cent in 1969 as a result of four Democratic years when inflation was allowed to gather speed unchecked. The pace rose to about 6 per cent in the first quarter of 1970 but it now is falling back to an annual rate of 4.5 per cent or less. Most importantly, productivity has finally begun to increase and this is a most hopeful sign in the fight against inflation. So my prediction is that inflation will slow to 4 per cent or less this year.

We are on the right economic path. We can look to the future with confidence -- a future that promises high employment, diminishing unemployment, stabilization of prices, and prosperity without war.

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CONGRESSMAN
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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
August 10, 1970

Statement by Rep. Gerald R. Ford, Republican Leader, U.S. House of Representatives

I am today joining with Representative Frank Bow (R-Ohio), the ranking Republican Member of the Committee on Appropriations, the entire House Republican Leadership and other Minority Members of the Appropriations Committee in sponsoring the "Fiscal Responsibility Act of 1970" which would prevent budget-busting by the Congress as well as by a President.

For years Presidents and Congresses have sought to blame each other for big spending and budget deficits. No matter who wins this political argument, the American taxpayer loses.

This bill would apply a $205,600,000,000 limitation on federal spending for fiscal year 1971 in a way that would permit Congress to control the results of its own actions on individual appropriation bills from the point of view of the total Federal budget. In order to accomplish this it would provide a means of modifying actions on individual appropriation bills if these actions collectively would exceed the limitation proposed in this bill.

Specifically:

(1) It would provide that Congressional increases over the budget on individual appropriation bills that would have the effect of increasing total expenditures above the bill's ceiling would then be subject to automatic reduction according to a formula and by an amount necessary for the budget to remain within the ceiling.

(2) It would make possible the application of this formula in those mandatory spending programs when appropriate and necessary to comply with the limitation and exempt the government from liability for any differences between the amount appropriated and the amount made available.

(3) It would only exempt from the ceiling those increases or decreases that result from the so-called uncontrollables -- social security trust fund payments, veterans' pension funds, etc. (as shown on p. 44 of the Budget -- House Document No. 240).

(4) It would repeal the previous expenditure limitation and substitute this one for it.

We will press for prompt consideration of this "Fiscal Responsibility Act of 1970" so that every Member of this Congress will have an opportunity to vote the same way he talks on the subject of big spending.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR RELEASE ON RECEIPT--

Statement by Rep. Gerald R. Ford August 13, 1970

I voted to save the taxpayers nearly a billion dollars. That is the significance of my vote to sustain the presidential vetoes of the Office of Education and Housing and Urban Development-Independent Offices appropriations bills. The two vetoed bills provided $994 million more than requested by the President, although the President's budget provided funding for education and housing at a level generously above that of the previous Administration.

The question was not whether education and housing would be adequately funded. These needs were amply met in the President's budget. The question was whether the Congress would appropriate far in excess of funding which is adequate for the times--appropriate excessive funds at a time which is critical in the fight against inflation.

This is a time when not only American families but the Federal Government should live within a sensible budget. If the Federal Government does not live within its means, how can the President ask the American people to do so? If the Congress does not cooperate with the President in holding to a sensible Federal Budget, how can the Congress expect the American people to act responsibly in the battle against inflation?

The issue in these veto override moves by the Democratic leadership in the Congress was just this: Fiscal responsibility. I am terribly disappointed that the House of Representatives has failed to fully measure up to the challenge.

CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
August 22, 1970

The cost of living figures for July, released yesterday, indicate that inflation is definitely easing and that the Nixon Administration was right in sticking to its policies of fiscal and monetary restraint.

The Nixon "game plan" is producing a victory over inflation. That is the significance of the July figures--the fact that the rise in the cost of living in July was 0.3 of one per cent on a seasonally adjusted basis, only about half of the rate of increase recorded last winter.

The fact that the increase in cost of living is easing is also reflected in an increase in the average worker's spendable earnings--up 80 cents a week in July for a worker with three dependents. The average purchasing power of the American worker is increasing under the Nixon Administration.

I think every American should be encouraged by the slowdown in inflation. This easing in inflation has become more pronounced in June and July. We now can look forward to a continued improvement in our overall economic situation, both from the standpoint of cost of living and the general strength of the economy.

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GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
September 23, 1970

A Statement by Rep. Gerald R. Ford, R-Mich., Republican Leader, U.S. House of Reps.

There is good news today for the workers and housewives of America.

The news is that the increase in the cost of living has slowed to the lowest pace in nearly two years.

This is conclusive evidence that the Nixon Administration policies of fiscal and monetary restraint are working in the fight against inflation. This is solid evidence that all of the scare talk about the need for wage and price controls was exactly that--wild talk which flowed from a desire to reap political advantage.

We have now not just turned the corner on inflation. We are on the road to relative price stability.

I have predicted that the Administration's policies will slow inflation down to a 3 per cent rate. I renew that prediction today. As I see it, the annual rate of consumer price advance will fall from the present level of 6 per cent to about 3 1/2 per cent by the end of this year and to 3 per cent by the summer or fall of 1971.

I firmly believe that the Administration's policies of fiscal and monetary restraint are producing a victory over inflation. This has been the Administration's game plan all along. It is a game plan which is going to push the ball over the goal line.

And now that we have started down the road to relative price stability, it is all the more important that Congress refrain from mandatory overspending--refrain from jeopardizing the economic gains we have made in our transition from a wartime to a peacetime economy.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR RELEASE AT 12 NOON FRIDAY--
January 29, 1971

President Nixon's fiscal 1972 budget is a carefully drawn fiscal plan which stands out as perhaps the first Federal budget clearly designed to help promote full employment and peacetime prosperity.

It is also a fair share budget, drafted to provide proper health care for our citizens regardless of economic circumstance, to place an income floor under every family in America, and to strengthen efforts to guarantee the civil rights of all Americans.

I fully support the concept of employing the Federal budget to bring about full prosperity in peacetime, in combination with monetary policy. It is far better to plan a deficit aimed at achieving prosperity with price stability than to stumble into a deficit with a blindfold on. In the one instance, we have our eyes focused on a healthy national objective; in the other, we simply sink into uncomprehending red ink.

It is time for an expansionary budget. We have turned the corner on inflation. We will continue to make progress on this problem. Meantime we cannot afford to keep a halter on the economy. Instead, we must prescribe the medicine of stimulation.

In the human needs sector of the budget, I reaffirm my support for reform of the scandalous welfare system and pledge my support for accelerated efforts to find a cure for cancer and to provide all needy Americans with proper healthy care. In combatting cancer, we must provide all the funds that can be profitably spent.

I shall also support every sound effort to restore and preserve our environment. One of the most serious shortcomings of the last Congress was its failure to establish an Environmental Financing Authority to help communities meet their share of water pollution control costs where necessary.

I am also pleased by the sharp increases in funding to fight street crime and organized crime and to bring about prison reform.

I thoroughly agree with the President that the Federal grant system must be revised. I have long favored block grants in broad problem areas, as the President has proposed under special revenue sharing, and also general sharing of completely untied revenue.

With regard to the Defense Department budget, I feel that deep thoughtless cutting by the Congress would be most ill-advised. Some of our forces are lacking in combat-readiness and must be modernized. We are confronted with the need for technological progress. We cannot afford to take a head-in-the-sand attitude toward our military needs. Our national defense is a matter of high priority.

Coincidental with the need to modernize our forces is the need to modernize our military personnel policies. We must reduce our draft calls to zero and make the transition to an all-volunteer force. The funds requested by the Defense Department to this end would be well used.

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House Galleries Only

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--

February 23, 1971

Statement by Rep. Gerald R. Ford

The action taken by the President to dampen inflationary pressures in the construction industry should be welcomed--not only by the American people generally but by construction workers in particular.

Suspension of the Davis-Bacon Act will increase competition in bidding on government projects. It will tend to hold down further rises in construction costs. It will tend to create more work for construction workers. In the final analysis, both the public and the construction workers will benefit.

The President is saying that the government will not have a part in abetting inflation. He is saying that the Nixon Administration will take decisive action as necessary to bring inflation under control.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS
RELEASE

April 20, 1971

FOR RELEASE AT WILL

The board of directors of the National Police Officers Association has appointed Congressman Gerald R. Ford an honorary vice-president of the association. Ford was notified of the honor by Frank J. Schira, association executive director.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
April 22, 1971

Statement by Rep. Gerald R. Ford

What is most striking and significant about the marked slowdown in the cost of living rise during the first quarter of 1971 is that it comes at a time when the economy has registered the sharpest quarterly growth in our history.

What this means is that we are now apparently enjoying the best of both worlds--a bringing of inflation under control at the same time that the economy moves briskly forward. This stands in sharp contrast to 1970, when the economy was at a virtual standstill while inflation still came on strong. That was a time when we temporarily suffered the worst of both worlds--a condition brought about by our refusal to deal firmly with inflation during the 1965-68 period.

A review of both the inflation and growth sides of the economic ledger gives us real cause for encouragement.

The cost of living during the first quarter of 1971 rose only 2.7 per cent on an annual basis, the smallest quarterly rise in four years.

At the same time the gross national product grew by $28.5 billion, the highest absolute increase in history. Retail sales are up. Automobile sales are setting records. Housing starts are at an annual rate of 1.9 million. Unemployment is levelling off and can be expected to move downward as the economy continues to expand and available jobs increase.

The cost of money is coming down. Interest rates have fallen sharply for the first time in 10 years. Roughly 60 days ago, U.S. Treasury bills sold at rates that marked an eight-year low.

We have genuine reasons for optimism. Overall, the economy is looking healthy.

# # #

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
April 22, 1971

Statement by Rep. Gerald R. Ford

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15 copies to Steuben Society only

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR RELEASE ON RECEIPT--

May 12, 1971

West German Chancellor Willi Brandt's policy of Ostpolitik (East Politics) will not benefit NATO or the Free World, House Republican Leader Gerald R. Ford declared today.

Ford said he is "disappointed" that Brandt has chosen to lead West Germany on the path of Ostpolitik. Ford said he has not discussed with President Nixon the Socialist West German premier's efforts to negotiate with the Communists. But he said he personally is convinced that Brandt is "giving away something he did not have to give away and is getting nothing in return."

Ford made his remarks in an interview with the legislative committee of the Steuben Society of America, a group which has just concluded a four-day visit to Washington, D.C. Ford will be the principal speaker at the Steuben Society's 52nd Founder's Day Banquet May 22 at the Hotel Americana in New York City.

"It appears," Ford told the Steuben Society committee, "that the West German chancellor is preempting the prerogatives of the Western powers in seeking to negotiate a final East-West settlement and a German peace treaty."

On another subject, Ford expressed the view that inequities were created by the Immigration Act of 1965. This Act, Ford said, should be reviewed by the Congress.

# # #

U. S. HOUSE OF REPRESENTATIVES REPUBLICAN POLICY COMMITTEE
REP. JOHN J. RHODES, (R.-ARIZ.) CHAIRMAN • 1616 LONGWORTH HOUSE OFFICE BUILDING • TELEPHONE 225-6168

92nd Congress
First Session

July 27, 1971
Statement Number 7

HOUSE REPUBLICAN POLICY COMMITTEE STATEMENT ON H.R. 8432, AS AMENDED, THE EMERGENCY LOAN GUARANTEE ACT

The House Republican Policy Committee supports the passage of H.R. 8432, as amended, the Emergency Loan Guarantee Act.

A severe economic and employment crisis has developed in the aerospace and defense industries, brought about by the substantial reduction of military requirements in Southeast Asia, the decrease of expenditures for space exploration, and the necessary application of strict fiscal and monetary policies to restrain the devastating inflationary forces unleashed during the 1960's. This combination of circumstances has contributed, to a large degree, to the present financial difficulties of the Lockheed Aircraft Corporation, the Nation's largest defense and aerospace contractor.

If the Lockheed Corporation is to avoid bankruptcy, financial assistance is immediately required, assistance which, without guarantees, is unavailable from private sources. Failure of this major U.S. enterprise would result in the loss of tens of thousands of jobs throughout the country, financial hardship for 35,000 subcontractors and suppliers (of which 27,000 are small businesses), increased procurement costs to the Department of Defense, a loss of tax revenue to the federal government and a substantial adverse effect upon our already critical international trade balance. The failure of other major enterprises, which might be similarly plagued by a temporary shortage of working capital, could have equal or greater

(over)

adverse effect on our economy. In every instance, the avoidance of such losses and the protection of the interests of jobholders, taxpayers, creditors and investors are of critical importance.

To establish systematic procedures for dealing with certain financial crises of major domestic enterprises, H.R. 8432, as amended, has been favorably reported by the Committee on Banking and Currency. The bill is in accordance with recommendations of the Administration and the Board of Governors of the Federal Reserve System.

H.R. 8432, as amended, establishes an Emergency Loan Guarantee Board with authority until December 31, 1973, to guarantee loans to major business enterprises facing temporary adversity, when it is determined that failure would seriously and adversely affect the economy or employment of the Nation or any region thereof. A guarantee would be made only if the Board found credit on reasonable terms were otherwise unavailable and a reasonable expectation for timely repayment of the loan existed. Dividend payments and asset transfers by the borrower would be restricted, and every effort would be made to collateralize fully the amount of the loan guarantee; the government's loan guarantee would have a prior claim to the lender's interest in any collateral securing the guaranteed loan and any earlier outstanding loan of the lender. Guarantee authority is limited to $2 billion outstanding at any one time; it is further limited to $250 million for any individual borrower.

H.R. 8432, as amended, provides limited loan guarantee authority to assist any major enterprise whose failure in terms of lost jobs, financial hardships and undermined confidence in the economy would be very great. It expands in a meaningful way the long-standing effort of the federal government to provide necessary credit assistance in those areas clearly in the public interest.

The House Republican Policy Committee urges the prompt passage of H.R. 8432, as amended.

CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR RELEASE AT 12 NOON--

August 6, 1971

Remarks by Rep. Gerald R. Ford, Minority Leader, U.S. House of Representatives, on the Floor of the House Friday, August 6, 1971.

Mr. Speaker: Those Americans who have been engaging in an exercise known as "knocking the economy" have been doing their country a terrible disservice. Not only does such criticism tend to undermine the steady recovery we are experiencing but it simply does not square with the facts.

The truth is that the U.S. economy is steadily moving toward full recovery. As proof of that we have a host of second-quarter earnings reports showing solid gains in various industries and we have the recent upsurge of sales in the auto industry, the bellwether of the economy.

The automobile companies reported record retail sales of 260,990 cars during the July 11-20 selling period. This sales increase was led by General Motors, which reported a record 10-day volume of 165,663 cars.

The sales pace from June 21 through July 20 represented a seasonally adjusted annual rate of 8.5 million domestic units--or roughly a 10 million rate when imported cars are included.

The July automobile sales figures confirm earlier reports of strong retail sales activity.

Total retail sales from January to June rose at a rate of 15 per cent per year, and sales for nondurables increased at a 12 per cent per year rate during this period. These outlays should continue to rise as real incomes enlarge and the rate of personal saving moves down to more normal levels.

The pace of residential building is also encouraging. Seasonally adjusted housing starts ran at an annual rate of 1,881,000 units during the first six months of 1971. This was an increase of 48 per cent over the rate for the comparable period in 1970.

The expanding rate of spending in these key categories contributed to an increase of $52 billion in the nation's gross national product during the first half of 1971.

During that same time, the rate of inflation, seasonally adjusted, averaged 4 per cent per year, well below the 6.2 per cent figure for the first half of 1969 when the present Administration assumed office.

There is also evidence that unemployment has begun to move down from the peak level reached last winter.

The facts are that we are taking an overheated economy back to a sustainable growth path during a period of painful transition from wartime to peacetime. The strong growth of consumer spending is a major factor in making this transition a success.

A closing note: If all the Americans who were in military uniform or in defense jobs when the present Administration took office were still thus occupied, our unemployment rate would be 4.2 per cent. The Republican Party wants prosperity and jobs without war.

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CONGRESSMAN
GERALD R. FORD
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NEWS RELEASE

--FOR IMMEDIATE RELEASE--
August 16, 1971

The President's prescription for the economy is strong medicine but the right action for these times. It is a coordinated, constructive combination that will promote consumer confidence, increase employment, stop inflation and make American products more competitive in both domestic and world markets.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
September 9, 1971

STATEMENT OF REP. GERALD R. FORD (R-MICH.), HOUSE MINORITY LEADER

I was impressed by the President's nonpartisan appeal to all Americans to work together for real prosperity without war and without inflation, and by the strong bipartisan response from the Congress.

President Nixon reassured the nation that all the elements contributing to our economic strength, including business, labor and agriculture, will be consulted in planning the system of wage and price stabilization that will follow the temporary 90-day freeze.

There is no longer any reason for anyone to fear that the sacrifices he is making will become permanent inequities. I am confident that most Members of the Congress, Democrats and Republicans, as well as the overwhelming majority of Americans will cooperate fully with the President in meeting the challenges of peace to our economy.

Internationally, President Nixon plainly put all nations on notice that the United States intends to compete vigorously but fairly and to retain its place as the number one economic power in the world. In this he surely speaks the united determination of the country.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR IMMEDIATE RELEASE--
October 8, 1971

Statement by Rep. Gerald R. Ford

President Nixon has outlined the proper course for this Nation to follow in the months ahead if its citizens are to enjoy price stability once again and the dollar is to recover its strength.

Phase II of the President's price and wage control program will demand the highest degree of good citizenship on the part of all Americans. If they respond, as I feel sure they will, the President's program to achieve price stability and promote prosperity in peacetime will succeed.

Phase II of the President's program will encourage the consumer. Prices will be controlled.

It will encourage workers. There will be equity and equality of sacrifices.

It will require sacrifice among businessmen, employes and investors.

The ultimate result will be an expanded and stable economy, with more jobs and less inflation.

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NEWS RELEASE

--FOR IMMEDIATE RELEASE--

November 9, 1971

Comment on Pay Board Decision

The Pay Board had no other responsible choice if we are to curb inflation and bring rises in the cost of living down to the 2 to 3 per cent level by the end of next year. The decision seems to me to be reasonable and wise.

It is now vital that members of Congress determined to lick inflation knock out of the Economic Stabilization Act of 1971 the committee-approved provision which would completely undermine the Pay Board decision and destroy the President's New Economic Policy.

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CONGRESSMAN
GERALD R. FORD
HOUSE REPUBLICAN LEADER

NEWS RELEASE

--FOR RELEASE AT 12 NOON--
November 29, 1971

Remarks by Rep. Gerald R. Ford on the Floor of the U.S. House of Representatives Nov. 29, 1971.

MR. SPEAKER: On November 19, the Washington Post acknowledged that the U. S. economy is faring better. And indeed it was right! Revised statistics show that the real gross national product grew at an annual rate of 3.9 per cent during the third quarter of 1971, rather than the 2.9 per cent shown in earlier projections. Simultaneously, inflation, as measured by the GNP deflator, rose at an annual rate of 3.0 per cent during the third quarter, as compared to 4.0 per cent in the second quarter and 5.3 per cent in the first. The rise in the Consumer Price Index during the month of October was .1 per cent, after seasonal adjustment. This was the smallest monthly rise in the CPI since April, 1967.

It is obvious that President Nixon's New Economic Policy is working. Phase I -- the freeze -- was a great success. It clamped down hard on the inflationary spiral which we inherited from the fiscal irresponsibility of the previous Administration. It united the American people in a massive attack on the monster which has been eating away at the purchasing power of the American worker. In constructing Phase II the Administration has sought to incorporate a high degree of equity into the framework of its policies. Requests for exception to or exemption from the guidelines of the Pay Board and the Price Commission will be examined carefully on an individual basis.

Because of these positive, innovative Administration policies, 1972 will fulfill President Nixon's prediction that it will be a great year economically. The prestigious Organization for Economic Cooperation and Development Secretariat has predicted that the U. S. economy will grow at a real rate of over 6.0 per cent during the first six months of 1972. Economic expansion at this rate will constitute a strong recovery from the economic slowdown which we experienced during most of 1970 and will return us to a path of steady economic growth in a climate of price stability.

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