REMOVAL OF GOLD COVER

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

NINETIETH CONGRESS

SECOND SESSION

ON

H.R. 14743

A BILL TO ELIMINATE THE RESERVE REQUIREMENTS FOR FEDERAL RESERVE NOTES AND FOR UNITED STATES NOTES AND TREASURY NOTES OF 1890

JANUARY 23, 25, 30, 31; FEBRUARY 1, 1968

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REMOVAL OF GOLD COVER

TUESDAY, JANUARY 23, 1968

House of Representatives,
Committee on Banking and Currency,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Sullivan, Reuss, Moorhead, Stephens, St Germain, Minish, Gettys, Annunzio, Rees, Bingham, Galifianakis, Bevill, Widnall, Fino, Halpern, Brock, Clawson, Johnson, Stanton, Mize, Lloyd, Blackburn, Brown, Williams, and Wylie.

Chairman Patman. The committee will please come to order.

This morning the committee begins consideration of H.R. 14743, a bill to eliminate the reserve requirements for Federal Reserve notes and for U.S. notes and Treasury notes of 1890.

Secretary Fowler and Chairman Martin are here this morning to begin the testimony on this legislation. Due to the fact that they have a previous commitment to appear before the Ways and Means Committee, I will forgo making my usual opening remarks so that the Secretary and Chairman Martin may have as much time as possible to present their statements.

I do not know how long these hearings will continue. Certainly there is no desire to unduly hasten them. Notification was given to the press last week. Yesterday I announced on the floor that the hearings would begin today and invited anyone who wished to testify to contact the Banking and Currency Committee. We will, of course, hear from any legitimate witness or organization. This does not mean to say, however, we will entertain any move to delay necessary and expeditious consideration of this legislation.

(The text of H.R. 14743 and Treasury Department report on the proposed legislation follow:)

[H.R. 14743, 90th Cong., second sess.]

A BILL To eliminate the reserve requirements for Federal Reserve notes and for United States notes and Treasury notes of 1890

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. Subsection (c) of section 11 of the Federal Reserve Act (12 U.S.C. 248(c)) is amended by striking both provisos, and by striking the last sentence, in such subsection.

Sec. 2. The first sentence of section 15 of the Federal Reserve Act (12 U.S.C. 391) is amended by striking "and the funds provided in this act for the redemption of Federal Reserve notes".

SEC. 3. That part of the third paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 413) which precedes the last two sentences of such paragraph is amended to read: "Federal Reserve notes shall bear upon their faces a distinctive letter and serial number which shall be assigned by the Board of Governors of the Federal Reserve System to each Federal Reserve bank."

SEC. 4. (a) The first sentence of the fourth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 414) is repealed.

(b) The sentence which, prior to the repeal made by this section, was the second sentence of such paragraph is amended by inserting immediately after "The Board" the following: "of Governors of the Federal Reserve System".

SEC. 5. The sixth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 415) is repealed.

SEC. 6. The fourth sentence of the paragraph which, prior to the amendments made by this Act, was the seventh paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 416) is repealed.

SEC. 7. The paragraph which, prior to the amendments made by this Act, was the eighteenth paragraph of section 16 of the Federal Reserve Act (12 U.S.C. 467) is repealed.

SEC. 8. Section 6 of the Gold Reserve Act of 1934 (31 U.S.C. 408a) is amended by striking in the second proviso the phrases "the reserve for United States notes and for Treasury notes of 1890, and" and ", and the reserve for Federal Reserve notes shall be maintained in gold certificates, or in credits payable in gold certificates maintained with the Treasurer of the United States under section 16 of the Federal Reserve Act, as heretofore and by this Act amended".

SEC. 9. There are hereby repealed the sentences of subsection (a) of section 43 of the Act of May 12, 1933 (48 Stat. 31, 52; 31 U.S.C. 821(a)), which read: "No suspension of reserve requirements of the Federal Reserve banks, under the terms of section 11(c) of the Federal Reserve Act necessitated by reason of operations under this section, shall require the imposition of the graduated tax upon any deficiency in reserves as provided in said section 11(c). Nor shall it require any automatic increase in the rates of interest or discount charged by any Federal Reserve bank, as otherwise specified in that section."

SEC. 10. Section 2 of the Act of July 14, 1890 (26 Stat. 289), as amended (31 U.S.C. 408), is hereby repealed.

SEC. 11. Section 7 of the Act of January 30, 1934 (48 Stat. 341, 31 U.S.C. 408b), is amended by striking the phrase "and as a reserve for any United States notes and for Treasury notes of 1890" and also by striking the phrase "as a reserve for any United States notes and for Treasury notes of 1890, and".

SEC. 12. Section 14(c) of the Act of January 30, 1934 (48 Stat. 344, 31 U.S.C. 405b), is amended by striking from the first sentence "except the gold fund held as a reserve for any United States notes and Treasury notes of 1890."

THE SECRETARY OF THE TREASURY,
Washington, D.C., January 22, 1968.

Hon. JOHN W. MCCORMACK,
Speaker of the House of Representatives,
Washington, D.C.

DEAR MR. SPEAKER: There is transmitted herewith a draft of a proposed bill, "To eliminate the reserve requirements for Federal Reserve notes and for United States notes and Treasury notes of 1890."

The proposed legislation, which is designed to implement the recommendation made by President Johnson in his State of the Union Message, would eliminate the present requirement that each Federal Reserve bank shall maintain reserves in gold certificates of not less than 25 per centum against its Federal Reserve notes in actual circulation. In addition, it is proposed that the gold reserve against United States notes and Treasury notes issued under the Act of July 14, 1890, be eliminated.

This legislation is being proposed for two basic reasons:

1. Prospective normal increases in holdings of Federal Reserve notes by the public will require a larger reserve requirement in the future. If the reserve requirement is not removed, it will inhibit the further normal expansion of the currency component of our money supply—growth that is necessary because of the growth of our economy.

2. It is necessary that there be no doubt about our assurance to the world that America's full gold stock stands behind our commitment to maintain the price of gold at $35 an ounce.

A gold reserve of $10.7 billion is now required as backing for Federal Reserve notes, United States notes, and Treasury notes. The U.S. gold stock now totals about $12 billion, thus leaving about $1.3 billion in gold not required as cover. By the end of this year, the normal increase in the economy's need for circulating currency will result in the absorption of another $500 million of our gold to meet the cover requirements against Federal Reserve notes. Moreover, industrial consumption of gold resulted in a net drain of gold from the Treasury's stock of about $160 million in 1967. Sales of gold to industrial users should be about the same or slightly higher this year. It is apparent that quite apart from any international considerations the normal growth in our money supply would soon bring us against the gold cover requirements and result in a restriction in our ability to supply our economy with the currency it needs. Thus, removal of the gold cover is necessary for domestic economic considerations alone.

It is equally important from the viewpoint of the smooth functioning of the international monetary system. The President said in his State of the Union Message:

"And we must also strengthen the international monetary system. And we have assured the world that America's full gold stock stands behind our commitment to maintain the price of gold at $35 an ounce. We must back up this commitment by legislating now to free our gold reserves."

The legislation now submitted to the Congress would give explicit and unmistakable assurance that our gold will be available for use for the fundamental and essential purpose for which it is now needed in the international monetary system. Enactment of legislation to remove the gold cover also would reinforce the balance of payments measures in the President's action program of January 1st, help to strengthen confidence in the dollar, and dispel any uncertainties that may have led to the recent outburst of speculation in gold in foreign markets.

I believe it is also essential to stress that the value of the dollar does not depend upon the gold cover legislation. The past 30 years amply demonstrate that the strength of the dollar depends upon the strength of the United States economy rather than upon a legal reserve requirement, and it is clearly appropriate for this fact to be recognized now in legislation.

It would be appreciated if you would lay the proposed bill before the House of Representatives. An identical bill has been transmitted to the President of the Senate.

The Department has been advised by the Bureau of the Budget that the enactment of the proposed legislation would be in accord with the program of the President.

Sincerely yours,

HENRY H. FOWLER.

Chairman PATMAN. Following Secretary Fowler's and Chairman Martin's testimony, we will then hear from Under Secretary Barr and Vice Chairman of the Federal Reserve Board, Mr. J. L. Robertson.

If the committee so desires, we will have Secretary Fowler and Chairman Martin back at a mutually convenient time.

Mr. Secretary, you may proceed.

Mr. WIDNALL. It was my desire to also make some preliminary remarks, and I will delay those until Mr. Patman has made his.

We understand your problem this morning and we also understand that there will be further opportunity to question you at a later period.

Do I understand there will also be opportunity for us to furnish you the names of proposed witnesses?

Chairman PATMAN. Yes, sir; you may do that and considerable consideration will be given to asking any witness to appear that you desire. Very likely we will ask them because we have never refused in the past.

Secretary Fowler?

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; ACCOMPANIED BY JOSEPH W. BARR, UNDER SECRETARY OF THE TREASURY

Secretary FOWLER. Thank you, Mr. Chairman and members of the committee.

I am grateful to you for the opportunity to appear promptly to support the President's recommendation for removal of the gold cover.

On December 15, 1967, the Honorable Wilbur Mills, chairman of the Ways and Means Committee, announced that his committee would reconvene on January 22 to continue its consideration of the President's surcharge proposals. Chairman Martin and I were alerted to stand by to appear before the committee on that date, and we accepted the invitation of Chairman Mills.

The committee will convene at 10 o'clock this morning, to resume questioning following yesterday's session, and Chairman Martin and I must be there at that time. With the committee's permission, we will both read our statements for the record and then ask Under Secretary Barr and Governor Robertson, Vice Chairman of the Federal Reserve Board, to answer your questions.

As the chairman has indicated, in the event the committee feels it would be desirable, after this morning's session, to question Chairman Martin and me directly, then we will be available to come back to this committee at a mutually convenient time.

The legislation before you would eliminate the 25-percent gold reserve requirement from Federal Reserve notes and the $156 million reserve held against U.S. notes and Treasury notes of 1890.

The administration believes that prompt action to remove the cover requirement is necessary for three principal reasons: First, the prospective normal increases in currency holdings, which take the form of Federal Reserve notes, by the public will "lock up" more and more of our free gold and soon reach a point inhibiting further expansion of our pocket cash. And obviously we cannot tolerate such a situation.

Second, there should be no doubt whatsoever that our total gold stock is available to insure the free international convertibility between the dollar and gold at the fixed price of $35 an ounce.

Third, the world knows as a fact that the strength of the dollar depends upon the strength of U.S. economy rather than upon a legal 25-percent reserve requirement against Federal Reserve notes, and it is clearly appropriate for this fact now to be recognized in legislation.

Despite these facts, the gold reserve requirement against Federal Reserve notes, instituted at a time when gold circulated freely in the domestic economy, is still part of our law. It should be removed.

The need for prompt removal is apparent from a look at the simple arithmetic of the problem.

The U.S. gold stock is now at $12 billion—the cover requirement is approximately $10.7 billion—the balance remaining is $1.3 billion.

The normal increase in notes will absorb over $500 million annually and a further $150 million or more will be absorbed each year for domestic artistic and industrial purposes. These two factors taken together mean that about $700 million a year of our free gold will be absorbed for domestic reasons. There is thus but 2 years' grace at most even if one assumes that no gold at all will be needed in that period for international purposes. Clearly we cannot proceed on such an assumption.

Since the passage of the Federal Reserve Act more than a half century ago, the function of gold in our monetary system has undergone a fundamental transformation. Gold no longer circulates freely as domestic currency in any major country in the world. We Americans have not used gold as domestic currency since 1934. Gold belongs in a nation's international reserves. The dollar serves as a reserve currency to the world; the U.S. gold supply is available to convert dollars held by national monetary authorities at a fixed price. As such, it is one cornerstone—and a very main cornerstone—of our international monetary system.

Today, the strength of the dollar is not a function of this legal tie to gold—a tie which is only applicable to one portion of our total money supply, Federal Reserve notes. The value of the dollar—whether it be in the form of a bank balance, a coin, or folding money—is dependent on the quantity and quality of goods and services which it can purchase. It is the strength and soundness of the American economy which stands behind the dollar. Balanced growth at home and a strong competitive position internationally give the dollar we use as everyday pocket money its strength.

An expanding U.S. economy, of course, needs an expanding supply of currency. Our main form of currency is Federal Reserve notes. In the years ahead, we can expect increases in Federal Reserve note circulation of about $2 billion a year. This growth is a normal response to the public's demand for cash in a growing economy. It is basically a trend development, reflecting a growing population, a growing economy, and a growing number of transactions.

Not to move on the cover requirement at this time would only mean putting off the inevitable. We cannot afford to permit an outmoded provision of our law to impinge on the Nation's supply of pocket money.

Removal of this requirement is also of key importance from the viewpoint of the role of the dollar and of gold in the international monetary system.

Mr. Chairman, rather than develop that point at great length, because most of the members of the committee, I think, are fully versed in this area, I would refer to the fact that there has been recently a full and more extensive development of this particular point, the role of the dollar in the international monetary system, in chapter 1 of a Treasury report which was issued last week, called "Maintaining the Strength of the U.S. Dollar in a Strong Free World Economy."

Chairman PATMAN. Would you like to have this in the record?

Secretary FOWLER. I would like to have a reference to it here. I think the members of the committee have all been furnished copies of this report.

Chairman PATMAN. Suppose we leave it to you to take the part you want and attach it to your testimony.

Secretary FOWLER. I think roughly pages 15 to 24.

Chairman PATMAN. Then, without objection, it will be inserted at this point.

(The material referred to follows:)

[Excerpt from Treasury Department report, "Maintaining the Strength of the United States Dollar in a Strong Free World Economy"]

I. International Monetary System and Adjustment of Payments Imbalances

The problem of the U.S. balance of payments can be understood and analyzed only against the background of an understanding of the present international monetary system. This paper therefore begins with a description of the complex institutional framework within which world trade and payments are carried out. A second chapter discusses the current problems facing the present system. Subsequent chapters then proceed to analyze the key elements of the U.S. balance of payments problem in detail, the measures previously employed, and the President's new program.

A. THE INTERNATIONAL MONETARY SYSTEM—WHY AND HOW IT WORKS

An international monetary system provides means and methods of payments in order to facilitate international trade, capital and other transactions. In a world composed of various countries, each with its own currency, trade and capital movements across national borders have not only to be paid for as they are within any country, but have to be provided with a mechanism to convert one currency into another.

The American exporter to Italy usually wants to be paid in dollars—his currency. The Italian importer has lire. Some mechanism has to be provided to convert the lire into dollars to pay the American exporter. And if credit is involved, there needs to be a financing mechanism that crosses the frontier.

The requirements for handling international payments smoothly are:

The various currencies should be convertible easily into each other.

There needs to be confidence in the stability of the exchange rates of the major currencies against each other.

The various countries need to have international reserves of unquestioned value so that if for a time their outpayments exceed their inpayments they can finance the difference by using these reserves.

The system works more smoothly if owned reserves as supplemented by credit facilities to tide nations over periods of imbalance.

In a strict sense, the international monetary system is not a system at all. It is a series of arrangements, procedures, customs and institutions which have evolved over time and which are laced together by a network of formal and informal agreements. It has been partially codified as to objectives, principles and procedures by the Articles of Agreement of the International Monetary Fund (IMF). It has been aided by international cooperation on the part of the important central banks of the world—most notably through the so-called "swap network." It works partly through correspondent relationships of the major commercial banks of the world. Money and capital markets in the United States and Europe are important factors in making the system work. In recent years it has been strengthened by a series of consultative arrangements undertaken under the auspices of the Organization for Economic Cooperation and Development (OECD).

The system rests on five pillars:

a dollar convertible into gold at $35 per ounce;

other major currencies convertible into dollars at stated rates of exchange—under IMF rules they may vary plus or minus 1 percent from parity;

adequate international reserves and credit facilities designed to support these relationships;

a general presumption that a country will over time be in equilibrium in its international position—that surpluses will be offset by deficits on the average;

in seeking to adjust from deficit to surplus, or *vice versa,* a country will take into account the consequences of its actions on the world community.

B. THE ROLE OF THE DOLLAR

In practice, all member countries of the IMF which have convertible currencies operate through their central banks or monetary authorities to keep their currencies in an established relationship to the dollar. For example, the exchange parity of the D-mark is 4 to the dollar, or $0.25. The IMF intervention limits are $0.2475 and $0.2525. In practice, the German Federal Bank intervenes within somewhat narrower limits. When the dollar is strong against the D-mark, the dollar price of the D-mark falls toward $0.2475. The Bundesbank supplies dollars from its reserves to buy up the excess D-marks. When the D-mark is strong against the dollar, its dollar price rises toward $0.2525. Then the Bundesbank supplies marks and buys dollars.

Each monetary authority acts essentially in the same way—intervening in its own markets to maintain the price of its currency *vis-a-vis* the dollar within the narrow band of plus or minus 1 percent from its parity.

The United States does not have to carry on operations like this. It fulfills its IMF parity obligations by freely buying and selling gold for dollars—only with monetary authorities and for legitimate monetary purposes, of course—at $35 per ounce.

The point is that virtually every country does its market interventions by buying or selling dollars. It does so because the dollar is the major transactions or vehicle currency and is widely used in the payment and receipt transactions of international trade and capital flows. It does so because the dollar is a reserve currency and most countries hold dollars in their international reserves.

The dollar is both a reserve currency and a vehicle currency because:

it is strong, being backed by a strong economy;

it can be invested profitably because there exists a big money and capital market in the U.S.;

it is known and is acceptable as a store of value—that is, it holds its purchasing power better than most other currencies;

it is in sufficient supply so that there are dollars that can be used or borrowed for transactions; and

it is convertible by monetary authorities into gold so that they are willing to hold it.

The U.S. did not deliberately make the dollar a reserve currency or a transactions currency. The dollar evolved as such out of its basic strength.

But this strength can be called into question in two ways:

If the supply of dollars in foreign hands becomes greater than the amount foreign central banks and private holders want to hold, either because of their basic needs or for other reasons.

If declines in the U.S. gold reserve and consequent unfavorable effects on the relationship between U.S. gold and the U.S. dollar liabilities raise questions as ot the ability of the U.S. freely to convert outstanding dollars into gold at $35 per ounce.

It is to prevent such developments that the U.S. must achieve sustainable equilibrium in its payments position. Unless it does so, its liabilities to foreigners increase and its gold reserves decrease, and the monetary system becomes more vulnerable to a shrinkage in overall liquidity that can cause serious financial and business disruption through an international credit squeeze.

Foreign central banks and other official institutions hold some $16 billion of liquid dollar assets. Private foreigners hold another $16 billion.

The official holdings are reserves for the rest of the world and constitute nearly 30 percent of such reserves. But so long as they are not withdrawn in the form of gold, they have not reduced our reserves. Thus, our balance of payments deficit, unlike those of a nonreserve currency country, has been only partially reflected in a decline of gold reserves or in our reserve position in the IMF. A considerable part of our balance of payments deficit has been covered by an increase in our liabilities rather than by a reduction in our reserve assets.

While it is not necessary for a commercial bank to maintain liquid assets to cover all or even a major part of its liquid liabilities, the U.S. as a reserve center is a bank in a rather special sense, and needs to maintain a substantial reserve against its liabilities. It is important that our reserves be adequate to meet demands for conversion, and to maintain confidence in the bank on the part of the official and private dollar holders abroad.

Rising dollar liabilities which constitute reserves for other countries have permitted the world as a whole to build up its reserves more rapidly than would otherwise have been the case. A return of the United States to equilibrium would cut off this growth of reserves for these countries. It has become increasingly clear, therefore, that some other means of providing for the future growth in world reserves will be required. To this end, the members of the International Monetary Fund have now agreed on a plan for the deliberate creation of reserves through multilateral action. When this plan is in effect, the world would no longer be dependent upon gold and the deficits of the United States to provide for the expansion in world reserves which will be needed in the future.

Thus the role of the dollar as a reserve currency has been intertwined with the problem of our balance of payments and has also been related to the general problem of expanding world reserves. Through a multilateral system of reserve creation, we can relieve the dollar of its responsibility to provide for a growth in world reserves, and permit concentration on the balance of payments problem.

The following sections of this chapter set forth the elements of the international monetary system.

C. EXCHANGE RATES

One of the distinguishing features of the present international monetary system is the relative stability of exchange rates. Under the Articles of Agreement of the International Monetary Fund—which since their adoption at Bretton Woods, New Hampshire, in 1944 have embodied the formal principles and procedures which underly the present system—countries undertake to maintain exchange rates for transactions in their currencies within a margin of one percent of a declared par value. This par value may be changed, with the approval of the IMF, in the event of a "fundamental disequilibrium" in a country's balance of payments. For the most part, however, all the members of the IMF have shown a strong preference for stable exchange rates that are changed only infrequently.

In order to maintain their currencies within a margin of one percent of the declared par value, the monetary authorities of almost all countries other than the United States intervene when necessary in their exchange markets, buying or selling dollars against their own currency. There are a few exceptions to this method of official exchange-market intervention (notably in the sterling area), but for the most part the entire pattern of stable exchange rates is maintained by virtue of the fact that countries "peg" their exchange rates to the dollar.

Since most other countries peg their currencies to the dollar, the United States itself does not need to intervene in the exchange markets to maintain the value of the dollar in terms of other currencies. Although it may at times find it advantageous to do so in order to assure more orderly markets and more efficient and economical use of its reserves, the United States basically maintains its obligations regarding exchange stability in a very different manner: by freely buying and selling gold in transactions with monetary authorities (primarily central banks of other countries) at the price of $35 an ounce. No country other than the United States freely buys and sells gold. The whole exchange-rate system is therefore pegged to gold only through the commitment of the U.S. monetary authorities to buy and sell gold freely at the $35 price.

D. RESERVES

In order to weather periods of deficit in a system of stable exchange rates, monetary authorities must hold reserves of internationally-acceptable liquid assets. If a central bank had no reserves with which to purchase its own currency at times when its currency was in excess market supply, it would have no choice but to ask the IMF to approve a change in its par value.

Reserves are held primarily in the form of gold and dollar claims on the United States. Because dollars are held so widely in countries' reserves, the dollar is the main "reserve currency" of the international monetary system. Countries in the sterling and franc areas hold part of their reserves in sterling or French francs, and thus—to a much lesser extent—the pound and the franc also function as reserve currencies. Gold and reserve currencies are supplemented by reserve credit available from the International Monetary Fund (see below).

After an initial accrual of dollars resulting from market intervention, the country can either retain its reserve gain in the form of dollars or choose to convert the dollars into another reserve asset, usually gold. Conversely, a country necessarily experiences a reserve loss by the act of selling dollars in its exchange market, thereby reducing its dollar holdings. In order to stand ready to intervene in the market, central banks have to hold at least a working balance in dollars. This working balance can be replenished as necessary either by selling other reserve assets (such as dollar securities, time deposits, or gold) held by the monetary authorities or by drawing on the IMF or other credit facilities.

Many diverse factors enter into the decisions of central banks when they determine the proportions of their reserves to hold in gold, dollars, and other assets. Some central banks have traditionally held their reserves primarily in gold except for foreign-exchange working balances. Others have historically invested almost all their reserves in dollar or sterling assets. There are many different patterns of behavior in between these two extremes. Moreover, many countries have changed their reserve-composition policies over time.

One important motive for holding dollars is that they can be invested at interest. Gold does not earn any interest and actually costs something to store safely.

It has already been pointed out that the United States maintains its exchange stability obligations in a unique manner. It is equally true that the United States must of necessity have a unique policy with respect to its reserves. Whereas other countries use their reserves by buying or selling dollars in their exchange markets, the United States uses its reserves only to redeem excess dollars acquired by the monetary authorities of other countries.

This structural feature of the international monetary system has another important implication; when the United States does use its reserve assets to redeem outstanding dollar liabilities, this redemption—both in amount and timing—is determined by the reserve-asset preferences of foreign monetary authorities. The amount and timing of U.S. use of reserve assets is therefore not directly subject either to U.S. desires or to U.S. official policy actions. The United States can influence the rate at which it gains or loses reserves only by influencing the attitudes and asset preferences of foreign monetary authorities. One of the major factors influencing foreign official attitudes, of course, is the prevailing appraisal of the strength or weakness of the U.S. balance of payments and reserve positions.

Just as the United States uses reserves in a unique manner, it must *hold* its reserves subject to considerations that are unique. Whereas other countries have a range of assets from which to choose that includes gold, dollars, other currencies, and reserve positions in the IMF, the United States has a much more restricted field of choice. It must hold assets which are acceptable to other countries when they call upon the United States to redeem our outstanding reserve-currency liabilities. While there is some scope for holding other countries' currencies in our reserves, it is clear that in the present system the United States must hold most of its reserves in gold.

Given the wide extent to which the dollar is used as the "intervention currency" and as a reserve currency, it is clear *that the stability of the entire international monetary system is intimately bound up with the behavior of U.S. reserves.* If a widespread feeling were to develop that U.S. reserve assets might be inadequate in comparison with the size of outstanding reserve-currency liabilities, or especially if U.S. reserve assets threatened to continue to decline simultaneously with a further large expansion of U.S. reserve-currency liabilities, dollar assets might be viewed with increasing distrust by individuals and governments all around the world. The U.S. Government fully appreciates the significance of the fact that the stability of the entire monetary system is interdependent with U.S. reserve and balance of payments policy. This fact and the desire to act responsibly in the face of it have been one of the primary considerations underlying U.S. balance of payments policy since the large payments deficits of 1958–60, accompanied by heavy gold losses, first underscored the existence of a problem.

E. OPERATIONS OF THE INTERNATIONAL MONETARY FUND

In addition to the gold and reserve currencies which countries hold in their reserve outright (sometimes referred to as "unconditional" liquidity since they are usable without any outside institution or government placing conditions on their availability), countries have access to a pool of currencies in the International Monetary Fund. The amount of resources a country may draw from the Fund is governed by its quota, which reflects its economic size and importance relative to other countries. When initially paying in its quota subscription, each country subscribes 25 percent in gold and 75 percent in terms of its own currency. In return for agreeing that the 75 percent balance of its own currency may be drawn upon in case of need to finance other countries' drawings from the currency pool, countries obtain the right to draw the currencies of others from the Fund themselves under certain stipulated conditions.

The right of a country to draw on its gold subscription ("gold tranche") is essentially beyond challenge; so also is its right to draw on any credit balance it acquired as a result of other countries having drawn its currency. These two amounts together are described as the country's "reserve position in the Fund;" it is also a form of unconditional liquidity. Most countries, including the United States, regard their reserve positions in the Fund as an asset fully liquid and usable in case of balance of payments need, and accordingly include the Fund reserve position in their published reserves.

Under circumstances which involve increasingly stringent analysis and discussion of a country's economic policies, members of the Fund may draw successive further amounts from the Fund up to 100 percent of their quotas. These further borrowings in a country's "credit tranches" are not comparable to reserves. They are conditional credit facilities (hence sometimes referred to as "conditional" liquidity). They carry specific repayment obligations and interest charges.

The role of the International Monetary Fund in supplying conditional liquidity to governments for the purpose of maintaining stability in exchange rates and the adjustment of payments imbalances has expanded greatly since the inauguration of the Bretton Woods system. The aggregate quotas of all members of the IMF are now some $21 billion. The appropriateness of quotas is reviewed every five years; the last round of general quota increases became effective in 1966. In addition to expanding the general level of quotas and selectively increasing the quotas of certain countries, the IMF was also strengthened in 1962 by an agreement among the ten main industrial countries (the "Group of Ten") known as the General Arrangements to Borrow (GAB). The GAB is an undertaking by these countries to lend the Fund specified amounts of their currencies (aggregating to the equivalent of about $6 billion) if the Fund decides that supplementary resources are needed to forestall or cope with an impairment of the international monetary system. The GAB arrangements have been activated several times in connection with large U.K. drawings from the Fund.

The U.S. quota in the IMF is $5.2 billion, out of total Fund quotas of about $21 billion. As of the end of 1967, the United States had approximately $400 million of its "gold tranche" and the full $5.2 billion of credit tranches available.

F. OTHER INSTITUTIONAL ARRANGEMENTS

In 1961, the new U.S. Administration began to foster the development of a new system of international short-term credits in the form of the "swap network" of the Federal Reserve System, and also introduced the so-called "Roosa bonds." Both of these provide a type of exchange protection to the lending country. That is, the lending country is repaid in a constant value in its own currency, and is thereby protected against an exchange adjustment by the borrowing country. The United States, at the center of the swap network, can borrow foreign currencies and sell them in the market in lieu of making gold sales, in the expectation that a subsequent reversal of part of the outflow will reduce the eventual drain on its reserves. In the meantime the swap partner holds dollars with a form of exchange protection. Similarly, the United States has, itself, been able to extend credit and acquire foreign currency with exchange protection when, for example, Italy or Canada or the United Kingdom had an outflow of funds. This network of short-term reciprocal borrowing of reserves, frequently called "a first line of monetary defense," now totals about $7.1 billion. It has helped to avoid gold losses resulting from short-term flows that were later reversed. When the United States has been drawn upon, other countries have been provided with dollars to hold their exchange rates stable.

Roosa bonds were designed to provide a longer-term instrument for the investment of dollars accumulated by foreign monetary authorities. Most of them have been denominated in the foreign country's currency as an added attraction to the purchasing country. A total of about $1.5 billion of these bonds was outstanding as of November 30, 1967.

Since its reopening in 1954, the free market for gold in London has re-emerged as the largest and most important center in the world for free-market gold transactions. During most of the period since that time the flow of gold to the London market, from new production and Russian sales, have exceeded the various demands on it. Accordingly, the residual supply of gold was absorbed by central bank purchases and by the U.S. Treasury at prices varying fairly closely around the U.S. fixed price at $35 per ounce. For short periods, sudden outbreaks of speculative demand for gold substantially exceeded the supply available to the market. Such a situation occurred in October 1960 when the market price rose to around $40 and aroused widespread anxieties concerning the international monetary system. The U.S. monetary authorities supported the Bank of England in intervening in the London market to stabilize the price within an acceptable range.

In the following year, after a similar but milder strain on the London market, the U.S. authorities suggested that, in view of the mutuality of interest among the monetary authorities of the major industrial countries in maintaining orderly conditions in the gold and exchange markets, an informal gold selling arrangement be arranged among the group of central banks that are members of the BIS or are associated with it. Under the arrangement, each member of the group (Belgium, France, Germany, Italy, The Netherlands, Switzerland, the United Kingdom and the United States) undertook to supply an agreed proportion of such net gold sales to stabilize the market as the Bank of England, as agent for the group, determined to be appropriate. The U.S. share was 50 percent. This informal arrangement has essentially been continued (without French participation since midyear 1967 and with the U.S. share at 59 percent since then), both as to purchasing net gold acquisitions as well as supplying net market demand. Representatives of the central banks participating in the "pool" meet periodically at Basle to discuss all aspects of the gold and foreign exchange markets, providing a means thereby to coordinate exchange operating policies as well as to keep fully informed of developments in the London and other gold markets.

G. THE DOLLAR AS A TRANSACTIONS CURRENCY

In addition to its role as the international monetary system's major reserve currency, the dollar is also the primary international means of payment and a major medium for the international investment of short-term funds. This "transactions demand" for dollars has grown greatly over the whole postwar period. In recent years the growing importance of the Euro-dollar market has provided further illustrations of the central versatile role played by the dollar in private international financial transactions.[1]

LIQUID LIABILITIES TO FOREIGNERS

Chart I.

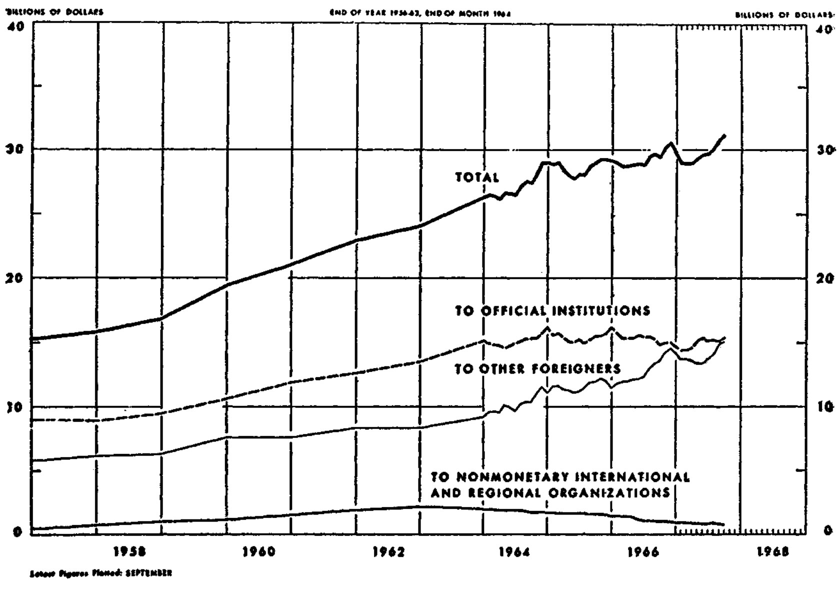

Chart I, entitled "Liquid Liabilities to Foreigners," gives some indication of how rapidly U.S. liquid liabilities to nonofficial foreigners have grown in the recent past. Liquid liabilities to "other foreigners"—foreign commercial banks (including the foreign branches of U.S. banks) and other private foreigners—

[1] Euro-dollars are deposits in banks outside the United States, principally in European financial centers, that are denominated in U.S. dollars.

increased over the period 1957 to 1967 from approximately $6 billion to about $16 billion. These liquid dollar assets of foreigners held in the United States are invested in demand and time deposits and money market paper. The secular growth in foreign private dollar holdings can be expected to continue in the future *pari passu* with continued expansion in world trade and other international transactions.

The existence of very large outstanding dollar liabilities, not only to foreign official institutions ("reserve-currency" balances), but also to private foreign individuals and organizations ("transactions-currency" balances) underlies the importance of maintaining confidence in the dollar and, more generally, in the international monetary system itself. The following chapter of this paper, which deals with current problems facing the international monetary system, returns to this important point.

H. BALANCE OF PAYMENTS SURPLUSES AND DEFICITS

When a country consistently loses reserves, it is in a balance of payments "deficit." Conversely, if a country consistently gains reserves, it has a "surplus" in its balance of payments.

Strictly speaking, the matter is more complicated than that. "Surplus" and "deficit" are analytical concepts with a variety of possible definitions. For example, it may be appropriate in some circumstances to take into account changes in the foreign assets and/or liabilities of the country's commercial banking system—as well as changes in official reserves—in measuring a deficit.

The measurement of the U.S. balance of payments deficit is more complex than for other countries because of the unique position of the U.S. dollar, and was examined by a special review committee.[2] Following this report, the conclusion was reached that no single indicator of surplus or deficit was suitable for all purposes. The primary measure used in this paper is the balance on the "liquidity" basis, although for some purposes reference is made to the balance on the "official reserve transactions" basis.[3]

Balance of payments surpluses and deficits sometimes are desired. This was the case in the early 1950's, for example, when (on the definitions of surplus and deficit then in use) the European countries undergoing reconstruction had surpluses and the United States had deficits. These deficits and surpluses enabled the European countries to build up their reserves; the declines in the swollen U.S. gold reserves and the increases in our reserve-currency liabilities—representing as they did a redistribution and augmentation of the world's stock of reserve assets—were universally welcomed as such.

On the other hand, *large* and *persistent* payments imbalances, either surplus or deficit, are not sustainable and can give rise to instability in the international monetary system. There is an obvious limit to imbalances of the deficit type: countries can support their exchange rates with their reserves and credit facilities only so long as they have reserves or can arrange further credit. In the case of a reserve-currency country, there are limits to the willingness of private and official holders abroad to accumulate that currency. The limits on the ability of countries to run large and persistent surpluses are much less clear. What is clear, however, is that large and persistent surpluses impose strains on the international monetary system as great as those resulting from large and persistent deficits.

I. THE ADJUSTMENT PROCESS—BASIC OBJECTIVES

Each individual country has its own multiple economic and social objectives. These include full employment and a satisfactory rate of growth, reasonable price stability, an equitable distribution of income, and balanced regional and sectoral development. While seeking to attain these objectives, as already noted, countries must also avoid large and persistent imbalances in their external accounts. It is also widely agreed (in the words of the Convention setting up the Organization for Economic Co-operation and Development) that countries should "promote policies designed to contribute to the expansion of world trade on a multilateral, nondiscriminatory basis in accordance with international obligations."

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[2] See *The Balance of Payments Statistics of the United States: A Review and Appraisal*, Report of the Review Committee for Balance of Payments Statistics to the Bureau of the Budget (E. M. Bernstein, Chairman), U.S. Government Printing Office, April 1965.

[3] For the differences between these two alternative measures of the balance, see Chart VII in Chapter III.

The international monetary system set up at Bretton Woods and based on a pattern of stable exchange rates was then and is now believed by its participants to be the most appropriate system designed to foster these objectives. The system has evolved over time to meet changing needs and problems. It is once again going through a key evolutionary stage, as the work on proposed amendments to the IMF Articles of Agreement reaches completion, to establish a facility for deliberate reserve creation (see below) and to improve certain rules and practices of the Fund.

The simultaneous achievement of all the economic and social objectives described above, even for an individual country, is far from easy. Governments have only a limited number of policy tools at their disposal. They have not always been able or willing to use these tools in appropriate combinations. Governments in different countries attach different priorities to achievement of various internal and external aims. The nature of imbalances in payments, as well as the appropriate range and mix of instruments required to deal with them, can vary substantially from country to country in line with wide differences in economic and financial structure and in the nature of political institutions.

These difficulties have important implications for the speed and effectiveness with which the adjustment of payments imbalances can be attained. The adjustment process may work somewhat imperfectly, and in any case is apt to be gradual. In a few difficult cases, adjustment of payments imbalances may not take place at all, or will take place only with the costly sacrifice of some of the basic objectives that the system is intended to advance, unless a large measure of multilateral cooperation is brought to bear on the problem.

J. THE ADJUSTMENT PROCESS—NEED FOR MULTILATERAL COOPERATION

The need for multilateral cooperation in achieving and maintaining balance of payments equilibrium has become increasingly widely recognized in the last few years. An understanding of this need has been particularly advanced by an international working group formed under the auspices of the Organization for Economic Co-operation and Development (OECD). The Economic Policy Committee of the OECD established a Working Party in 1961 for the specific purpose of promoting better international payments equilibrium. This group, consisting of senior officials from Ministries of Finance and other key government agencies and Central Banks concerned with balance of payments questions, has met together at approximately six-to-eight week intervals ever since. In 1964, the Ministers and Governors of the ten countries participating in the General Arrangements to Borrow suggested that this OECD working party, known as Working Party 3, make a study of the balance of payments adjustment process with a view toward improving the process of continuing international consultation and cooperation.

The Working Party's report on this subject was issued in August 1966. In addition to endorsing the commonly agreed view that prolonged imbalance in either direction is in general undesirable, the Working Party also noted that "the objectives of international consultation are broader and more general than the mere avoidance of imbalance. The purpose of consultation regarding adjustment policies is to ensure that the policies pursued by individual countries do not hinder others in the pursuit of the general aims of economic policy; more positively, the object is to ensure that as far as possible countries, while avoiding imbalance, collectively support each other in their policies."

The Working Party's report does not fail to point out that there are often inherent difficulties in managing an economy in a way which is consistent with domestic objectives, with the aims of its trading partners, with stable exchange rates, and with the general health of the world economy. But it also recognizes that there is clear room for improvement and that improvement is an urgent order of business. The report describes appropriate methods of dealing with these problems in different circumstances. It refers specifically to the need for clearer formulation of balance of payments aims; early identification and better diagnosis of payments problems; new and more selective instruments of economic policy; more timely action to correct inappropriate demand levels, competitive positions and capital flows; and a further strengthening of the processes of international consultation.

The U.S. Government has strongly supported the Working Party's report and its recommendations. At the recent meeting, November 30 to December 1, of the Ministers of the countries belonging to the OECD, for example, the United States representative, Under Secretary of State Eugene V. Rostow, said:

"We have no doubt that the Atlantic countries can resolve this problem; if they deal with it together, in ways which fortify the world monetary system and permit an early and assured return to growth patterns closer to our full employment objectives. All I am suggesting today is that we recognize that some aspects of the adjustment process require cooperative solutions and that we set about promptly to find them. Cooperation in handling the adjustment process, I suggest, is the next major step after Rio [see below for a discussion of the agreement reached in Rio de Janeiro in September 1967] for us to take in improving our machinery for managing the monetary system."

K. THE ADJUSTMENT PROCESS—EQUILIBRIUM FOR THE SYSTEM AS A WHOLE

For any country to reduce its deficit or move into surplus, it is generally necessary for other countries to reduce surpluses or increase deficits. This is simply a statement of what must happen mechanically and statistically if payments imbalances are to be adjusted at all.

This inescapable interdependence of surpluses and deficits makes it very clear that countries must have compatible balance of payments aims if the whole system is not to be working at cross purposes. If all the countries in the system that are in surplus set their policies in such a way as to have continued surpluses, while deficit countries take active measures to eliminate their deficits, then either the deficit countries will still find themselves running deficits or else surplus countries will find that they have not been able to attain their targeted surpluses. All countries together cannot possibly achieve these inconsistent aims; someone is bound to be disappointed.

Virtually all countries take it as their balance of payments objective to be in surplus (and so to have growing reserves) over time. Few if any countries have indicated either a policy or a willingness to have their reserves fluctuate around a fixed level rather than around an upward trend.

It is understandable why countries tend to have this preference for surpluses. The volume of trade and other international transactions has a strong upward trend. It is a reasonable presumption that, because of this trend, the absolute size of imbalances will also increase over time. These facts alone suggest that reserves should likewise have an upward trend if they are to continue to be adequate to support the fixed exchange rate against balance of payments swings. Another factor leading countries not to attempt to reduce their surpluses may be a propensity to discount an existing surplus as partly or wholly "temporary;" it is natural and prudent to conduct affairs so as to prepare for "rainy weather" in the future, and not to presume that current good fortune will continue. Even to the extent that countries aim at a long-run objective of a zero surplus over time, which they tend not to do, they still probably react more quickly to a deficit situation that when they are in surplus (if only because countries in surplus are under much less urgent and intense pressures to act to reduce the imbalance).

Given the set of prevailing attitudes which makes an upward trend in reserves (balance of payments surplus) the targeted long-run "norm" for each country taken individually, the obvious question suggests itself: when, if at all, can the international monetary system as a whole be in equilibrium? Given that it is difficult enough to bring about adjustment of payments imbalances even under ideal conditions where deficit countries take actions to reduce deficits and surplus countries willingly take cooperative actions to reduce their surpluses, how can the system possibly function smoothly when countries in surplus by and large do not want to see their surpluses reduced?

Happily, there is a solution to this dilemma. It is not the case that for every dollar of surplus in the system there must be an exactly offsetting dollar of deficit. When the gross deficits and gross surpluses (consistently defined) of all countries are offset against each other, the sum of the surpluses can exceed the sum of the deficits by the amount of new reserves being added to the system which are not at the same time the liability of a particular country. The key point of this relationship is that if new reserves of the appropriate kind are flowing into the system, it *is* possible for some countries to satisfy their preferences for reserve increases without necessitating that other countries be in corresponding deficit.

Up to the present time, the only "new reserves" which have allowed this margin to exist have been increases in countries' monetary gold stocks. When newly-mined gold is sold to a monetary authority, that government has a reserve gain without any other country having experienced a deficit. When the dollar component of world reserves increases, on the other hand, this increase in reserves does not allow the system as a whole to have a margin of surpluses exceeding deficits. When the rest of the world adds to its dollar reserves, these new assets are also an increase in U.S. reserve-currency liabilities, and there is therefore a U.S. deficit corresponding to the surplus of the rest of the world. However, gold is not the only reserve asset that is capable of permitting the system to have a situation in which the sum of surpluses exceeds the sum of deficits. Deliberately created new reserve assets, such as the proposed Special Drawing Rights (SDR) described in the next chapter, will serve this function equally well.

Equilibrium for the system as a whole thus requires that new reserves—gold or new reserve assets such as SDR—be added to the system at such a rate that the sum of surpluses can exceed the sum of deficits by a reasonable margin. This condition for "equilibrium" of the system should be thought of as a necessary, but not sufficient, condition. Other considerations, such as the degree to which the system is promoting the achievement of its basic objectives, also need to be taken into account.

Only under these conditions is there a good chance of making countries' balance of payments aims mutually compatible; only then is there a plausible hope of attaining the objectives the system is intended to promote, including relative freedom from trade and payments restrictions while still getting the adjustment of payments imbalances to proceed smoothly.

What is a "reasonable" margin by which surpluses should exceed deficits? The answer to this question is not fully clear to the financial experts and economists who have studied this question. Broadly speaking, the rate at which new reserves should be added to the system should probably bear some relationship to the rate at which international transactions are expanding (though the two rates need not be the same and there is no necessity for a precise relationship). The margin should not be too small, and certainly should not be negative. Nor should the margin be an excessive one. At either of these two extremes, one would have to say that the system as a whole was in "disequilibrium."

It is important to be clear on the fact that the above condition for equilibrium of the system, if satisfied, in no way reduces the need for countries to avoid large and persistent imbalances in their external payments. It is still imperative for countries in large or prolonged deficit to reduce their imbalance. And it is just as important as ever for countries with large and persistent surpluses to reduce these surpluses to the point where they are moderate and broadly consonant with the rate at which reserves are growing in the system as a whole. The need for adjustment is not removed. The margin by which surpluses exceed deficits only means that, for each country individually and for the system as a whole, adjustment takes place around an upward trend in reserves rather than around a constant level.

Secretary Fowler. Today, the international monetary system relies primarily on gold and dollars and the interchangeability of gold and the dollar at $35 an ounce is the fulcrum of the system—and we hope that at a very early date these two factors will get help as they need help from a third, the new international reserve asset to be created under multilateral agreement in the International Monetary Fund, by an amendment of the articles of agreement of that Fund, which article amendment we hope will be before the Congress some time in the spring. But gold and dollars will continue to play a very vital role in the international monetary system.

If this system, which has served the entire free world so admirably in the past 20 years, is to continue to facilitate the growth of world trade and prosperity, we must assure that confidence in the system and in the strength of the dollar is maintained. And this requires action on four fronts:

First, we must continue the longstanding U.S. policy of maintaining the gold-dollar relationship at $35 an ounce. This must not be open to question, and the best way to make continuation of that policy crystal clear is to free our entire gold stock for that purpose.

Second, we must assure that the U.S. economy grows in an environment of cost and price stability through enactment of the anti-inflation tax and through expenditure controls and appropriate monetary policy.

Third, we must achieve sustained equilibrium in our balance of payments; and

Fourth, we and the rest of the free world must put into place the plan for the creation of a new reserve asset agreed upon in Rio last September, at the meeting of the International Monetary Fund.

Our policy of maintaining the fixed relationship between gold and the dollar at $35 an ounce for legitimate monetary purposes is one of the reasons why virtually all countries hold dollars in their reserves and why many of them hold very large amounts of dollars. In addition, of course, countries hold dollars because, unlike gold, they can invest them in interest-earning assets.

The monetary authorities of most of the major industrialized countries understand full well that the link between gold and domestic currencies is no longer a pertinent and relevant fact and that gold is an international asset. Only three major countries still maintain some link between their domestic currencies and gold. While foreign authorities are aware of the fact that the Federal Reserve can suspend the cover requirement, they find it difficult to understand why the United States, the world's major reserve currency country, still maintains this legal impediment to the free international use of gold.

Thus, legislative action on the cover requirement, by making it clear to the world that the Congress as well as the executive branch are committing our total gold stock to international use, is necessary to maintain confidence in the dollar.

Removal of the gold cover will not solve the U.S. balance-of-payments problem nor is it a substitute for the solution of that problem.

The need to achieve sustained equilibrium in our international payments position is essential to confidence in the dollar and the future stability of the international monetary system. The series of measures announced by the President on January 1, with which you are all familiar, are designed to bring us to, or close to, equilibrium this year. It is vital that they be successful. I ask, Mr. Chairman, that the President's message be made a part of the record of these hearings. That is January 1.

Chairman PATMAN. Without objection, it is so ordered.

Secretary FOWLER. In conclusion, I urge the committee to consider and act promptly on the gold cover legislation before you in order that, domestically, we can continue to be assured that the Federal Reserve will be able to supply appropriate amounts of currency to meet the needs of our growing economy for cash and in order that our policy of maintaining the gold-dollar relationship—one of the major elements of confidence in the dollar and the international monetary system—will not be open to question.

Mr. Chairman, that concludes my statement. But the Secretary of State has asked me to submit to the committee a brief statement of his views concerning the removal of the gold cover, and I should like also to submit that.

Chairman PATMAN. That may be inserted at this point in the record.

(The material referred to follows:)

President's Message to the Nation on the Balance of Payments

WHERE WE STAND TODAY

I want to discuss with the American people a subject of vital concern to the economic health and well-being of this Nation and the Free World.

It is our international balance of payments position.

The strength of our dollar depends on the strength of that position.

The soundness of the Free World monetary system, which rests largely on the dollar, also depends on the strength of that position.

To the average citizen, the balance of payments, and the strength of the dollar and of the international monetary system, are meaningless phrases. They seem to have little relevance to our daily lives. Yet their consequences touch us all—consumer and captain of industry, worker, farmer, and financier.

More than ever before, the economy of each nation is today deeply intertwined with that of every other. A vast network of world trade and financial transactions ties us all together. The prosperity of every economy rests on that of every other.

More than ever before, this is one world—in economic affairs as in every other way.

Your job, the prosperity of your farm or business, depends directly or indirectly on what happens in Europe, Asia, Latin America, or Africa.

The health of the international economic system rests on a sound international money in the same way as the health of our domestic economy rests on a sound domestic money. Today, our domestic money—the U.S. dollar—is also the money most used in international transactions. That money can be sound at home—as it surely is—yet can be in trouble abroad—as it now threatens to become.

In the final analysis its strength abroad depends on our earning abroad about as many dollars as we send abroad.

U.S. dollars flow from these shores for many reasons—to pay for imports and travel, to finance loans and investments and to maintain our lines of defense around the world.

When that outflow is greater than our earnings and credits from foreign nations, a deficit results in our international accounts.

For 17 of the last 18 years we have had such deficits. For a time those deficits were needed to help the world recover from the ravages of World War II. They could be tolerated by the United States and welcomed by the rest of the world. They distributed more equitably the world's monetary gold reserves and supplemented them with dollars.

Once recovery was assured, however, large deficits were no longer needed and indeed began to threaten the strength of the dollar. Since 1961 your government has worked to reduce that deficit.

By the middle of the decade, we could see signs of success. Our annual deficit had been reduced two-thirds—from $3.9 billion in 1960 to $1.3 billion in 1965.

In 1966, because of our increased responsibility to arm and supply our men in Southeast Asia, progress was interrupted, with the deficit remaining at the same level as 1965—about $1.3 billion.

In 1967, progress was reversed for a number of reasons:

Our costs for Vietnam increased further.

Private loans and investments abroad increased.

Our trade surplus, although larger than 1966, did not rise as much as we had expected.

Americans spent more on travel abroad.

Added to these factors was the uncertainty and unrest surrounding the devaluation of the British pound. This event strained the international monetary system. It sharply increased our balance of payments deficit and our gold sales in the last quarter of 1967.

THE PROBLEM

Preliminary reports indicate that these conditions may result in a 1967 balance of payments deficit in the area of $3.5 to $4 billion—the highest since 1960. Although some factors affecting our deficit will be more favorable in 1968, my advisors and I are convinced that we must act to bring about a decisive improvement.

We cannot tolerate a deficit that could threaten the stability of the international monetary system—of which the U.S. dollar is the bulwark.

We cannot tolerate a deficit that could endanger the strength of the entire Free World economy, and thereby threaten our uprecedented prosperity at home.

A TIME FOR ACTION

The time has now come for decisive action designed to bring our balance of payments to—or close to—equilibrium in the year ahead.

The need for action is a national and international responsibility of the highest priority.

I am proposing a program which will meet this critical need, and at the same time satisfy four essential conditions:

> Sustain the growth, strength and prosperity of our own economy.
>
> Allow us to continue to meet our international responsibilities in defense of freedom, in promoting world trade, and in encouraging economic growth in the developing countries.
>
> Engage the cooperation of other free nations, whose stake in a sound international monetary system is no less compelling than our own.
>
> Recognize the special obligation of those nations with balance of payments surpluses, to bring their payments into equilibrium.

THE FIRST ORDER OF BUSINESS

The first line of defense of the dollar is the strength of the American economy.

No business before the returning Congress will be more urgent than this: To enact the anti-inflation tax which I have sought for almost a 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.

No challenge before business and labor is more urgent than this: To exercise the utmost responsibility in their wage-price decisions, which affect so directly our competitive position at home and in world markets.

I have directed the Secretaries of Commerce and Labor, and the Chairman of the Council of Economic Advisers to work with leaders of business and labor to make more effective our voluntary program of wage-price restraint.

I have also instructed the Secretaries of Commerce and Labor to work with unions and companies to prevent our exports from being reduced or our imports increased by crippling work stoppages in the year ahead.

A sure way to instill confidence in our dollar—both here and broad—is through these actions.

THE NEW PROGRAM

But we must go beyond this, and take action to deal directly with the balance of payments deficit.

Some of the elements in the program I propose will have a temporary but immediate effect. Others will be of longer range.

All are necessary to assure confidence in the American dollar.

1. Direct investment

Over the past three years, American business has cooperated with the government in a voluntary program to moderate the flow of U.S. dollars into foreign investments. Business leaders who have participated so wholeheartedly deserve the appreciation of their country.

But the savings now required in foreign investment outlays are clearly beyond the reach of any voluntary program. This is the unanimous view of all my economic and financial advisers and the Chairman of the Federal Reserve Board.

To reduce our balance of payments deficit by at least $1 billion in 1968 from the estimated 1967 level, I am invoking my authority under the Banking Laws to establish a mandatory program that will restrain direct investment abroad.

This program will be effective immediately. It will insure success and guarantee fairness among American business firms with overseas investments.

The program will be administered by the Department of Commerce, and will operate as follows:

> As in the voluntary program, over-all and individual company targets will be set. Authorizations to exceed these targets will be issued only in exceptional circumstances.

New direct investment outflows to countries in continental western Europe and other developed nations not heavily dependent on our capital will be stopped in 1968. Problems arising from work already in process or commitments under binding contracts will receive special consideration.

New net investments in other developed countries will be limited to 65% of the 1965–66 average.

New net investments in the developing countries will be limited to 110% of the 1965–66 average.

This program also requires businesses to continue to bring back foreign earnings to the United States in line with their own 1964–66 practices.

In addition, I have directed the Secretary of the Treasury to explore with the Chairmen of the House Ways and Means Committee and Senate Finance Committee legislative proposals to induce or encourage the repatriation of accumulated earnings by U.S.-owned foreign businesses.

2. Lending by financial institutions

To reduce the balance of payments deficit by at least another $500 million, I have requested and authorized the Federal Reserve Board to tighten its program restraining foreign lending by banks and other financial institutions.

Chairman Martin has assured me that this reduction can be achieved:

without harming the financing of our exports;

primarily out of credits to developed countries without jeopardizing the availability of funds to the rest of the world.

Chairman Martin believes that this objective can be met through continued cooperation by the financial community. At the request of the Chairman, however, I have given the Federal Reserve Board standby authority to invoke mandatory controls, should such controls become desirable or necessary.

3. Travel abroad

Our travel deficit this year will exceed $2 billion. To reduce this deficit by $500 million:

I am asking the American people to defer for the next two years all nonessential travel outside the Western Hemisphere.

I am asking the Secretary of the Treasury to explore with the appropriate Congressional committees legislation to help achieve this objective.

4. Government expenditures overseas

We cannot forgo our essential commitments abroad, on which America's security and survival depend.

Nevertheless, we must take every step to reduce their impact on our balance of payments without endangering our security.

Recently, we have reached important agreements with some of our NATO partners to lessen the balance of payments cost of deploying American forces on the Continent—troops necessarily stationed there for the common defense of all.

Over the past three years, a stringent program has saved billions of dollars in foreign exchange.

I am convinced that much more can be done. *I believe we should set as our target avoiding a drain of another $500 million on our balance of payments.*

To this end, I am taking three steps.

First, I have directed the Secretary of State to initiate prompt negotiations with our NATO allies to minimize the foreign exchange costs of keeping our troops in Europe. Our allies can help in a number of ways, including:

The purchase in the U.S. of more of their defense needs.

Investments in long-term United States securities.

I have also directed the Secretaries of State, Treasury and Defense to find similar ways of dealing with this problem in other parts of the world.

Second, I have instructed the Director of the Budget to find ways of reducing the numbers of American civilians working overseas.

Third, I have instructed the Secretary of Defense to find ways to reduce further the foreign exchange impact of personal spending by U.S. forces and their dependents in Europe.

LONG-TERM MEASURES

5. Export increases

American exports provide an important source of earnings for our businessmen and jobs for our workers.

They are the cornerstone of our balance of payments position.

Last year we sold abroad $30 billion worth of American goods.

What we now need is a long-range systematic program to stimulate the flow of the products of our factories and farms into overseas markets.

We must begin now.

Some of the steps require legislation:

I shall ask the Congress to support an intensified five year, $200 million Commerce Department program to promote the sale of American goods overseas.

I shall also ask the Congress to earmark $500 million of the Export-Import Bank authorization to:

Provide better export insurance.

Expand guarantees for export financing.

Broaden the scope of Government financing of our exports.

Other measures require no legislation.

I have today directed the Secretary of Commerce to begin a Joint Export Association program. Through these Associations, we will provide direct financial support to American corporations joining together to sell abroad.

And finally, the Export-Import Bank—through a more liberal rediscount system—will encourage banks across the Nation to help firms increase their exports.

6. Nontariff barriers

In the Kennedy Round, we climaxed three decades of intensive effort to achieve the greatest reduction in tariff barriers in all the history of trade negotiations. Trade liberalization remains the basic policy of the United States.

We must now look beyond the great success of the Kennedy Round to the problems of nontariff barriers that pose a continued threat to the growth of world trade and to our competitive position.

American commerce is at a disadvantage because of the tax systems of some of our trading partners. Some nations give across-the-board tax rebates on exports which leave their ports and impose special border tax charges on our goods entering their country.

International rules govern these special taxes under the General Agreement on Tariffs and Trade. These rules must be adjusted to expand international trade further.

In keeping with the principles of cooperation and consultation on common problems, I have initiated discussions at a high level with our friends abroad on these critical matters—particularly those nations with balance of payments surpluses.

These discussions 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 conditions.

Through these means we are determined to achieve a substantial improvement in our trade surplus over the coming years. In the year immediately ahead, we expect to realize an improvement of $500 million.

7. Foreign investment and travel in U.S.

We can encourage the flow of foreign funds to our shores in two other ways:

First, by an intensified program to attract greater foreign investment in U.S. Corporate securities, carrying out the principles of the Foreign Investors Tax Act of 1966.

Second, by a program to attract more visitors to this land. A Special Task Force headed by Robert McKinney of Santa Fe, New Mexico, is already at work on measures to accomplish this. I have directed the Task Force to report within 45 days on the immediate measures that can be taken, and to make its long-term recommendations within 90 days.

MEETING THE WORLD'S RESERVE NEEDS

Our movement toward balance will curb the flow of dollars into international reserves. It will therefore be vital to speed up plans for the creation of new reserves—the Special Drawing Rights—in the International Monetary Fund. These new reserves will be a welcome companion to gold and dollars, and will strengthen the gold exchange standard. The dollar will remain convertible into gold at $35 an ounce, and our full gold stock will back that commitment.

A TIME FOR RESPONSIBILITY

The program I have outlined is a program of action.

It is a program which will preserve confidence in the dollar, both at home and abroad.

The U.S. dollar has wrought the greatest economic miracles of modern times.

It stimulated the resurgence of a war-ruined Europe.

It has helped to bring new strength and life to the developing world.

It has underwritten unprecedented prosperity for the American people, who are now in the 83d month of sustained economic growth.

A strong dollar protects and preserves the prosperity of businessman and banker, worker and farmer—here and overseas.

The action program I have outlined in this message will keep the dollar strong. It will fulfill our responsibilities to the American people and to the Free World.

I appeal to all of our citizens to join me in this very necessary and laudable effort to preserve our country's financial strength.

THE SECRETARY OF STATE
WASHINGTON

STATEMENT

I welcome the opportunity to comment on the proposal to remove the requirement that Federal Reserve banks maintain a 25% reserve in gold certificates against the bank notes which they have in circulation.

Confidence in the United States dollar is an important factor in the continuing efforts of the United States Government to assure that international relations evolve along lines compatible with the aspirations and requirements of the American people. Confidence in the dollar is an essential element of a healthy, expanding world economy. This growth is vital to the well being of the other countries of the world and to the security and prosperity of the United States itself. Prompt enactment of legislation removing the "gold cover" requirement will demonstrate to the world the determination of the United States Government to keep the dollar strong.

This action is especially timely now following the recent changes in the value of other currencies and the accompanying speculative flurries in world gold markets. I believe that explicitly freeing our entire gold stock to be available to buttress the international position of the dollar will materially reinforce the world's confidence in the dollar, and will support the efforts Americans are being asked to make in the new balance of payments program.

I hope that the Congress will, by eliminating the "gold cover" requirement, contribute significantly to our strength and effectiveness throughout the world.

DEAN RUSK.

Chairman PATMAN. Just one question that I want to ask you. All Federal Reserve notes and U.S. notes will be on a parity, as they have been in the past?

Secretary FOWLER. Yes, sir.

Chairman PATMAN. There will be no change and there will be no effort made to discontinue the printing of U.S. notes?

Secretary FOWLER. No.

Chairman PATMAN. You will continue to print them as they are needed, as you have in the past?

Secretary FOWLER. Yes, sir.

Chairman PATMAN. Mr. Martin, we are delighted to have you.

You may proceed in your own way.

STATEMENT OF HON. WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM; ACCOMPANIED BY HON. J. L. ROBERTSON, VICE CHAIRMAN, BOARD OF GOVERNORS

Mr. MARTIN. The Board of Governors of the Federal Reserve System recommends prompt enactment of legislation to repeal the statutory provisions that now require each Federal Reserve bank to maintain reserves in gold certificates of not less than 25 percent of its Federal Reserve notes in circulation. Some change in this requirement this year or next will be unavoidable as the volume of our currency grows in response to the demands of a growing economy. Its repeal now would help to make absolutely clear that the U.S. gold stock is fully available to serve its primary purpose as an international monetary reserve.

I want to emphasize that elimination of the cover requirement would in any event be needed in the relatively near future even if there were no further net sales of gold to foreigners. Federal Reserve notes in circulation increase each year with growth in our economy. The increase in 1967 was more than $2 billion, and this alone added more than $500 million to the amount of gold required under present law to be held as cover for Federal Reserve notes. Moreover, our domestic industrial and artistic uses of gold, over and above domestic production, amounted to $160 million last year, and such uses can be expected to be at least that large in the future. These two factors together would reduce our free gold—the amount of gold over and above that required as cover for notes—by about $700 million a year. At that rate, our free gold, currently $1.3 billion, would be absorbed in less than 2 years, even in the absence of further sales of gold to foreigners. And it would be unrealistic, of course, not to allow for some additional foreign purchases. Thus, it is clear that a change in the cover requirement is unavoidable, and cannot be postponed for long.

It is true that Congress has given the Federal Reserve Board authority to suspend the gold cover requirement for a period of up to 30 days and to renew such suspension for 15-day periods thereafter. But this authority, granted at a time when Federal Reserve notes were convertible into gold domestically, was not designed to deal with present-day conditions. With growth in the economy the attendant need for steadily increasingly currency in circulation will certainly continue. To provide the additional currency requires a permanent change in the law, rather than Board action every 15 days.

The primary function performed by gold today is not as a reserve against domestic currency but as a monetary reserve for use internationally. The major part of the U.S. international monetary reserve is in gold. Since midyear, our gold stock has declined by more than

$1 billion, and it now amounts to about $12 billion. In order to arrest this decline, we must achieve a major improvement in our balance of payments. That is the objective of the program announced by the President on January 1.

But while we are taking the fundamental steps needed to bring our international payments into equilibrium and stop the drain on our gold reserves, we should make it absolutely clear that all of our gold stock is available to serve its primary purpose, and thus discourage market speculation against the dollar or anticipatory takings of gold by central banks. Speculation against the dollar might be encouraged if the gold cover requirement were regarded as immobilizing part of our reserves; the labeling of only part of our gold reserves as "free" might seem to imply that the rest of our reserves are somehow unavailable to perform their primary function of maintaining the convertibility of the dollar. Any possible misunderstandings on this point should be put at rest. This legislation would do that.

Removal of this requirement would in no way reduce our determination to preserve the soundness of the dollar. To achieve our goals both domestically and internationally we must pursue sound and equitable fiscal and monetary policies.

Convertibility of the dollar into gold at a fixed price—$35 an ounce—is a keystone of the international monetary system and is a fundamental reason why foreign monetary authorities are willing to hold dollar reserves. The role of the dollar as the major international reserve currency, together with the readiness of private foreign residents to hold dollar assets, places the dollar in a unique position in international commerce and finance. Prompt enactment of legislation to remove the gold cover requirement would reaffirm to the world the convertibility of the dollar. At the same time it would meet the long-run requirements for an expansion in note circulation commensurate with steady growth in the economy.

Thank you.

Chairman PATMAN. Thank you very much, Mr. Martin.

Mr. Widnall wanted to make a request for the filing of information, since obviously we will not have time to interrogate you gentlemen this morning.

Mr. WIDNALL. Thank you, Mr. Chairman; with the complete understanding that it will be subject to call later after you have testified before the Ways and Means Committee.

I would just ask one question now. Would you provide for the record the amount of gold that was bought and sold last year throughout the world, what nations absorbed that production, and I think that is all to start.

Mr. MARTIN. Yes, sir.

Secretary FOWLER. Congressman Widnall, we will supply that. I don't know whether it is available here now, but we will try to get it as complete as possible before the end of the day.

(The information requested follows:)

CHANGES IN GOLD HOLDINGS—1967

Full data on changes in gold reserves for 1967 are not yet available. For the first three quarters of the year the picture is as follows:

[In millions of dollars]

Changes in gold reserves of—	*Amount*
United States	−163
United Kingdom	−109
Industrial Europe	−35
Canada	+53
Other developed areas	−109
of which—	
South Africa	−109
Portugal	+47
Latin America	+5
of which—	
Mexico	+46
Peru	−45
Middle East	+25
Other areas	+35
Africa	0
Total, all countries	−290
IMF	+27
EPU	−14
BIS	+60
Total, loss monetary gold	−225
Plus new production (estimated)	1,050
Total	1,275

NOTE.—The above data indicate that private sources absorbed all of new production and about $225,000,000 additional from monetary stocks in the first 3 quarters of 1967. Of the private use in this same period it is estimated that about $540,000,000 was for industrial (including artistic) use.

Mr. WIDNALL. I think there is something to be answered on page 4 of your statement, where you say "gold belongs in a nation's international reserves."

Secretary FOWLER. I think it is a reference to the most important functional purpose rather than a definition of the title thereto.

Chairman PATMAN. Thank you, gentlemen, very much. With the thanks of the committee, we will release you for the present.

Mr. REUSS. I ask that there be inserted in the record at this point an exchange of letters between myself and the Treasury, to the effect that the Congress, and only the Congress, has the power to change the price of gold.

Chairman PATMAN. Without objection, so ordered. And without objection, I would like to insert in the record at this point a statement by the American Bankers Association approving the bill; a newspaper article quoting remarks of Mr. Alfred Hayes, president of the Federal Reserve Bank of New York, approving the bill; and a statement by Mr. David Rockefelelr, of the Chase-Manhattan Bank, approving the bill.

(The material referred to follows:)

JANUARY 22, 1968.

Hon. HENRY H. FOWLER,
Secretary of the Treasury,
Department of the Treasury, Washington, D.C.

DEAR MR. SECRETARY: I wish to ask you a question concerning the legal intricacies of changing the price of gold. My impression is that when one considers the various laws relating to this subject, including the Gold Reserve Act of 1934, the Bretton Woods Agreements Act of 1945, the Articles of Agreement of the International Monetary Fund, and our commitments thereunder, it becomes clear that the power to change the price of gold is placed in the Congress of the United States.

I hope that you can confirm to me that my impression that only Congress can change the price of gold is correct. I would add that it is my determination—one that I believe is widely shared in the Congress—never to authorize an increase in the present price of gold, since to do so would not only break the faith with those who have expressed confidence in the dollar, but would unjustly reward those speculators who might seek to undermine confidence in the dollar.

Sincerely,

HENRY S. REUSS,
Member of Congress.

THE UNDER SECRETARY OF THE TREASURY,
Washington, D.C., January 23, 1968.

Hon. HENRY S. REUSS,
House of Representatives,
Washington, D.C.

DEAR MR. REUSS: This is in reply to your letter of January 22, 1968, in which you state that when one considers the various laws and international obligations relating to gold, it becomes clear that the power to change the price of gold is placed in the Congress of the United States.

The use and price of gold in the International Monetary System is governed by a complex of provisions of United States laws and international obligations. These include the Gold Reserve Act of 1934, the Bretton Woods Agreements Act of 1945, the Articles of Agreement of the International Monetary Fund, and our commitments thereunder. The basic fact is that the United States has communicated to the Fund a par value of $35 per fine troy ounce of gold. This par value may not be changed without legislation by the Congress, and it is the par value of the dollar which effectively fixes the price at which the United States may buy and sell gold. While the Gold Reserve Act of 1934 authorized the Secretary of the Treasury to buy and sell gold on terms and conditions he deems advantageous, as a practical matter he cannot do so at a price other than $35 because of our commitments under the Fund Articles which have been approved by the Congress and which cannot be changed without Congressional action.

I am pleased to note that it is your view, and that of others in the Congress, that we must maintain the price of gold at $35 per ounce. As you know, this Administration has reiterated time and time again our determination to maintain the soundness of the dollar and to keep gold at its present price. As recently as last week in his State of the Union Message, President Johnson stated: "We have assured the world that America's full gold stock stands behind our commitment to maintain the price of gold at $35 an ounce. We must back this commitment by legislating now to free our gold reserves."

Sincerely yours,

JOSEPH W. BARR.

THE AMERICAN BANKERS ASSOCIATION,
Washington, D.C., January 26, 1968.

Hon. WRIGHT PATMAN,
Chairman, Banking and Currency Committee, U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed is a statement of the position of the American Bankers Association on the recommendation made by President Johnson in his State of the Union Message for removal of the gold cover.

This statement has been approved by our Administrative Committee and represents the official position of the Association. We ask that it be included in the record of the hearings your Committee is currently holding on H.R. 14743 and related legislation.

Sincerely,

CHARLES R. MCNEIL,
Director, Washington Office.

STATEMENT OF THE AMERICAN BANKERS ASSOCIATION

The continued efficient operation of the international monetary system—based upon gold and the dollar—is threatened by the statutory requirement that Federal Reserve notes be backed by 25 per cent in gold. Although it is therefore clear that the requirement must be relaxed or removed, such action will be useless and actually harmful in the long run unless Congress and the Administration take firm accompanying steps to eliminate our chronic balance of payments deficit and dismantle existing foreign exchange controls. Otherwise, gold will continue to flow abroad—$12 billion, or half of our gold stock, has moved out since 1949—leading ultimately to a gold embargo or dollar devaluation, and a breakdown in the international monetary system.

The steps necessary for elimination of our payments deficit and the ultimate dismantling of exchange controls (which in the long run are self-defeating) include—

A frugal, no-fat Presidential budget for the coming fiscal year; cuts should be made in all noncontractual categories except direct Vietnam spending;

Congressional enactment at the earliest possible date of the President's proposed income tax surcharge; and

A relentless program to reduce the heavy outflow of dollars resulting from our foreign military and economic aid, including cutbacks in troops and dependents stationed in Western Europe.

These measures are severe but necessary. They recognize that the root causes of our balance of payments deficit are inflation and economic overheating at home and excessive Federal spending abroad. Until there is clear and convincing evidence that these causes are to be attacked effectively at their source—more effectively than in the President's message of January 1—any change in the gold reserve requirement, however, necessary to maintain confidence in the dollar in the short run, could in the long run actually undermine or destroy that confidence.

[From the Washington Post, Jan. 23, 1968]

PERMANENT CURE HELD NEEDED FOR DOLLAR ILLS

NEW YORK, January 22.—Alfred Hayes, president of the Federal Reserve Bank of New York, said today the dollar crisis appears to have been surmounted by President Johnson's balance-of-payments restrictions and the cooperation of major industrial countries.

"While we have made an excellent start, a great deal remains to be done," Hayes told the midwinter meeting of the New York State Bankers Association.

"I can see a risk that some Americans may mistake a necessary remedial crash program for a permanent cure," Hayes said.

"Interference with the free movement of capital and with tourist spending is certainly neither a desirable nor a practicable long-run solution of the problem," he said.

Hayes endorsed President Johnson's proposal to remove the gold cover from Federal Reserve notes.

Hayes said the President's balance of payments restrictions "as a whole deserve the nation's full support, both because the Administration now seems determined to conquer this hitherto intracable problem, and because there is an evident desire to spread the burden of remedial measures as widely as possible."

Concerning a tax boost, Hayes said an increase "along the lines proposed by the President is essential to achieve fiscal restraint on the scale needed . . . I am hopeful that the sheer necessity of a tax rise will bring it into being without further delay."

Reductions in Federal spending that would be "large enough to deal with our present problems are simply not feasible," he said.

CHASE MANHATTAN BANK,
New York, N.Y., January 22, 1968.

Hon. WRIGHT PATMAN,
Chairman, Banking and Currency Committee,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: The House Committee on Banking and Currency is now considering a bill you have introduced to eliminate the present requirement that the Federal Reserve maintain gold certificates equal to 25% of its note liabilities. I should like, by means of this letter, to indicate my support for that legislation.

In supporting removal of the so-called "gold cover", I do not in any way want to detract from the central importance of bringing the long period of gold losses to an early end. We should be clear that removing the cover in no way meets that basic need. Indeed, the fact that our gold stock has now declined to the point where the reserve requirement must be relaxed is itself a symbol and warning of the need for more fundamental measures to protect the dollar.

I am deeply disturbed by growing evidence at home and abroad of spreading uncertainty over the stability of the international monetary system, which rests so heavily on the stability of the U.S. dollar and its convertibility into gold. Our economic policies must, it seems to me, be directed as a matter of national priority at the basic sources of that concern—namely, the strong and evident inflationary pressures in the domestic economy and the long-standing balance of payments deficit. I see no alternative, in meeting these problems, to the disciplines of responsible monetary and fiscal policies. Specifically, I strongly feel that the present situation demands both vigorous control on Federal spending and a temporary tax increase adequate to achieve a decisive reduction in the Federal budgetary deficit.

Important as it is to stem the losses of gold, the present gold reserve requirement is not, in my opinion, a useful means to that end. Instead, it has perverse effects. Under present and foreseeable conditions, maintenance of the requirement would give rise to unnecessary and dangerous uncertainty over our settled policy to convert dollars held by foreign governments and central banks into gold upon demand.

Recent losses of gold and rising levels of Federal Reserve notes in circulation have now reduced the margin of gold in excess of requirements to about $1¼ billion. Given the size of our balance of payments deficit in recent months, the time necessary to stem the outflow of dollars even with forceful and effective policies, and the unsettled atmosphere in world financial markets, that margin is insufficient to meet possible demands. Moreover, looking to the future, the prospect that a growing economy will require increased circulation of Federal Reserve notes, thus impounding more of our gold into the required reserve, would further squeeze the available margin of gold.

I recognize there is a clause in present law that would enable the Federal Reserve to suspend the gold reserve requirement. However, my own contacts abroad confirm that this rather vaguely worded provision is not understood. Moreover, the provision appears to be designed to meet temporary emergencies.

I would certainly support use of the emergency provision if absolutely necessary to meet our pledges with respect to gold. But I believe reliance on that escape clause for a prolonged period could only contribute to continued uncertainties in world financial markets. It would pose a grave risk of accelerating the demand for gold by stimulating unnecessary fears that gold sales will shortly be terminated by the U.S.

Consequently, I see no satisfactory alternative to relaxing the present gold reserve requirement. Elimination of the requirement altogether would be an effective expression of the repeated and appropriate pledges by the President to maintain and defend the present value of the dollar with all the means at our command.

But I urge that this removal be recognized for what it is—a stop gap measure that can be useful only as part of a broad and effective attack on inflation and the balance of payments deficit through responsible fiscal and monetary policies.

Sincerely yours,

DAVID ROCKEFELLER, *President.*

Chairman PATMAN. All right, Mr. Barr and Governor Robertson. We are glad to have you, gentlemen. Do you have a prepared statement, or do you just want to answer questions?

89-292—68——3

Mr. BARR. I have no prepared statement. Governor Robertson and I are at your disposal and the disposal of the committee to answer the questions you may have.

Mr. ROBERTSON. Or try to.

Mr. BARR. Or try to.

Chairman PATMAN. Mr. Widnall would like to be recognized for a statement, and certainly he will be.

Mr. WIDNALL. Thank you, Mr. Chairman.

I am making this statement on behalf of the Republican members of this committee.

We are deeply concerned over the need for legislation removing the gold cover from Federal Reserve notes. We are unified in calling for full and complete hearings before action is taken on this most important question.

Three years ago, we cooperated with the Johnson administration when we agreed to brief committee hearings and prompt action on the bill to remove the gold cover from Federal Reserve deposits. Then, as now, we were told that favorable action would reinforce world confidence in the future of the dollar; that by putting more gold chips on the table we would assure the world that we were not bluffing in our desire to maintain the sanctity of the dollar.

Then, as now, the administration tried to convince the Nation and the world that our balance-of-payments deficits could be cured if private industry and banking "temporarily" cut back on their profitable worldwide investments. With a shrug of the shoulders and a curious sense of national purpose, Congress, the public, the media, and business and banking willingly joined forces with the administration in that "voluntary" effort.

In the 3 intervening years the plight of the dollar has gone from bad to worse. During that time the congressional committees with legislative jurisdiction over international monetary affairs—primarily ours—have ignored the growing payments crisis, apparently hoping that the problem would go away. Businessmen and bankers did little more than grumble, while hailing every administration promise that suspension of the temporary voluntary restraints program was just around the corner. Fortunately, many of our Nation's top experts in the field of international finance resisted the paths of least resistance by repeatedly asserting the dangers of existing policies. Few of us listened.

We are here this morning more at the request of international bankers and speculators than of the Johnson administration. Our chronic balance-of-payments problem has put us in the unenviable position of having to respond to those in foreign lands who threaten to cash in their dollar balances for gold unless we adopt their monetary and fiscal dictates. The political course would be to condemn De Gaulle, condemn the gnomes of Zurich. While they deserve to be criticized for their shortsighted actions, to vent our frustrations in this manner alone would be as fruitless as throwing over the poker table when your opponents failed to be bluffed out of a large pot.

The name of the game has been and always will be "confidence." The administration apparently feels that confidence can be restored by making available for sale the last remaining gold, while adopting short-run expedients aimed at short-run gain and long-run disaster. The President's latest balance-of-payments program clearly and unmistakably aims at funding deficits caused by Government actions with artificially induced receipts from private investment while asking Aunt Nellie to postpone her foreign vacation. Many foreigners applauded the President's action, not because their confidence was restored but because they welcomed the mandatory controls over competition from U.S. direct investments. Many who should know better here at home reluctantly go along with the program because they believe shortsighted policies can be tolerated for a short time. What they fail to realize, however, is that, to the extent the President's balance-of-payments program significantly reduces the deficits, the need for undertaking a full review of our economic policies here at home and our commitments abroad can be postponed. In short, history has taught us that the degree to which shortsighted expedients are successful insures their continuation. And, if we continue to downgrade the role of U.S. capital movements and direct investments overseas—where our comparative advantage vis-a-vis the rest of the world is greatest—then surely our Nation's future world leadership will be threatened.

Before Congress accepts at face value the priorities established in President Johnson's balance-of-payments program, the appropriate committees of Congress should undertake extensive hearings. Because a major portion of the current program finds its authority in section 5(b) of the 1917 Trading With the Enemy Act (12 U.S.C. 95a) of the banking statutes, our committee would be the most appropriate choice. Such hearings should explore the following subject areas of immediate concern:

1. U.S. ability to maintain or increase balance-of-trade surpluses. Since 1962, the U.S. share of total world export of manufacturers significantly has declined. Without Public Law 480 and foreign aid grant programs tied to U.S. exports our trade surpluses would be virtually eliminated.

2. The extent to which the growth of "regionalism" and worldwide commodity agreements have adversely affected our balance of trade, together with a full review of foreign nontariff barriers.

3. Full disclosure to the extent possible of the factors accounting for the huge fourth quarter—1967—balance-of-payments deficit and the extent to which further liquidation of U.S. securities by foreign nations could cause recurrent balance-of-payments dislocations.

4. A full review of the role of the gold speculator and the extent to which various devices could be employed to counter gold speculation.

5. The extent to which the United States can maintain bilateral and multilateral assistance at current levels in view of the Treasury Department's admission that "tied" grants and loans create a significant degree of substitution resulting in little net gain in exports.

6. Whether or not domestic labor costs have adversely affected U.S. exports to the degree suggested by the Johnson administration. Treasury figures indicate they have not.

7. The adverse impact on U.S. trade balance that would be caused by threatened postponement of purchases by foreign-flag carriers of U.S. commercial jet aircraft in retaliation for the proposed clampdown on U.S. tourist travel. In this connection, the balance-of-payments impact of the F–111 contract cancellation by the United Kingdom and the degree to which the balance-of-trade surplus depends upon arms sales.

8. The charge that less than 10 percent of U.S. dollars accruing to the Government of Vietnam from piastre sales for the support of U.S. forces in Vietnam find their way back to the United States. The House Committee on Government Operations estimates that for 1967 the Government of Vietnam expended about $300 million of its foreign exchange derived in this manner for imports, and that less than 10 percent will be spent in the United States.

9. Long-term effects on U.S. overseas business interests caused by controls over capital flows, direct investments, and forced repatriation of profits. Does the President's program suggest extraterritorial law with regard to the internal operation of joint ventures?

10. The extent or lack of international cooperation in the operation of the London "gold pool."

We recognize that the primary responsibility for conducting our international monetary affairs rests with the executive branch. Nevertheless, the role of Congress is one of review and independent assessment. Congress has failed to assume this responsibility in connection with a specific legislative request of major importance, such as the bill before us.

We urge that these hearings on the gold cover bill include witnesses representing the best talent available from business, labor, and banking, as well as the academic community.

Thank you, Mr. Chairman.

Chairman PATMAN. I wanted to pursue just briefly the question I asked Mr. Fowler about U.S. notes.

Now, it is my understanding that the passage of this bill will not affect any money that is now outstanding?

Mr. BARR. That is correct.

Chairman PATMAN. All money will be on a parity, one with the other?

Mr. BARR. That is correct.

Chairman PATMAN. All legal tender?

Mr. BARR. That is correct.

Chairman PATMAN. If you owe a debt or if you owe taxes, or any obligation that you have, you may tender to the person to whom you owe the debt a certain amount of any of this money?

Mr. BARR. That is correct.

Chairman PATMAN. U.S. Federal Reserve notes, Treasury notes of 1890, pennies, nickels, dimes, quarters, what have you, all must be accepted in payment of debts.

Mr. BARR. That is correct.

Chairman PATMAN. It pays the debt?

Mr. BARR. Yes.

Chairman PATMAN. So I wonder what better money you can have than that, especially with our huge debts and taxes today.

Now, Governor Robertson, you agree with that, do you not?

Mr. ROBERTSON. Very much so. This is the law of the land.

Chairman PATMAN. It is our understanding there is a law—it has been a long time since I have gone into it—that U.S. notes cannot be retired without an act of Congress.

Mr. BARR. That is correct.

Chairman PATMAN. That there are $322 million approximately, known as the Lincoln greenbacks. That is correct, too?

Mr. BARR. Yes, sir; $322 million.

Chairman PATMAN. And that money is on a par with the Federal Reserve notes. If this bill passes they will still be on a par with Federal Reserve notes and just as good as Federal Reserve notes for any purpose in the world——

Mr. BARR. Yes, sir.

Chairman PATMAN (continuing). By any person who desires to use them.

Mr. Widnall, would you like to ask questions?

Mr. WIDNALL. I will forgo asking questions at this time.

Mr. BARR. Mr. Chairman, Mr. Widnall alluded to several factors in his statement. I am prepared to address any of these factors. He enumerated 10 points. I am prepared, as I listened to the statement, to comment on any of them except Vietnam, and I can supply that for the record.

I am prepared to comment on any area, although we are here to testify on the bill that is pending before the committee. I thought it was only responsible and reasonable that we be prepared to answer any questions that this committee may want to ask in the entire international financial area.

Mr. WIDNALL. Well, the particular question that I pose is whether or not domestic labor costs have adversely affected us to the degree suggested by the Johnson administration. The Treasury figures indicated they have not. Why is this?

Mr. BARR. I will supply this for the record, sir. But I can give you a tentative answer at this time. It would seem that U.S. labor costs, as an element in the cost of what we produce declined in the period 1960–65, taken as a whole. Recently, however, there has been a turnaround. I am not certain whether or not this turnaround has been reflected in recent figures. But over the whole period there was an actual decline in the cost of the labor input in the production of U.S. goods and services. I will submit for the record further information.

(The information referred to follows:)

The data on comparative unit labor costs given in Table 7 of the Treasury document were full-year averages, and thus not available beyond 1966. Even these figures show, however, a 2-point increase in the index of U.S. unit labor costs in 1966 over 1965, compared with decreases of 3 and 4 points, respectively, for France and Italy.

A similar comparison through September 1967 of available quarterly data on this subject (expressed in terms of percentage changes from year-earlier levels) is shown in the following table.

RECENT TRENDS IN UNIT LABOR COSTS IN MANUFACTURES

Years and quarters	Percent increases (from year-earlier levels)				
	United States	United Kingdom	Japan	Germany	France
1965 (average)	−0.7	−4.4	6.0	7.0	2.7
1966:					
I	.9	4.5	4.2	4.2	−3.5
II	2.9	6.2	2.5	5.8	−.9
III	2.5	3.5	−3.2	5.6	−2.6
IV	2.8	4.4	−4.8	2.4	.9
1967:					
I	5.5	.9	−5.6	0	.9
II	5.4	−.8	−.8	0	.9
III	5.5	NA	4.2	NA	NA

Sources: Based on available quarterly (or monthly) indexes: for the United States, from Business Cycle Developments, Department of Commerce; for other countries, from Economic Review, published by (United Kingdom) National Institute of Economic and Social Research. These data differ from those given in table 7 of the Treasury document "Maintaining the Strength of the U.S. Dollar in a Strong Free World Economy" in that the latter are based on GNP accounts (not available on a quarterly basis for most industrial countries) whereas the quarterly data are based on production indexes.

What these more recent data show is that:

Our own unit labor costs, following a persistant though moderate downward trend over the 4 years 1961–65, turned upward again early in 1966 and have since the beginning of last year been rising at an accelerated rate;

Whereas the corresponding cost indices of several of our major foreign competitors, which had during the 1961–65 period been rising at rates ranging from 3.5 to 6 percent per annum, have since the beginning of 1966 either leveled off sharply or actually declined.

The recent sterling devaluation will, of course, tend to add to the weakening of our international competitiveness implied by this new adverse trend in our domestic currency costs relative to the United Kingdom and other countries.

The improving trend in our relative cost and price position which was evident through the early 1960's did not, admittedly, bring as much improvement in our export position and trade surplus as would have been necessary to eliminate our payments deficit. However, it was certainly one of the important factors helping to offset various other developments adversely affecting our trade position, such as the continuing growth of effective manufacturing capacity in countries such as Italy and Japan.

In considering either this earlier period of relative improvement or the current danger of relative deterioration in our cost and price competitiveness internationally, there are several further points as to the causal relationships between cost and price developments and international trade patterns which should, however, be noted:

The trade effects of changes in relative costs and prices are not immediate, but instead occur gradually, after some delay. By the same token, however, they also tend to persist for a considerable period.

In addition, there are many other factors which—particularly in the short run—also affect the levels of both our exports and our imports. These include: (a) absolute and relative changes in over-all levels of business activity here and abroad; (b) the commodity and country pattern of the aggregate increases in world demand; (c) the extent to which we or our competitors have slack resources available; and (d) changes in tariff structures and various other arrangements affecting trading relationships.

Mr. Widnall. In the book that you issued in January, "Maintaining the Strength of the United States Dollar in a Strong Free World Economy," on page 79 there is an analysis in table 7 of the unit labor costs of manufacturing in selected industrialized countries since 1961. The U.S. figures are quite constant—1962 to 1966.

Mr. Barr. The costs declined through 1965, but rose in 1966.

Mr. Widnall. With all the other countries, with the exception of Canada, there is a marked increase, very marked increase.

Mr. Barr. That is correct.

Mr. Widnall. Now, at the same time, our figures in connection with trade are going down, our balance-of-payments situation has worsened and worsened badly.

Would you give us, for the record, a breakdown of the fourth-quarter balance-of-payments situation?

Mr. Barr. We do not have those figures yet, Mr. Widnall, and they won't be available until roughly the middle of February. We can't give you a detailed analysis. I can tell you a main cause, however, of the big shift, was the sale by the United Kingdom of $570 million of securities which she held in the United States.

As you realize, the United Kingdom was under pressure. She held these securities and she sold them and that was one of the main reasons for the very large swing in the fourth quarter.

Mr. WIDNALL. The figures, I think, you also issued, show $600 million.

Mr. BARR. $570 million was the amount of securities.

Mr. WIDNALL. To what extent do the other countries hold U.S. Government securities, and to what extent does this pose a threat to future balance-of-payments deficits in the same manner as the fourth-quarter liquidation by the United Kingdom did?

Mr. BARR. Other governments hold U.S. obligations, which they hold in their reserves. The total amount of obligations held by other nations I will furnish for the record. We have a table we can furnish for the record.

Mr. WIDNALL. You will put them in for each country, for the record?

Mr. BARR. Yes, sir.

(The information requested follows:)

The large adverse impact of securities liquidations by the United Kingdom Government on our balance of payments during the fourth quarter of last year represented the final step in the conversion into liquid form of the remaining balance of a large investment portfolio of U.S. corporate securities which the United Kingdom Government had requisitioned from private United Kingdom citizens and firms at the outset of World War II.

While there are no available statistics which would show the existence or extent of possible holdings of U.S. corporate stocks and long-term bonds other than Treasury issues by other foreign governments or central banks, we are not aware of, and have no reason to believe that there are likely to be, any other cases similar to that of the United Kingdom involving signficant holdings of investment portfolios of U.S. stocks and long-term bonds by foreign official institutions.

What the United Kingdom did in the forth quarter, and the reason that this had an adverse effect on our balance of payments, was to convert the remaining balance of these long-term investment holdings into forms that are treated in our balance-of-payments accounting as liquid liabilities to foreigners. This act of converting, therefore, appears as a capital outflow on the liquidity balance.

All of the long-term U.S. securities that we know to be held by other foreign governments and central banks represent either marketable U.S. Government bonds and notes or special nonmarketable Treasury securities, a good part of which are convertible into marketable issues. These foreign holdings of marketable and convertible nonmarketable U.S. Government securities are already included in our statistics on liquid liabilities to foreign official institutions, and for this reason their possible conversion into other types of liquid dollar assets would have no effect on our balance-of-payments deficit.

There follow three tables. The first shows foreign holdings, by country, of U.S. Government bonds and notes. This table includes private foreign holdings as well as official foreign holdings. The second table shows, by country, the special nonmarketable securities held by foreign official institutions. The third table is a summary table showing total official foreign holdings of long-term U.S. Government securities by type since 1959, the first year for which these data are available.

SUMMARY BY COUNTRIES OF ESTIMATED HOLDINGS OF U.S. GOVERNMENT BONDS AND NOTES

[Position at end of period in millions of dollars]

Country	December 1963	December 1964	December 1965	December 1966	1967 May	1967 June	1967 July	1967 August	1967 September[1]	1967 October[1]
Europe:										
Austria	3	3	3	3	3	3	3	3	3	3
Belgium	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Denmark	14	14	14	13	12	12	12	12	12	12
Finland	1	1	1	1	1	1	1	1	1	1
France	6	7	7	7	7	7	6	6	6	7
Germany	1	1	1	1	1	1	1	1	1	1
Greece	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Italy	1	1	1	2	2	9	9	9	9	9
Netherlands	4	5	6	5	5	4	4	4	4	5
Norway	131	98	49	51	51	51	51	51	51	51
Portugal	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Spain	2	2	2	2	2	2	2	2	2	2
Sweden	129	40	24	24	24	24	24	24	24	24
Switzerland	75	79	89	93	91	90	88	87	87	91
Turkey	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
United Kingdom	328	414	553	348	359	364	368	375	379	383
Yugoslavia	----	----	----	----	----	----	----	----	----	----
Other Western Europe	45	48	49	50	50	50	50	50	50	50
U.S.S.R.	----	----	----	----	----	----	----	----	----	----
Other Eastern Europe	7	7	7	7	7	7	7	7	7	7
Total, Europe	748	721	807	605	613	624	626	633	637	646
Canada	687	690	676	692	719	716	717	717	718	716
Latin America:										
Argentina	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Brazil	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Chile	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Colombia	1	1	1	1	1	1	1	1	1	1
Cuba	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Mexico	2	1	(2)	1	1	1	1	1	1	(2)
Panama	10	1	1	2	2	2	2	2	2	2
Peru	(2)	1	1	1	(2)	(2)	(2)	(2)	(2)	(2)
Uruguay	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Venezuela	(2)	(2)	1	1	1	1	1	1	1	1
Other Latin American Republics	2	2	2	2	2	1	1	1	1	1
Bahamas and Bermuda	3	4	4	2	2	2	2	2	2	2
Netherlands Antilles and Surinam	15	16	17	16	16	16	16	16	16	16
Other Latin America	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Total, Latin America	32	25	27	25	24	24	24	24	24	24
Asia:										
China mainland	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Hong Kong	(2)	1	1	1	(2)	(2)	(2)	(2)	(2)	(2)
India	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Indonesia	1	1	1	1	1	1	1	1	1	1
Israel	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Japan	5	5	9	9	9	9	9	9	9	9
Korea	----	----	----	----	----	----	----	(2)	(2)	(2)
Philippines	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Taiwan	2	2	2	2	2	2	2	2	2	2
Thailand	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Other Asia	39	40	38	38	50	50	51	51	51	51
Total, Asia	47	49	51	50	62	62	63	63	63	63
Africa:										
Congo (Kinshasa)	----	----	----	----	----	----	----	----	----	----
Morocco	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
South Africa	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
United Arab Republic (Egypt)	----	----	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Other Africa	9	16	16	15	28	28	28	22	22	22
Total, Africa	9	16	16	15	28	28	28	22	22	22
Other countries:										
Australia	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
All other	(2)	1	1	1	1	1	1	1	1	1
Total, other countries	(2)	1	1	1	1	1	1	1	1	1

See footnotes at end of table, p. 35.

SUMMARY BY COUNTRIES OF ESTIMATED HOLDINGS OF U.S. GOVERNMENT BONDS AND NOTES

[Position at end of period in millions of dollars]

Country	December				1967					
	1963	1964	1965	1966	May	June	July	August	September[1]	October[1]
International and regional:										
International	1,135	827	679	250	172	172	169	169	169	169
European regional	(2)	-----	-----	-----	-----	-----	-----	-----	-----	-----
Latin American regional	84	76	74	75	61	57	58	38	38	38
Asian regional	-----	-----	-----	-----	1	1	1	1	1	1
Total, international and regional	1,218	903	752	325	233	230	227	207	207	207
Grand total	2,742	2,405	2,329	1,713	1,680	1,685	1,685	1,666	1,671	1,679

[1] Preliminary.
[2] Less than $500,000.

Note: Data represent estimated official and private holdings of U.S. Government securities with an original maturity of more than 1 year, and are based on a July 31, 1963, survey of holdings and regular monthly reports of securities transactions.

NONMARKETABLE U.S. TREASURY BONDS AND NOTES ISSUED TO OFFICIAL INSTITUTIONS OF FOREIGN COUNTRIES

[In millions of dollars or dollar equivalent]

End of calendar year or month	Total	Payable in dollars				Payable in foreign currencies						
		Total	Canada [1]	Italy [2]	Sweden	Total	Austria	Belgium	Germany	Italy	Switzerland	Bank for International Settlements
1962	251	----------	----------	----------	----------	251	----------	----------	----------	200	51	----------
1963	893	163	125	13	25	730	50	30	275	200	175	----------
1964	1,440	354	329	----------	25	1,086	50	30	679	----------	257	70
1965	1,692	484	299	160	25	1,208	101	30	602	125	257	93
1966	695	353	144	184	25	342	25	30	50	125	111	----------
1966—November	593	355	144	186	25	238	25	30	----------	125	58	----------
December	695	353	144	184	25	342	25	30	50	125	111	----------
1967—January	767	353	144	184	25	414	25	30	101	125	133	----------
February	767	353	144	184	25	414	25	30	101	125	133	----------
March	766	352	144	183	25	414	25	30	101	125	133	----------
April	766	352	144	183	25	414	25	30	101	125	133	----------
May	784	349	144	180	25	434	25	----------	151	125	133	----------
June	809	349	144	180	25	460	25	----------	151	125	159	----------
July	934	349	144	180	25	585	25	----------	276	125	159	----------
August	1,007	347	144	178	25	660	50	----------	326	125	159	----------
September	1,257	546	344	178	25	710	50	----------	376	125	159	----------
October	1,483	546	344	178	25	937	50	----------	551	125	211	----------
November	1,563	516	314	177	25	1,047	50	60	601	125	211	----------

[1] Includes bonds issued to the Government of Canada in connection with transactions under the Columbia River treaty. Amounts outstanding were $204,000,000, September 1964 through October 1965; $174,000,000, November 1965 through October 1966; and $144,000,000, November 1966 through latest date.

[2] Bonds issued to the Government of Italy in connection with military purchases in the United States.

HOLDINGS OF LONG-TERM U.S. GOVERNMENT SECURITIES BY GOVERNMENTS AND CENTRAL BANKS OF FOREIGN COUNTRIES, END-YEARS 1959-66 and NOVEMBER 1967

[In millions of dollars]

End of period	Liquid holdings: Total	Liquid holdings: Marketable U.S. Government bonds and notes [1]	Liquid holdings: Nonmarketable convertible U.S. Treasury bonds and notes	Nonliquid holdings—nonmarketable nonconvertible U.S. Treasury bonds and notes
1959	966	966		
1960	876	876		
1961	890	890		
1962	751	751		251
1963	1,886	1,183	703	190
1964	2,204	1,125	1,079	361
1965	2,306	1,105	1,201	491
1966	1,116	860	256	439
1967, November	1,619	908	711	852

[1] Estimated on basis of periodic benchmark surveys and monthly reports of securities transactions.

Mr. WIDNALL. Now, after the progress that was made in connection with trade as a result of the Kennedy round, we had high hopes for the present and for the future. It seems that in many instances the gains that we anticipated have been vitiated by taxes and rebates by foreign countries.

Mr. BARR. That is right.

Mr. WIDNALL. I have been reading that there is a move afoot for the United States to enter for the same type of program—I believe it has been mentioned in the press and Ways and Means is seriously considering this type of action. Does the administration support export tax rebate and——

Mr. BARR. Mr. Widnall, you have correctly pointed out that since the Kennedy round has concluded, as we have reduced tariffs, the focus of attention has shifted to the so-called nontariff impediments to trade, border taxes, all sorts of regulations and other matters. The President indicated in his balance-of-payments message of January 1 our concern about these nontariff barriers and indicated our intention to start intensive negotiations with our allies on this subject and also to discuss it with the Congress. That is precisely the position he is in at the moment. We have no formal position as to whether or not we are going to ask for border taxes, border adjustments in this country, such as the Europeans use.

Mr. WIDNALL. On page 115 of "Maintaining the Strength of the United States Dollar in a Strong Free World Economy," at the foot of the page it says, speaking about trade restrictions:

> If, however, a continued movement toward trade liberalization may be expected, the economic justification for some part of these capital flows is lessened.

How does that square with what has happened?

Mr. BARR. Mr. Widnall, I have a different printed copy than you. You are reading from the bottom of page 115?

Mr. WIDNALL. Was this abandoned? My copy has a gold cover.

Mr. BARR. Would you read that again? Here you are:

> If, however, a continued movement toward trade liberalization may be expected, the economic justification for some part of these capital flows is lessened.

Would you repeat the question? I see the quotation.

Mr. WIDNALL. "If, however, a continued movement toward, trade liberalization may be expected"——

Mr. BARR. Right.

Mr. WIDNALL (continuing). "The economic justification for some part of these capital flows is lessened."

Mr. BARR. And your question is? The reason for that statement, sir, is that there has been a feeling in U.S. industry that if the border taxes and other nontariff barriers, including the tariffs themselves, are maintained at a high level in the Common Market, then they only have one chance to compete and that is to get into the Common Market with a direct investment, to build a plant within the Common Market itself.

If these border taxes, if the tariffs themselves are reduced, there is less need to build a plant abroad—rather than export from the United States. That is the thrust of this statement.

Mr. WIDNALL. Thank you. My time has expired.

Mr. BARRETT. Mr. Chairman, I just have a short question. I would also like to take the opportunity to welcome our former colleague here. He has always indicated that he is very knowledgeable in this field and I am certainly very happy when a member who leaves this committee demonstrates his ability elsewhere.

I was wondering, from the statement that the chairman made, does this exclude the printing of all gold notes?

Mr. BARR. Mr. Barrett, gold notes have not circulated domestically in the United States since 1934.

Mr. BARRETT. I am speaking of the gold certificate, for example. It would eliminate the 25-percent gold reserve requirement——

Mr. BARR. That is right.

Mr. BARRETT (continuing). From the Federal Reserve notes and, of course, it would also eliminate the $156 million reserve held against the U.S. notes and Treasury notes of 1890.

Mr. BARR. Yes, sir.

Mr. BARRETT. Now, we will discontinue these gold certificates which have served as a so-called reserve with respect to much of our circulating currency.

I was wondering now what will be the impact on the States and the world psychologically, if this move is made.

I would like to say to you gentlemen, for example, in Turkey, many people buy gold and they have no interest in the bank and they take the gold and use it in a way that they think it is best protected.

What effect will it have on people of countries such as Turkey?

Mr. BARR. Mr. Barrett, the position of anyone outside the United States is not changed in the slightest. The only thing we are saying to them is that the gold that we have available behind our international commitments is completely available. We are removing any domestic limitation and it is completely available to meet our international commitments.

The position in the United States is not changed either, sir.

You cannot, if you were to give me $35 today and say give me an ounce of gold, I would have to tell you it is illegal, I couldn't do it. So your position is not changed. The only thing that is removed, sir, is a potential hindrance to the normal issuance of currency that would apply to the Federal Reserve Board. That is the only thing that is changed.

Mr. BARRETT. I just want to point this out. Just about 2 weeks ago I was talking to a gentleman and I asked him where do you live and he says in an upside-down world. I was wondering, are those people who are not knowledgeable about gold and who are preserving gold for their future and old age protection, what effect will it have, the psychological effect it would have on those people? Will it create a disturbance in other countries? I am sure it will not in the banking industry and among all knowledgeable people.

Mr. BARR. Let's put it this way: Suppose the Congress refused to give us this legislation today. That would mean that at the most in 2 years we would be up against the dilemma. Then the country would be faced with some difficult alternatives. I suppose what could happen, the Federal Reserve Board could quit issuing any more currency and we would not have any currency to meet the business transactions of the United States. And, secondly, the people you talk about and other nations who do, as you put it, put away gold for their security, would I believe, be more concerned if we do not make it clear that our gold supply is fully available for international use.

This, I think, could be extremely disturbing in the world itself.

Chairman PATMAN. Mr. Clawson.

Mr. CLAWSON. Thank you very much, Mr. Chairman. Mr. Barr, it has been suggested that I be a punster and find out if your appearance here this morning is an indication of our willingness to go down to the very last bar of gold?

Mr. BARR. I would subscribe to that statement, sir.

Mr. CLAWSON. We are willing to go that far?

Mr. BARR. Yes, sir.

Mr. CLAWSON. The statements of Mr. Fowler and Mr. Martin indicated that we may have sufficient free gold to carry us through this year; and you just indicated within 2 years we will be faced with a very critical emergency situation, unless we enact legislation of this type.

The reason for my prefacing my question with that statement is whether or not 3 or 4 weeks of very extensive hearings in depth by this committee would interfere with the situation as it now exists—if we took that long in order to really accomplish the purposes of this committee in delving into the problems?

Mr. BARR. Mr. Clawson, I have learned over the years not to comment upon the legislative possibilities of Congress. We are here today with a recommendation. We are urging its prompt enactment. In urging its prompt enactment, I would not be so presumptuous as to tell you how to proceed to resolve the issues that are before you. You can proceed, of course, as you want.

I do want to make it clear and I want to clear up any misunderstandings, while the Secretary and Chairman Martin said that it is possible that this would last for 2 years, I want to indicate that it is highly unlikely. They assumed that there would be no losses in the London gold market, that no nations would ask to convert dollars into gold. That is a very, very unlikely assumption, sir.

Mr. MIZE. Why do you say that, Joe?

Mr. BARR. Simply because there are $33 billion held by foreigners and there is an active market in London. The world today is going through the rather dramatic experience of the British devaluation, and with a world in today's situation, Mr. Mize, I think that we must make it unequivocally clear that we are standing by our international commitments. I can't predict what would happen.

If there were no gold sales by the United States in the year that is coming up, I would be very surprised indeed.

Mr. CLAWSON. The Board still has the power under the emergency provision to use their authority up to 30 days on the 25-percent coverage?

Mr. BARR. Yes, sir.

Mr. CLAWSON. In an emergency situation this could be exercised?

Mr. BARR. It has been used very rarely—1919, 1920, and 1933—and only in a crisis situation. And a crisis situation is precisely what we want to avoid.

Mr. CLAWSON. If we took 1, 2, or possibly even 3 months before Congress finally acts on this, do you think we would reach a crisis situation in that length of time? I thought the indication was we would not.

Mr. BARR. I wouldn't care to predict. We have made our statement and we have urged prompt action. What we mean by prompt action and what the Congress determines prompt action to be may be something else.

Mr. CLAWSON. That is what I am trying to find out.

Mr. BARR. We would like to have prompt action. I want this committee to explore the issues and we will be delighted to do so with you on anything you want. The only thing is that I would hope that I would give you, if I had any druthers, as we used to say in Indiana, I druther have this legislation out in 30 to 45 days. If this is not possible because of the congressional schedule, we will meet it.

Mr. CLAWSON. We have discussed very briefly the gold holdings of the countries that are involved. It is indicated by some of the figures that I have looked at that holdings by Belgium, Germany, the Netherlands, Switzerland, and the United Kingdom, amount to about $14.6 billion. France, when they were participating, held $5.2 billion more, making a total of $19,827 million, with the United States having approximately $13 billion, or $32.8 billion total. This then gave the United States holdings of approximately 40 percent?

Mr. BARR. It was about 42 percent.

Mr. CLAWSON. We were participating, however, to the level of 50 percent, as far as our participation in the pool is concerned and since France's withdrawal, we still now have about 47.5 percent?

Mr. BARR. Right.

Mr. CLAWSON. We are participating to 59 percent?

Mr. BARR. Yes, sir.

Mr. CLAWSON. Do you think this needs reevaluation and restudy for the balance of the participation in the situation as a whole?

Mr. BARR. Perhaps, Mr. Clawson, there can be a slight adjustment here. But, as you indicate, it is not large, in the area. Maybe we are off 5 or 6 percent. If they increase by 5 percent, we came down by 5 percent, and we would be in the rough balance that you have indicated.

Mr. CLAWSON. In a critical situation this might mean a great deal to our country, in connection with the amount of gold we have on hand as free gold?

Mr. BARR. Possibly.

Mr. CLAWSON. My time has expired. I have quite a number of other areas that I would like to explore and I hope we can come back.

Chairman PATMAN. Mrs. Sullivan.

Mrs. SULLIVAN. I would like to have you clarify one of your remarks to Mr. Barrett. You said that it is illegal at the present time for you to sell an individual an ounce of gold for $35. Is that just today? If this legislation is passed, would it still be illegal?

Mr. BARR. No, madam; it has been illegal since 1934. When I say we can't sell an ounce of gold, I mean you cannot hand me a bill and ask me to give you cold goins or gold bullion in exchange. If you have a license, you can come to the U.S. Mint and buy gold under the licensing provision.

Mrs. SULLIVAN. So the passage of this legislation would have no——

Mr. BARR. Would have no effect whatsoever on the currency.

Chairman PATMAN. Mr. Johnson.

Mr. JOHNSON. Now, I would like to ask you something. Mr. Fowler seems to predicate that there are two reasons for wanting to remove this cover. One is, he says at the conclusion, "We can continue to be assured that the Federal Reserve will be able to supply appropriate amounts of currency to meet the needs of our growing economy for cash."

I notice in the Federal Reserve bulletin that Mr. Robertson put out in 1967, that in 1960 there was $33 billion worth of currency outstanding, and right now there is $45.9 billion, as of the end of November 1967. I notice in 1965 the currency was increased in circulation by $2.5 billion, and in 1966, by $2.3. But in 1967, the currency increase in circulation was only $1.4 billion. Why, 1967 being a year when we needed expansion of our currency, was currency expanded only $1.4 billion?

Mr. ROBERTSON. I would take another look at that table because I doubt that it includes the entire year of 1967.

We don't have those figures as yet.

Mr. JOHNSON. By the end of November, the currency outstanding was $45.9 billion. The year before, $45.3 billion. So that is a $1.4 billion increase in the first 11 months.

Mr. ROBERTSON. The figures in December would add to that. So, just don't weigh it too heavily. The volume of currency goes up or down, not depending upon what we think it should be, but depending upon what the needs are as they come to us through the banks, the commercial banks. When people need more currency, the commercial banks come in and get it from the Federal Reserve banks. We do not control the supply. The people of this country control the supply. So that the total volume will vary from year to year, month to month, day to day, and week to week.

Mr. BARR. Mr. Johnson, may I add that those 1965–66 figures, I think, are distorted. As you will remember, this committee eliminated the silver certificate in 1964. There was a surge of Federal Reserve notes in circulation in 1964, 1965, and 1966, as the silver certificates were gradually retired and burned up, and replaced by Federal Reserve notes. That accounts for a rather large swing in those years.

Mr. JOHNSON. I thought your answer would be a self-serving one, by your saying that you inflated currency only $1.4 billion last year up to November because you didn't have the 25-percent gold backing, you were scared of the ceiling, so you didn't issue currency.

Mr. ROBERTSON. Let me clarify that immediately. The amount of gold which we have in this country has no bearing whatsoever on the amount of Federal Reserve notes outstanding.

As I stated earlier, the amount of Federal Reserve notes that are issued depends upon what the needs of the people happen to be at any given time. We are not down to the level where we would have to even suspend the gold cover at this time. We still have $1.3 billion of free gold. The only purpose now of asking for this legislation is to remove any anticipatory doubts about their ability to get gold because of the diminution of that free gold supply.

Mr. JOHNSON. And if we were to remove this 25-percent gold cover you, in effect, will not be restrained and you can issue currency just as rapidly and inflate it in any way you want, depending upon——

Mr. ROBERTSON. Mr. Congressman, we have not been restrained in any way by the gold cover, and we will be in exactly the same position after this gold cover is removed as we are now. Under the law, we have the power to suspend the gold cover.

Mr. JOHNSON. Then the statement by Mr. Fowler, that we have to remove the gold cover so we can continue to supply appropriate amounts of currency is not a statement of fact.

Mr. ROBERTSON. Yes; it is a fact. We are trying to keep the free gold supply from getting down so low people feel they have to come in and get it while the getting is good. This is what we are trying to avoid. By making it very clear to the world right now, not in any panicky situation or crisis, that our entire gold supply is available for the primary purpose for which it exists; namely, the backing of the international monetary mechanism of this whole free world.

Mr. BARR. May I reinforce one statement the Governor has made? We don't pay our bills in the United States with paper money or coins. We write checks. And those checks are dependent upon Federal Reserve deposits and tax collections. You must draw a distinction between the deposits and coins. We make coins when we get an order from the Federal Reserve banks and the Federal Reserve banks put in an order to us for coins. When they get an order from the commercial banks of the United States and the commercial banks put in the order for coins, when the people with whom they are dealing say, "we want more coins," and it is precisely the same situation with Federal Reserve notes, Mr. Johnson.

The chain of reaction starts with the people who say, "we want more currency, we need more in our transactions." The bank asks for it from the Federal Reserve and the Federal Reserve turns to us and we print it in the Bureau of Engraving and Printing. There is no inflation, no payment of bills, except the response to the needs of the people for coin or paper to perform commercial transactions.

Mr. JOHNSON. I notice in this Federal Reserve bulletin that as the currency outstanding in the United States increases, the amount of Government bonds held by the Federal Reserve System almost equals the amount of currency you issue. Maybe that is a coincidence.

Mr. ROBERTSON. Pure coincidence. We buy or sell Government bonds for the purpose of increasing or decreasing the availability of money and credit in the country, and how it will jibe with any other particular statistics is coincidental.

Chairman PATMAN. Mr. Moorhead.

Mr. MOORHEAD. Thank you, Mr. Chairman.

Mr. Barr, on page 2 of Secretary Fowler's statement, he said something like this:

* * * the strength of the dollar depends upon the strength of the U.S. economy.

Again, on page 4—

The value of the dollar is dependent upon the quantity and the quality of goods and services which it can purchase. It is the strength and soundness of the American economy which stands behind the dollar.

This would be true, both domestically and internationally, would it not?

Mr. BARR. That is precisely correct.

Mr. MOORHEAD. And would you not say that this is the more important aspect, more important than whether there is gold convertibility?

Mr. BARR. Absolutely. There is no question about it.

Mr. MOORHEAD. Let me read you an excerpt from a Washington Post editorial of January 2. It says that—

* * * there is nothing immutable in the system of fixed exchange rates; indeed, nothing patently advantageous. The time has come for a frank debate on the issue of whether we would not all be better off if the dollar were permitted to flow freely in the foreign exchange market.

Would you care to comment on that sentence?

Mr. BARR. I would be delighted to comment on that sentence. It was written by an editorial writer and theoretical economist who has not been charged with the operating responsibility of maintaining a viable international monetary system. Theoreticians like to speculate in this area.

But I would like to point out that the real test of whether an international monetary system is working or not is whether or not it facilitates and lubricates the flow of trade in the world.

Let me give you the figures. In 1959, the free world trade was $106,700 million. The latest figures we have, latest estimate for 1967, is $200 billion. This trade has grown up, Mr. Moorhead, around a solar system, where the dollar is fixed, a fixed point, fixed in its relationship to a gold price. Other currencies are also fixed, as you know, by operations in the exchange market moving against that central point.

While economists love to talk about it and dream up other devices, the burden of proof that this system can be improved upon is on them, because it has facilitated the greatest expansion of free world trade that the world has even seen.

I am not saying that any system is immutable. The only thing I am saying is that the system has served the world very, very well. I am not ready to junk it, for editorial writers or economists.

Mr. MOORHEAD. I am not suggesting that this is the time to junk things. But I am suggesting that it does appear that the importance of gold over the long haul is changing.

Mr. BARR. That is correct.

Mr. MOORHEAD. I further feel that the measures which have been suggested in the January 1 statement, and now in the removal of the gold cover, are not long-term solutions to a changing situation, but merely a way of finding some time so you can get some long-range

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solutions. What I am trying to do in this discussion is to be sure we are working toward the long-term solution, which I can see reflected in the next 4 or 5 or more years.

Mr. BARR. Let me give you that long-term solution that the President recommended in his January 1 message.

No. 1, pass the tax bill. As it has been pointed out in the testimony today, Mr. Widnall has alluded to it, a crucial factor is not gold. And, as you pointed out, the crucial factor is the strength and stability of the U.S. economy. It can't get ahead of us, and we cannot price ourselves out of the world market.

We must pass a tax bill and we must have a tough restraint on all of our Federal expenditures while in Vietnam, and we must maintain internal discipline.

No. 2, we have moved in the Kennedy round to pull down the trading barriers.

The President did announce, as I mentioned to Mr. Widnall, that we are now preparing to look closely at the nontariff barriers that all nations have practiced against us.

These are the long-run approaches to the problem of maintaining the strength of the U.S. economy in the world. And, incidentally, the U.S. dollar. But mainly, it is the strength of the U.S. economy.

Mr. MOORHEAD. I have serious doubts about these proposals but if there is no alternative I would hope that, No. 1, these interferences with the individual American's freedom of travel; and No. 2, the market freedom of investments, crossing over borders, would be thought of as temporary measures.

Mr. BARR. The President clearly indicated that. The President clearly indicated that he took these steps with the greatest reluctance, and they were temporary measures.

We do not desire to restrain direct investment. Clearly, as Mr. Widnall pointed out, this is one of the strongest parts of the U.S. economic position, vis-a-vis, the whole world. The only thing we are saying, however, is that there is a pace at which direct investment can move, and if it moves beyond that pace perhaps it is unsustainable. So we are temporarily restraining it at this juncture.

We are saying the same thing about tourism.

When I sat on this committee 10 years ago—almost 10 years ago—the tourist deficit in the United States was a billion dollars. It has doubled now to $2 billion and no other nation in the free world can earn that kind of surplus to go all over the world.

These are the issues we face as a free nation. The temporary measures that the President has asked us to undertake at this juncture are necessary. But beyond that, it is the long-term approach of keeping this country strong in its position with the rest of the world.

Chairman PATMAN. Mr. Stanton.

Mr. STANTON. Thank you, Mr. Chairman.

Mr. Barr, in your three-point program for the salvation of the United States, you left no room for reduction of Federal expenditures.

Mr. BARR. I think I did. The record will indicate—maybe I didn't speak loudly when I got to that point. But it is certainly a definite part of it. We asked the Congress and Congress agreed last year to cut 1968 appropriations by $10 billion, and I think the spending total was, roughly, four. And I can assure you we are exercising every possible kind of restraint, including in the international area a directive, which I would like to submit for the record. The President of the United States is instructing that all overseas personnel be reduced by 10 percent, and for the executive branch of the Government, to stop this traveling. We are not referring to you gentlemen. You will have to work out your own salvation.

(The information referred to follows:)

THE WHITE HOUSE,
Washington, January 18, 1968.

To the Heads of Executive Departments and Establishments.
Subject: Reduction of Overseas Personnel and Official Travel.

Today I sent the attached memorandum to the Secretary of State and the Director of the Bureau of the Budget directing them to undertake a four-part program to reduce United States personnel overseas. I expect each Department and agency to cooperate fully in this endeavor.

In addition, I hereby direct the head of each Department and agency to take steps to reduce U.S. official travel overseas to the minimum consistent with the orderly conduct of the Government's business abroad. I have asked private U.S. citizens to curtail their own travel outside the Western Hemisphere in the interest of reducing our balance of payments deficit. Federal agencies should participate in this effort.

The policy applies particularly to travel to international conferences held overseas. Heads of Departments and agencies will take immediate measures to

reduce the number of such conferences attended.

hold our attendance to a minimum and use U.S. personnel located at or near conference site to the extent possible.

schedule conferences, where possible, in the U.S. or countries in which excess currencies can be used.

You should present your plans for travel to international conferences held overseas to the Secretary of State, who, with the Director of the Budget, will undertake a special review of this matter.

This directive shall not apply to

travel necessary for permanent change-of-station for U.S. employees, for their home leave, and for medical and rest and recuperative leave.

travel made necessary by measures to reduce U.S. employment overseas outlined in the attached memorandum.

travel financed from available excess foreign currencies.

You are requested to submit to the Director of the Budget, not later than March 15, a statement on the actions you have taken to reduce all types of overseas travel, the results expected from such actions, and your recommendations as to any additional measures that might be taken.

LYNDON B. JOHNSON.

Attachment

THE WHITE HOUSE,
Washington, January 18, 1968.

Memorandum for the Secretary of State and Director, Bureau of the Budget.
Subject: Reduction in U.S. employees and official travel overseas.

As a part of my program for dealing with our balance of payments problem, announced on New Year's day, I would like you jointly to take the specific measures to reduce U.S. employment and curtail official travel abroad, as outlined herein. Within the Department of State, the Senior Interdepartmental Group, chaired by Under Secretary Katzenbach, shall serve as the focal point for carrying out this directive.

You should make these reductions in a way which maintains the effectiveness of our international programs. I would like you to give particular attention to personnel reductions which can be made through relocation and regrouping of functions, the elimination of overlapping and duplication, the discontinuance of outdated and marginal activities, and a general streamlining of operations.

I. REDUCTION IN U.S. PERSONNEL OVERSEAS

This directive applies to all employees under the jurisdiction of U.S. diplomatic missions and includes the representatives of all U.S. civilian agencies which have programs or activities overseas. It also includes military attaches, Military

Assistance Advisory Groups, and other military personnel serving under the Ambassadors. It does not apply to U.S. personnel in Vietnam.

The Secretary of Defense has already initiated measures to reduce staffing of the military assistance program. I am asking the Secretary to complete these studies in time to support the goals outlined below.

You are directed to take the following actions:

1. *As a first step, you should proceed, with appropriate participation by U.S. Ambassadors and agencies, to reduce the total number of American personnel overseas by 10 percent,* with reductions of at least this magnitude applied to all missions of over 100. Similar reductions should be made in employment of foreign nationals and contract personnel. Your decisions on this first phase, which shall be final, shall be completed by April 1.

2. *You should also initiate a special intensive review of our activities and staffing in 10 countries with very large U.S. missions.* Your objective, in this second step, should be to reduce U.S. employment by substantially more than the 10 percent immediate reduction taken in the first step. Your final decisions should be made on this phase by August 1.

3. *As a third step, you should proceed to extend these intensive reviews of U.S. activities to other countries beyond the first 10 as rapidly as feasible.*

4. *Simultaneously, you should initiate special studies from Washington of functional areas* aimed at reducing instructions, assignments, and activities which unnecessarily create the need for maintaining or increasing overseas staff, e.g., reporting requirements, consular work, and administrative support.

Clearly, reductions of this magnitude will involve major changes in agency staffing and personnel plans. I am asking Chairman Macy of the Civil Service Commission to assist agencies in solving attendant personnel problems and in facilitating the reassignment of employees returning to the United States.

II. CURTAILMENT IN OFFICIAL TRAVEL

I am requesting all Department and agency heads to reduce official travel outside the U.S. to the minimum consistent with orderly conduct of the Government's business. I would like you to give special attention to measures to minimize travel to international conferences.

By April 1, I would like you to report on the actions taken in this regard and to recommend any additional steps required.

LYNDON B. JOHNSON.

Mr. STANTON. Mr. Robertson, I lost you when you were talking to Mr. Johnson on any restraint we have on the amount of Federal Reserve notes in this country at this time.

Mr. ROBERTSON. The gold reserve does not restrain us because we are not down to the restraining point. If we were, we could suspend the gold cover under the power which the Congress has given to us, for a 30-day period, and then renew it every 15 days. But when you get to this point, then you do create a lot of doubts in the world as to whether or not dollars can be converted into gold. And that is what we want to avoid.

Mr. STANTON. The reason I question that, is that Mr. Multer, 3 years ago, asked Mr. Dillon that same identical question and he said, "Presently, the maximum amount of Federal notes that may be issued by the Federal Reserve bank is fixed by law as a result of our 25-percent cover." Mr. Dillon said, "That is correct, it is the 25-percent cover. There is a 25-percent cover, and that is the only thing that fixes the maximum amount."

Mr. ROBERTSON. I stand on my answer.

Mr. STANTON. I wish to clarify your answer with that of Mr. Dillon 3 years ago.

Mr. ROBERTSON. As you read it, and I state it, they sound to me absolutely contradictory. I don't back down a bit from my position.

Mr. BARR. Mr. Stanton, may I indicate, and add one little thing to it. Mr. Robertson, of course, is correct in that they can waive the cover requirement down to 20 percent. But if they go below 20 percent, then there is a tax that is added to the discount rate for every 2½ points it drops.

Mr. STANTON. And lower if it goes to 15?

Mr. BARR. Yes, sir.

Mr. STANTON. I am familiar with that. In comparing this hearing today with the one of 3 years ago, it was made very clear that the future of the subject of the 25-percent gold cover rested in our solving of our balance-of-payments problem. It was not then a question, primarily, of the availability of dollar cover on our money.

Mr. BARR. That is correct.

Mr. STANTON. Would you say, Mr. Barr, our attempt to balance our payments has been a failure?

Mr. BARR. No, sir; I read those hearings rather carefully, and at the time when Secretary Dillon was testifying before this committee he had good reason to be rather optimistic. The second quarter of 1965 provided the first surplus, of $200 million, in our accounts since 1961, and the second quarterly surplus since 1957. The next quarter, however, saw the buildup in Vietnam. This is when we moved about 150,000 troops almost immediately to Vietnam.

This entailed a very large additional foreign exchange cost—now at the rate of about a billion and a half a year—for Vietnam. In spite of these added Vietnam costs, we did pull down our liquidity deficit in calendar 1966 to $1.3 billion. We cut down from a deficit of $2.8 billion in 1964 to $1.335 billion in 1965. It ran $1.357 billion in calendar year 1966. It will run at a rate in excess, as we have indicated, of $3.5 billion in 1967.

Mr. STANTON. Mr. Barr, you brought up the subject of Vietnam again. I do notice that some of us here have pointed out that the Government Operations Committee of Congress has estimated for 1967 that the Government of Vietnam is spending about $300 million of its foreign exchange, for exports, and that less than 10 percent was spent in the United States. Do you have any comment to make on that?

Mr. BARR. I will have to supply that for the record. I am not an expert on the operations in Vietnam.

Mr. STANTON. It seems by the surplus, if this is a correct figure here, there is certainly a loophole that should be corrected.

Mr. BARR. It might seem so. I will be delighted to check it.

(The information requested follows:)

VIETNAMESE COMMERCIAL IMPORTS FROM THE UNITED STATES

The U.S. share of merchandise imports into Vietnam financed by Vietnam's own foreign exchange earnings is undoubtedly small. There are signs of improvement, however. In 1966 arrivals from the United States financed by GVN-owned foreign exchange, came to 2.8 percent of the total. For the first 7 months of 1967 the percentage, based on licensing, was 7.8 percent.

For geographical and historical reasons, the United States has not been a big factor in the Vietnamese market. Japan is getting the largest share of the market and other countries in the area such as Taiwan, Hong Kong, and Singapore are also getting large shares. There are also special factors, such as the Vietnamese fondness for motor scooters and light-weight motorcycles of type which the United States is not a major producer.

Vietnam is thus a new market for the United States. It will take aggressive salesmanship and export promotion on the part of U.S. industry if our market share is to be increased significantly.

The U.S. mission in Saigon and the Washington agencies are well aware of the basic facts in this situation. The mission is actively engaged in determining which commodities the United States is or could be competitive in, in the Vietnamese market, and based on such information will explore with the Vietnamese Government ways in which sales of such U.S. products can be increased.

In considering direct actions which might be taken to assure that funds from the United States are used for purchases from the United States, care has to be taken that international agreements are not violated. However, U.S. officials have had discussions with Vietnamese officials on this problem and are seeking to work out with them measures which can be taken to increase U.S. market shares.

DIRECTIONS OF TRADE—VIETNAM—IMPORTS (FINANCED BY VIETNAM'S OWN FOREIGN EXCHANGE EARNINGS)

[In millions of U.S. dollars]

	1965	Percent	1966	Percent	1967 (9 months)	Percent
Total	[1] 115.0		[1] 225.0		[2] 211.6	
United States	4.8	4.2	6.2	2.8	16.6	7.8
Japan			112.4		68.5	
Italy			27.2		12.9	
Germany			16.4		6.5	
France			15.4		7.2	
Republic of China					23.3	
Hong Kong					7.8	
United Kingdom					5.9	
Belgium					2.1	
Singapore					18.8	
Switzerland					4.3	
Miscellaneous					37.7	

[1] From Moss committee report dated Aug. 25, 1967.
[2] Based on foreign exchange licenses issued from USOM, Saigon.

Note.—Licensed imports from United States for 1967 predominately POL; from Japan motor scooters, textile yarns, and radios and TV's; from France pharmaceuticals, industrial machinery, and motor vehicles.

Chairman Patman. Mr. Stephens,

Mr. Stephens. There are two questions I would like to ask: On the second page of the statement of Mr. Martin—it is the first paragraph—

It is true that Congress has given the Federal Reserve Board authority to suspend the gold cover requirement for a period of up to 30 days, and to renew such suspension for 15-day periods thereafter.

What does that mean? How does that operate?

Mr. Robertson. All we would do would be to suspend, under the power which has been given by the Congress. We would suspend the operation of the gold cover requirement and continue issuing Federal Reserve notes until we got down to the next tier, which would be 20 percent, and then 15, and then, going on down. We would merely suspend it and renew it.

But this was obviously designed as a temporary means of avoiding a crunch sort of operation.

Mr. Stephens. You would have authority to issue more than the 25-percent reserve; is that correct?

Mr. Robertson. No. What we do, would be issue notes, even though 25 percent of them exceeded the amount of free gold.

Mr. Stephens. The second question is on the third page of Mr. Martin's testimony:

Convertibility of the dollar into gold at a fixed price—$35 an ounce—is a keystone of the international monetary system and is a fundamental reason why monetary authorities are willing to hold dollar reserves.

Where do we get the fixed price of $35 an ounce?

Mr. Robertson. This was fixed, of course, in accordance with the International Monetary Fund arrangement. The Congress approved this particular fixing with the Fund. It is a position which the United States has taken since this time.

Mr. STEPHENS. Congress has not fixed $35 an ounce?

Mr. ROBERTSON. No; they did not fix that price, but they approved the fixing of that price with the Fund by the United States.

Mr. STEPHENS. The fixing of $35 an ounce, or the fixing of a price?

Mr. ROBERTSON. Both. A parity of $35 an ounce was set with the Fund, and that advice was given to the Congress, which in turn then approved the International Monetary Fund agreement.

Mr. STEPHENS. At $35 an ounce?

Mr. ROBERTSON. Right.

Mr. STEPHENS. How was that arrived at as a particular fixed price?

Mr. ROBERTSON. I can't answer that. I simply don't know how that particular fixed price was arrived at.

Mr. BARR. Mr. Stephens, I am not sure that anybody can arrive at this. It goes back into a rather murky phase of history when President Roosevelt changed the price of gold, literally every day, and finally hit on a point. The chairman would probably have as much knowledge of this as anyone. But the history books are notoriously silent on this subject.

Mr. STEPHENS. Let me see if I am right in my observation, and I would rather not, on that particular thing—Mr. Widnall has talked about the continuing plight of the dollar and how in the last few years we have taken one measure and then had to go to another measure, and then another measure.

I would leave with the conclusion—I would disagree with the conclusion that Mr. Widnall has arrived at, that the plight of the dollar seems to be the success of the measures we have taken, because every time that we take a step that will maintain the stability of the dollar, then there are counter moves made from the other side of the picture because the dollar continues to be desirable, and more desirable.

So, we can't stand still, because if we do stand still and take no measures, then we will find ourselves out all around and the stability of the dollar will be gone. So, the success to allow our moves in the past few years, continuing the plight of the dollar merely to offset the moves that have been made by us to maintain the stability of the dollar—am I correct in that?

Mr. BARR. Mr. Stephens, I think this is a very good point, and I would like to point out for the record here that the plight of the dollar, the fact that we can no longer run sizable balance-of-payment deficits, as we have done since 1951—I think we generally recognized since 1959, under President Eisenhower's administration, at that time we began to tie foreign aid. You remember that Secretary Anderson in 1960 moved again, as the position of the dollar worsened. The deficits were very large in those years, $3.3 in 1968; $3.8 in 1959; and $3.9 in 1960. President Eisenhower tried to bring dependents of our troops in Europe home at that time, and this proved politically impractical and was abandoned. However, it did trigger an intensive effort on the part of the United States to neutralize our costs and we continued to move, and the Government sector was the primary point of attack. We tried to economize in the dollars we spent overseas, but we had a surge of bank loans in 1963 that literally threatened to engulf our payments.

Then we enacted the interest equalization tax and in 1964 there was an enormous outpouring of direct investments to Europe. At that time, the direct investment program, the voluntary program for banks and direct investments of corporations was established. Until the British devaluation threw the world into another turmoil—and we are acting again—and the history of this country in this extremely difficult area, through three administrations, I think has been one of courageous acts to attack the problems as they arise.

Mr. STEPHENS. I see that my time has expired. I would like to conclude with a comment that our continued effort to maintain the stability of the dollar keeps us under attack all the time, and the best way to keep the gold drain, then, from being made as an international thing, would be to make the dollar less desirable and change its stability, and then when you do that, you play the dickens with the economy of the United States and the world.

Mr. BARR. I say amen to that.

Chairman PATMAN. Mr. Mize.

Mr. MIZE. You say the international central bankers look to the soundness of our economy and soundness of our monetary fiscal policies in general, as the basis for establishing the true value of the dollar, not the amount of gold behind it. And I presume we would agree with that.

Some years back, back in the Eisenhower administration, there was some $24 billion worth of gold, and now there is only $12 billion left. If we free this $12 billion worth of gold, against which there is some $30 billion-plus claims—now this is a hypothetical question—and for various reasons the countries holding these dollar claims convert the available $12 billion and it is gone; then there is still some $22 billion worth of claims left—what then? What are you going to come up here and ask us to do then?

Mr. BARR. Mr. Mize, I would say, first of all, we are not going to let this come to pass. We have an active program. As I have indicated, this country has moved ever since starting in 1958, under President Eisenhower, it has moved to meet every challenge that has confronted it, and we will continue to move.

We have a program currently before the Congress. If that is not enough, we will come forward with more. We are going to do whatever is necessary to preserve the competitive position of this country in the world, and I am not going to admit we are ever going to come to the situation you hypothesize.

Mr. MIZE. I prefaced this question by saying, "hypothetically." If you were the Secretary of the Treasury, Mr. Barr, what do you think you would do, if, for a variety of reasons, international policies and so forth, this $30 billion worth of claims against the $12 billion of gold were exercised, and there wasn't enough to go around. Supposing in the next 2 years—and we passed legislation—$6 billion is converted, and we only have $6 billion of gold left, are you going to say the remaining $6 billion is free?

Mr. BARR. We will say any amount that we have is free, Mr. Mize, but I want to point out that if somebody started to convert that amount of money we would be back here within a week with even more stringent programs than we have before the Congress at this time.

We would act precisely as President Eisenhower and President Kennedy, and this President is acting. We are going to do what is necessary to stop this situation. The gold drain is not a cause, it is a symptom. It is a symptom of difficulty either in the domestic side of our economy, or the world in general. We are moving in the world in general with the creation of the special drawing rights, which will probably be before this committee in April, and then we will have a supplement to dollars and gold for world reserve, backed by the credit of the free nations of the world.

We are moving in this direction, but I want to emphasize very strongly, we are going to do what we have to do to stop any runs on our gold reserve.

Mr. MIZE. Then you are announcing publicly that even if we pass this legislation, we are not going to free this gold and any nation or any country central bank holding dollar claims should not get excited about free convertibility because if they start to convert too much we will stop exchanging dollars for gold.

Mr. BARR. No, I'm saying we are going to cure our payments problem which will greatly reduce the likelihood of substantial conversions of dollars into gold. In addition, the people holding the large sums in gold and dollars are the Europeans. They realize, and I have no hesitation in putting this in the record, a run on the dollar would have unfortunate consequences on them as well.

No. 2, they are our partners in the London gold pool and they share in the cost that we incur.

There is no reason for them, none, with the possible exception of one nation, and that is France, to make any attempt to damage our reserve position.

Now, you get out into the less developed parts of the world and there is not too much doubt they need the dollars they hold. The threat, if there is a threat, it is in Europe. They are our partners in the gold pool and they realize that the creation of instability will be to the detriment of all.

So I don't look for a threat from that direction. I look instead for cooperative action such as we have had in the past.

Chairman PATMAN. Mr. St Germain.

Mr. ST GERMAIN. I would like to ask one question that actually requires two answers. That question would be: What would be the impact on our domestic and on the international economy if we were to stop buying and selling gold? One directed to domestic, and one to international.

Mr. BARR. Mr. St Germain, on the domestic side, there would be no impact. I would assume that our stocks would be available to industrial users, as they are at the moment.

In the international sense, Mr. St Germain, this is the situation. As I indicated, the world, the monetary system of the world operates like a solar system. You have a fixed point, the sun. That is the U.S. dollar. And it is fixed because it has a fixed relationship to the price of gold—$35 an ounce. The currencies of other countries revolve around this fixed point. Each has declared a par value for its currency with the International Monetary Fund and has agreed to maintain the value of its currency within 1 percent of its par value. They do this by buying or selling dollars.

Taking the German mark, its par value is worth 25 cents. The Germans say that they will keep that price at a low of 0.2475, and a high of 0.2525. If there are more marks in the market than the market can absorb, the price starts to sag, and the Bundesbank goes into the market and takes the excess off the market by selling dollars.

If there are not enough marks on hand, then the Bundesbank supplies marks for the markets and takes in dollars. Now, this is the way that this system has worked, literally, since the establishment of the Bretton Woods arrangement, and more particularly since 1958 when the major free nations made their currencies convertible.

The point that I attempted to make to Mr. Mize, in connection with the Europeans, especially, is when we remove this fixed point in the system, then you have a system against which no one can operate. Literally, you have chaos, and as I indicated, the doubling of world trade that has occurred in the past 10 years would be impossible without a financial system that is reliable and fixed. This is what would happen.

Mr. St Germain. Thank you. No further questions.

Chairman Patman. Mr. Lloyd.

Mr. Lloyd. Mr. Barr, on page 3 of Mr. Fowler's testimony, he refers to the dollars, 150 million or more, which are absorbed each year by domestic, artistic, and industrial users. What are the mechanics under which they secure gold?

Mr. Barr. They are licensed by the Office of Domestic Gold and Silver Operations of the U.S. Treasury. They come in and say, we need so much gold for our operations, and the operations are licensed.

Mr. Lloyd. Are they supervised?

Mr. Barr. Yes, sir.

Mr. Lloyd. So you know the use to which the gold is put?

Mr. Barr. That is correct.

Mr. Lloyd. Would you favor a bill to subsidize the production of gold in this country?

Mr. Barr. No, sir. Mr. Lloyd, our position has been unequivocal in this area. No. 1, we are at the moment spending about $8 or $10 million a year, to find potential gold deposits in the United States, to see what is here. From the best evidence we have, any subsidy would have to be huge, and even then it wouldn't produce much.

Mr. Lloyd. Are the world reserves of gold today adequate for domestic and artistic and industrial uses? Does the consumption exceed the production on a worldwide basis?

Mr. Barr. No, sir. I can give you the latest figures.

Let me give you the figures for 1966. The production in South Africa was $1.081 billion.

The production in the rest of the world was around $400 million. A total of $1.445 billion.

Mr. Lloyd. That is production?

Mr. Barr. Yes, sir. From 1953 through 1965, the Soviet Union was selling amounts of gold that ranged from 75 million to a high of 550 million in 1965. They did not sell any in 1966 or 1967.

Mr. Lloyd. Excuse me. Are you reading from something that is going to be in the record?

Mr. Barr. I will be delighted to supply it.

Mr. Lloyd. I think Mr. Fowler said he put something in the record.

Mr. Barr. I can answer your question quickly.

Chairman Patman. You are on page 40 of this book you have here?

Mr. Barr. Yes, sir. In 1966 industrial uses absorbed $675 million worth of total production.

Mr. LLOYD. Are those 1961 figures?

Mr. BARR. 1966 figures. Less than half went for industrial uses.

Mr. LLOYD. What can gold producers get on the market today from the industrial users?

Mr. BARR. $35 an ounce.

Mr. LLOYD. Why don't we buy more gold? Why don't we get more gold in our gold stocks?

Mr. BARR. Why don't we get more gold?

Mr. LLOYD. Yes.

Mr. BARR. We have to look at the world as a whole. There has been, actually a decline in the gold reserves of the free nations in the past 2 years—1966 and 1967. There was an actual decline because the industrial use was climbing and evidently there was a large surge of private hoarding.

Mr. LLOYD. Would you comment on this? Suppose we decided we don't want to redeem dollars with gold—what happens?

Mr. BARR. This, as I understood it, and I am not sure I was completely responsive to Mr. Mize—if you are asking me what happens if we refuse to redeem——

Mr. LLOYD. I am just wondering, myself, what happens if we decide we don't want to back our dollars with gold any more, and then what happens to the dollar throughout the world?

Mr. BARR. Well, I am going to repeat that we are not going to let that happen. Mr. Moorhead is not here now, but he asked me the question about the floating rate, if you had a dollar that is floating, you have no fixed point in a monetary system, and we are not going to get to that.

As I indicated, the result, in my opinion, would be that there would be a collapse of world trade.

Mr. LLOYD. What has brought on the run on our gold supply?

Mr. BARR. You mean, the billion that we lost in the last quarter?

Mr. LLOYD. Yes.

Mr. BARR. The British devaluation. You will pardon me if I choose my words carefully. I am delighted to explore as completely as possible with this committee all answers, but I do not want to trigger other runs. Some fool put out a statement last Wednesday that the President was going to change the price of gold on his state of the Union message. That caused a serious embarrassment and some reserve losses, so you will pardon me if I phrase my answer rather carefully.

Would you put it again? What caused the run?

Mr. LLOYD. Yes.

Mr. BARR. To the best of my knowledge, Mr. Lloyd, the British devaluation created in the world a worry on the part of many people about the value of currencies. They had lost 14.3 percent in the British devaluation and they were worried about credit and paper money.

A large portion of them, I think, decided they would hedge their bets. Another reason is that there was speculation all over the world that other countries might be forced to devalue. There was speculation that the thrust of the attack would shift to the United States.

As a result of all these, this combination of circumstances, Mr. Lloyd, I think that is the best reason I can give you for this billion-dollar loss.

Chairman PATMAN. Mr. Minish.

Mr. MINISH. Thank you, Mr. Chairman.

Mr. Barr, Secretary Fowler, on page 6 of his testimony that "virtually all countries hold dollars in their reserves."

Could you tell me which countries hold the most?

Mr. BARR. Which countries hold the most dollars? I believe it is Germany. May I supply that for the record? The largest dollar-holding countries are Germany, Italy, Canada, and Japan.

Mr. MINISH. You left out France.

Mr. BARR. France limits the amount of dollars it holds, but, it still has quite a few.

Mr. MINISH. I see. Your Department is charged with collecting taxes and debts owed the Government, is it not?

Mr. BARR. Yes, sir.

Mr. MINISH. Have you ever thought about collecting the war debts owed the United States by foreign countries, particularly, France?

Mr. BARR. Yes, sir. I would like to submit at this point a statement for the record on the subject of World War II debts owed to the United States, and World War I debts owed to the United States.

Chairman PATMAN. You would like to insert it at this point in the record?

Without objection, it is so ordered.

(The information referred to follows:)

GOLD LOSSES AND DEBT REPAYMENT

REPAYMENT OF WORLD WARS I AND II DEBT

In its effort to halt the loss of gold the administration has given special attention to the potential contribution of debt repayment. Virtually all of the loan agreements and settlements made with foreign countries since the beginning of World War II established fixed amortization schedules which call for regular payments over a period of years. We expect both principal and interest on post-World War II obligations to be paid in accordance with these schedules, and with relatively few exceptions these payments are being made. Receipts from such scheduled debt repayments amounted to more than $800 million in 1966. Only in a few cases has it become impossible for debtor nations to meet scheduled payments, making it necessary to negotiate a rescheduling of the obligation. Some of the loan agreements provide for postponing payments under certain circumstances. Where disputes arise resulting in payment delays, efforts are made to reach agreement in order that payments may be resumed. There have been a few instances, notably in the case of the Republic of China and the U.S.S.R., where it has not yet been possible to reach agreement involving comprehensive settlement of World War II lend-lease and related accounts. (The U.S.S.R. is making payments on lend-lease items which were in production or storage in the United States before V–J Day.)

The United States has encouraged the governments of nations which are in a strong financial position to make payments in advance of the scheduled due dates and since 1959 advance repayments of nearly $3 billion have been collected. Several countries, among them Germany, Italy, and Sweden, have now prepaid all or nearly all of their World War II and postwar debt obligations to the United States.

The situation is different with respect to World War I debts. Most governments fulfilled their commitments under their World War I debt agreements until the depression. Debtor governments stopped making payments in 1932, following the expiration of the 1-year moratorium on debts owed to the United States negotiated by President Hoover in an effort to mitigate the effect of these debt obligations on Europe's economic health. Although some countries made token payments until the beginning of World War II, Finland is the only country which is presently meeting its obligations in full.

While the countries which have large World War I obligations to the United States have never denied the juridical validity of their debts, there is a view widely accepted among them that the payment of these debts should be dependent on reparation payments by Germany. Resolution of the problem of governmental claims against Germany arising out of World War I was deferred "until a final general settlement of this matter" by the London Agreement of 1953, to which the United States is a party.

The Government of the United States has never recognized that there was any connection between the World War I obligations of those countries and their reparations claims on Germany. While the London Agreement would not prevent the United States from raising, on a bilateral basis, the question of payment of any kind of the debtor countries' World War I obligations (except in the case of Germany), it must be recognized that any effort on the part of the United States to collect these obligations would undoubtedly raise the problem of German World War I reparations. From the practical viewpoint, therefore, there does not seem to be any possibility of reaching an agreement on repayment in the absence of an overall settlement of the World War I reparations problem, with its wide-ranging political ramifications.

FRENCH DEBT

The French hold to the generally prevailing view with regard to their debts to the United States. They not only have been servicing debts incurred after World War II regularly but have paid more than $880 million in advance of the due date. As of June 30, 1967 France's obligations to the United States (excluding World War I debts) were roughly $300 million.

The World War I indebtedness of the Government of France due and unpaid as of June 30, 1967, was $5,077 million, including $2,091 million of the principal sum and $2,986 million on interest arrearages. Unmatured principal was $1,773 million. No payments have been made since 1931. The total obligation which might be said to have been outstanding on June 30, 1967, including both matured and unmatured principal and interest arrearages to that date, was $6,850 million.

The French Government has not contested the validity of its debt to the United States. The French have instead asserted that there is a direct connection between French payment of this debt and reparation payments by Germany to France. The Chamber of Deputies ratified the 1926 agreement funding the World War I debt with the reservation that the debt to the United States was to be paid "exclusively by the sums that Germany shall pay France." The Chamber of Deputies resolution at the end of 1932 declared that payments to the United States were deferred until the United States should agree to enter a conference for the purpose of adjusting all international obligations and of putting an end to all international transfers or which there was no compensating transaction.

Mr. BARR. A simple answer is that the free world has prepaid, roughly, $3 billion of World War II debts. France has prepaid $880 million of their debt. They are not only current, but they have prepaid.

World War I debts have a long legal, difficult history.

Mr. MINISH. Have you ever thought of turning the question of the unpaid French war debts over to the International Court of Justice?

Mr. BARR. No.

Mr. MINISH. I wish the Treasury Department would do something about trying to collect it. I know you are adamant on the surcharge and I know that if one of our citizens fails to pay their income tax, the IRS moves in on them, and justly so, and I would hope the Treasury Department would move in on the countries that have owed us money since World War I.

Chairman PATMAN. Mr. Blackburn.

Mr. BLACKBURN. I am a little confused with all the testimony we have had that no need exists for gold reserves for domestic dollars. Why did we, initially, insist on 25 percent reserve?

Mr. BARR. Why, what?

Mr. BLACKBURN. Why did we, in the beginning, insist on 25 percent reserve?

Mr. BARR. Let me read you a statement by some gentlemen who preceeded you by a long time. This was a report of the Banking and Currency Committee in 1913, when they established this reserve requirement, and I will quote from the original report:

> In a general way, the Committee believes that the requirement of a fixed reserve is not a wise or a desirable thing, as viewed in the light of scientific banking principles. It believes, however, that in a country accustomed to fixed reserve requirements, the prescription of a minimum reserve may have a beneficial psychological effect.

Mr. BLACKBURN. That is, psychologically.

Mr. BARR. That is it. That was a 1913 report, when the Federal Reserve was created.

Mr. BLACKBURN. I am encouraged by your insistence that we are not going to let the gold become completely exhausted in the country, but at the same time I think Harold Wilson of Great Britain made equally strong statements some months back, that he was not going to devalue the pound, but ultimately he had to do it because of unsound fiscal policy.

Now, you started to say that the loss of gold is a symptom of a disease and not a disease within itself. Would you care to comment further on what the disease is that we are facing, so we can give some thought to the solution?

Mr. BARR. The President outlined the basic difficulty in the January balance-of-payments message. Temporarily—this is on a temporary basis. No matter how profitable the investments are overseas, and how profitable they can be, there is a limit to the rate at which American industries can invest overseas, just as you and I have a limit. I have been plagued all my life because some banker wouldn't loan me the money to let me go as fast as I thought I should go. And this is precisely the situation we are in on direct investments. We are not saying to stop direct investment. We say, slow it down a billion so we can live with it.

We are not saying to the American tourist, don't ever travel again. We haven't formulated our proposals completely, but I think what we are going to say to the American tourist is, probably, go ahead and travel, but we are going to make them think about how much money they are going to spend.

We are saying to the Defense Department and State Department, especially, hold down the number of people you have overseas. Stop traveling overseas. We are saying to our allies in Europe, look, we have our troops there to help you defend yourselves, but you must help us neutralize these exchange costs. You must do your part.

We are saying it, not only in Europe, but we have said it in Japan, and we are saying it in Taiwan and Thailand and in all the Southeast Asian perimeter where our costs are running a billion and a half a year.

Mr. BLACKBURN. I understand the President's proposals. I have reviewed them rather thoroughly. What is the ultimate effect of our foreign aid now? I do know that the dollars are tied. I know they have to come and buy goods in this country with dollars. To the extent that we are increasing our domestic debts to finance foreign aid, we are not paying enough taxes to finance the foreign aid programs that we now support, aren't we creating further domestic financial problems for our country which in turn aggravates the international situation?

Mr. BARR. It need not do so if we would impose the taxes which the President has required. I think we have an obligation in this country. We can't live in the richest nation of the world and get richer day by day without paying any taxes or any attention to the people in the developing countries. It need not be so. All we need is the will to tax ourselves domestically.

In the international area it is different. It is quite different, because actions of others are required as well as our own. We cannot come into balance on our international accounts unless we get the cooperation of the rest of the world. They can stop us. So we need cooperation in the international area.

Mr. BLACKBURN. Well, I notice that the proposals by the President are going to be temporary. I think we are paying temporary taxes now that were imposed in World War II. The interest equalization tax was going to be temporary when it was imposed 5 years ago. The voluntary restraints policy was temporary when it was imposed 3 years ago. If these proposals are merely temporary, then they are not going to solve the disease, are they—if everything we do is temporary—then we are not really getting to the root of the problem, are we? The permanent solution to the problem is what I am after.

Mr. BARR. The permanent solution to the problem is to have a nation that is strong enough to compete in the world and run an export surplus, and run a surplus on the income that it is receiving from its investments, its bank loans, and the rest of these things, to meet the military deployment costs of the United States, our aid costs, our investment costs, and tourists costs, and import costs.

These are the principal factors we have to meet. To do that, we need a strong, stable domestic economy. We need cooperation from the rest of the world and neutralizing our military deployment costs.

Mr. BLACKBURN. I have just one other question. If our gold should be exhausted, would the holders of the additional, say, $20 billion in demand currency, come into this country and attempt to exchange those dollars for goods?

Mr. BARR. They can do it right now. They are welcome to do it at this moment.

Mr. BLACKBURN. What effect would that have on the domestic economy?

Mr. BARR. If they came in and tried to do it in a week or a day, there would be an enormous impact and a great surge. I don't think it would happen overnight. Twenty billion in an $800 billion economy is not very much. Our country grows about that much every quarter.

Chairman PATMAN. Mr. Gettys.

Mr. GETTYS. What relationship, if any, does this proposal to withdraw the gold cover have to the reduction of silver in our coinage a couple years ago?

Mr. BARR. It has no relationship.

Mr. GETTYS. Other than the psychological?

Mr. BARR. It has no relation at all.

Mr. GETTYS. Wouldn't the reduction of imports into the United States, particularly in such fields like the textile industry, improve our balance of payments?

Mr. BARR. Very doubtful, Mr. Gettys. You see, we are running a trade surplus—Mr. Widnall disputed our figures—around a $4 billion trade surplus this year. We do include Public Law 480 and aid exports. I might add that this is the normal practice—the way other nations generally report their own exports, and the method followed by the IMF.

On this basis, we have a $4 billion surplus in our trade accounts. We are subject to retaliation. I think while, of course, an import, it might seem that an import quota would temporarily be helpful, there would be retaliation tomorrow.

Mr. GETTYS. Could I ask, right there, aren't a lot of these exports of ours, the surplus, directly due to government expenditures in foreign aid in which turn they are required to buy our goods?

Mr. BARR. That is correct.

Mr. GETTYS. In fact, the textile industry and others in the United States are bearing the costs of putting themselves out of business.

Mr. BARR. I don't follow you, Mr. Gettys.

Mr. GETTYS. In our textile industry, for example, isn't the industry simply paying taxes to send money to foreign countries to produce goods to compete with us in the United States?

Mr. BARR. You are saying that if AID aid builds a textile plant in some nation and they ship textiles back to the United States, that the U.S. textile industry is disadvantaged because we are in effect subsidizing imports coming into the United States?

Mr. GETTYS. I will get to the larger question. Foreign investments are being curtailed, and I think rightly so. Isn't the Government the chief offender of foreign spending? Why is it that the Government itself isn't taking more drastic measures to decrease its own spending overseas?

Mr. BARR. It goes much deeper than that, Mr. Gettys. The President said he is going to cut a half billion in the expenditures overseas, and mainly in the area of military.

Mr. GETTYS. But the request of the private sector is greater than it is of the Government in reduction in foreign spending.

Mr. BARR. In that direct investment is a billion, and in the reduction of Government outflows is a half billion. I guess you can say that.

The issue gets down to our security arrangements with the rest of the world. Nearly all of our Government expenditures are in the area of troop deployment. We have an exchange cost of $1.6 billion in Europe, and about $3 billion worldwide. We are offsetting portions of that. The Germans are buying $500 million of our bonds, offsetting a portion of that.

As I indicated, we are working with all these other nations to offset. But mainly, it is tied in with security measures, and the real issue, if we pull back our security from the world, our forces from the world, I have the strong hunch there would be no order left in the world and no point to invest, or travel. It would be too dangerous to do it.

Mr. GETTYS. I notice that Secretary Fowler refers to the $156 million reserve held against U.S. notes and Treasury notes of 1890. Do we have any idea how much of those are in circulation, or where they are?

Mr. BARR. $332 million.

Mr. GETTYS. They could, basically, be pretty well marked off?

Mr. BARR. They could be marked off. We are not going to. We are keeping them in circulation.

Mr. GETTYS. It is not a realistic reserve, is it?

Mr. BARR. $156 million? We cannot remove it without action by the Congress.

Mr. GETTYS. Don't you think it would be well to ask?

Mr. BARR. That is included in this legislation.

Mr. GETTYS. Thank you.

Chairman PATMAN. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

In answer to a question earlier, Mr. Barr, with respect to daily turnover, which Mr. Moorhead asked you, you said you were absolutely opposed to letting the dollar "float" internationally. Doesn't this legislation say we are going to let the dollar float domestically?

Mr. BARR. I am afraid I don't follow you. What change does it make domestically?

Mr. BROWN. If the dollar has no backing or cover it floats and finds its own value. The gist of the editorial is that we should remove the gold backing from the dollar internationally, and isn't that what we are doing here?

Mr. BARR. Yes, sir.

Mr. BROWN. So we are having the dollar float domestically.

Mr. BARR. The dollar has floated domestically, under that theory since 1934.

Mr. BROWN. You said there was a psychogical impact of the cover.

Mr. BARR. I suppose so.

Mr. BROWN. And I think you also said, in answer to Mr. Lloyd, that you thought the run on gold was caused by a fear of many about the holding of paper money.

Mr. BARR. That is right.

Mr. BROWN. So, probably, feeling and subjectivity have a great impact, or greater impact, than actually hard facts do as to the stability of the dollar; is that true?

Mr. BARR. In these areas, you have millions of people making millions of decisions. When I say that they are reluctant to hold paper or bank deposits, we don't know where all this demand came from. It probably came from the Middle East, Asia, and some parts of Latin America. We don't know where it all came from. Mr. Brown, we have had Secret Service checking this out ourselves to see if Americans have been violating the statute for holding gold overseas, and the indications were that Americans were not concerned.

Mr. BROWN. Has there been anything to date that you have observed stabilizing the value of the dollar because of your request for this legislation—in the international community?

Mr. BARR. Let me be very blunt, and say that since the President's January 1 balance-of-payments message, the exchange market and gold market have quieted down.

Mr. BROWN. How much of this is due to the balance-of-payments action and how much is based on your request for this legislation?

Mr. BARR. Can we supply that for the record? We will be delighted to supply for the record what the Europeans think about the importance of this legislation.

(The information requested follows:)

REMOVAL OF GOLD COVER

The comments with respect to removal of the gold cover by foreign authorities, public and private, that we have received clearly indicate the move would be welcomed.

The basic attitudes of the monetary authorities of the major countries, as represented by the Group of Ten plus Switzerland, was made clear as long ago as 1964 in the Deputies report of that group. The report said:

"The gold held by monetary authorities should be readily available for use in international settlements, and it is important in this respect that statutory or conventional relationships of gold to the domestic money supply should not prevent gold from playing its proper role in the international monetary system." Under Secretary Deming, who accompanied Under Secretary of State Katzenbach to Europe the first part of January to explore the President's newly announced balance of payments program, has reported the current interest in this matter and that in most of the capitals visited it was urged that prompt action by the United States would assist in calming the nervousness apparent in the gold markets.

Our Embassies in several countries have reported the foreign press comments on this portion of the President's state of the Union message. The telegrams received are as follows:

JANUARY 19, 1968.

To: Secretary of State, Washington, D.C.
From: American Embassy, London.
Subject: Reaction to President's announcement on repeal of U.S. gold cover.

1. State of Union message statement on repeal of gold cover requirement received favorable comment in United Kingdom's press. Times business news editorial of January 19 headed "No Joy for the Gold Speculators" says that anyone who can still believe after Wednesday night that gold price is likely to rise, will believe anything. Times acknowledges that the United States still faces difficulties on economic/fiscal front, but says that those who hope to make quick buck out of current problems of the United States "Grossly underestimate the economic power of that country and its will, when pressed to solve its problems in the most impressively thorough way." Times also had straight news story covering same ground. Financial Times calls proposal along with tax increase "Undoubtedly serious which Congress can reject only at risk of provoking fresh run on dollar."

2. Financial Times says there is reasonable chance that both proposals will be passed by Congress. It points out that mobilization of gold reserve is complementary to United States B/P program announced January 1 which would need to have considerable practical effect because "U.S. reserve is exceedingly large, but it is not infinite."

On London gold market Thursday's demand declined sharply from high level of Wednesday; price only declined one-eighth to $35.19⅝. Demand earlier in week had been stimulated by rumors that President would announce gold price increase on Wednesday. Announcement of gold cover removal was reported to have been moderating influence on demand. Gold shares on London Stock Exchange moved decidedly upward. Reports indicated that investor sentiment still believed in upward movement of gold price and investors could earn high yields on these shares. U.S. announcement had been widely anticipated and discounted, so had little impact on market sentiment.

BRUCE.

JANUARY 19, 1968.

To: Secretary of State, Washington, D.C.
From: American Embassy, Beirut.
Subject: Lebanese reaction to President's remarks on gold backing for dollar.

1. Lebanese press gave extensive coverage January 19 to comments of Dirgen Khalil Salem on President's announcement in state of Union message that Congress would be asked to pass legislation in liberating gold used as cover for dollar. In statement, which carried by National News Agency, Salem said, "Can-

celing the gold coverage of the dollar will not have any effect on the Lebanese currency." Continuing, Salem said move would strengthen dollar's international position by demonstrating determination of U.S. authorities to maintain its value.

2. In press statement Deputy Joseph Chader, former Minister of Finance, said strength of dollar not based on 25-percent gold cover.

3. Industrialist Association President Butros El-Khoury told press his initial reaction was that U.S. move would not affect Lebanon.

4. In only editorial reaction to appear, moderate Al-Hayat said world's present financial problems all stem from Vietnam war which is causing us balance-of-payments deficit, which in turn made it impossible for us to assist UK with her financial crisis and led to devaluation.

5. Dollar appreciated by one piaster to LL 3.14 in 24 hours following speech.

PORTER.

JANUARY 19, 1968.

To: Secretary of State, Washington, D.C.
From: American Embassy, Paris,
Subject: French press comment on removal of gold cover.

1. French press comment on President's request for removal of 25-percent gold cover generally views action as necessary minimum step by United States to insure greater stability for dollar. While French opinion has favored removal, some press comments doubted whether United States was in fact willing to see gold reserves decline to "the last ingot."

2. Figaro calls measure admission by United States of dollars fragility and obvious need for vigorous measures to halt dollar outflows.

3. Le Monde takes more negative view of significance of action. While basically an archaic guarantee of value under system prohibiting direct conversion of dollar notes into gold, gold cover nevertheless serves as technical restraint on excessive money supply increases. Le Monde continues: "Basic cause of American deficit beyond any doubt is financing made available through budgetary deficits. At very moment gold cover is needed as warning signal, it's removed." Finally, Le Monde concludes that it's doubtful United States genuinely prepared to put its entire gold reserve on line for defense of dollar in international markets because of need to maintain kind of war chest in gold.

4. Les Echos regards action as removing useless anachronism and taking minimum first step in shoring up international confidence in dollar. United States is rapidly increasing dollar liabilities made removal of cover more or less imperative. Important factor now to be watched is how effective new U.S. balance-of-payments program will be in attacking real causes of deficit.

WALLNER.

AMERICAN EMBASSY, BRUSSELS.
January 19, 1968.

TO SECRETARY OF STATE,
Washington, D.C.

Subject: Press coverage, state of the Union message.

1. State of the Union message extensively covered on front pages of Friday papers. (Time differential prevented Thursday coverage.) Most papers highlighted Vietnam and defense of the dollar and noted that President gave other subjects summary treatment. Most also noted prudence of President's response to recent "feelers" from Hanoi.

2. Gazet Van Antwerpen (Catholic) observed that achieving peace in Vietnam now seems even more difficult "since the President . . . revealed a harder line which might be decisive in preliminary contacts with Hanoi." "It is also significant" that Johnson is using "stronger words" after Mai Van Bo's Paris declaration. Paper suggests that U.S. officials "apparently accept the idea that Bo's statement proves Hanoi's recent peace feeler was only a propaganda maneuver" to end bombing. "The President does not want to get trapped" into this without some reciprocal action from North Vietnam.

3. La Libre Belgique (influential conservative Catholic) said that "there was clearly nothing new" on Vietnam, the President "only reaffirmed a well-known position," however, this repetition after recent North Vietnamese declarations "appeared to many observes as a sort of hardening." Paper observed United States clearly feared being led to stop bombing of North Vietnam with no reciprocal diminution from the other side. Here, viewpoints of Washington

and Hanoi "clearly diametrically opposed" and any narrowing of this gap seems "problematical." No progress is being made toward negotiation because "neither camp trusts the others' promises." Nonetheless, it is obvious that "the war at the present level can result in neither American nor North Vietnamese victory."

4. On monetary policy La Libre felt measures announced by the President "served electoral purposes above all." The President avoided issues which could be used against administration and planned only "short-term policies." Gold will not be revalued—obviously the President "intends to leave the burden of definite decisions to a possible successor."

5. New Flemish financial daily De Tijd took more favorable line than La Libre Belgique on financial measures. Paper saw "great chance that balance of payments might soon be brought into equilibrium" and also commented that "removal of gold cover of dollar should be considered a valid medicine in immediate future."

6. Le Soir (Mass Circulation Independent) pointed up election year tendency to assess message on partisan basis either as "weighty and sincere" or as "dull and flat." At the beginning of his presidency Johnson was too euphoric but is forced by events to navigate more closely. These facts were quite evident in address. Paper added that many subjects were omitted or mentioned in passing even in foreign policy field. On Vietnam, President avoided false optimism, was rather "sober and realistic." On domestic front, big news was request to lift gold cover of dollar.

7. De Standaard (Influential Catholic) ran editorial by editor in chief Vandeweghe entitled "In A Minor Key." This contended that message announced no "spectacular initiative"; writer believed President did not want to start "discussions" with North Vietnam now because parties disagree on an agenda and on participation of the NLF.

KNIGHT.

Mr. BROWN. Mr. Barr, maybe it has been done before, but could you tell me the gold reserve as of 1940, 1950, 1960, and 1967? Do you have them handy? And then, would you also indicate to me the ratio of the reserves of gold to the amount of currency in circulation?

Mr. BARR. Here it is. Now, the question was, sir, what was the total gold reserve in the United States in 1940?

Mr. BROWN. I just picked out 1940, 1950, 1960, and 1967.

Mr. BARR. $22.8 billion.

Mr. BROWN. What was the next?

Mr. BARR. 1950, $22.8 billion.

Mr. BROWN. 1960?

Mr. BARR. $17.8 billion.

Mr. BROWN. 1967?

Mr. BARR. Well, $12 billion.

Mr. BROWN. Do you have the figures there of the amount of currency for those same periods?

Mr. BARR. No, but we can supply that for the record.

(The information requested follows:)

Currency in circulation:	*Billion*
1940	$7.8
1950	27.2
1960	32.1
1967	43.3

Mr. BROWN. Obviously, from the discussion that we have had this morning, you don't think, during this period, say, from 1950 to 1967, there was a run on gold?

Mr. BARR. No.

Mr. BROWN. Although it amounted to some $10 billion loss?

Mr. BARR. On the contrary, gold was flowing to the United States. Excuse me.

Mr. BROWN. 1950 to 1967?

Mr. BARR. In that period, there was actually a net flow from the United States. From 1950 through 1967, of course, there was a reduction.

Mr. BROWN. Well, my time has expired, but the impact of this legislation is that Congress is going to exercise the emergency powers that the Federal Reserve can exercise, but only on a temporary basis; is that about what you are saying?

Mr. BARR. The Federal Reserve can operate on a temporary basis. We say we are here to discuss this whole issue and we are asking you to take a permanent step to remove this gold cover behind our Federal Reserve notes and U.S. notes.

Mr. BROWN. But your earlier comments were, we need this legislation now so, therefore, there is a bit of an emergency. But it is not the emergency which would cause the Federal Reserve to use its emergency powers?

Mr. BARR. No.

Chairman PATMAN. Mr. Rees.

Mr. REES. Last October, the International Monetary Fund met in Rio and there was an agreement among all the nations to create a new international currency called a special drawing right. I would like to ask a question in two parts: No. 1, what is the time schedule for implementing the SDR's, both in terms of developing rules and regulations, and then coming before Congress for specific legislation; and No. 2, what will be the relationship of the SDR's toward the relieving of pressure on the dollars used as a reserve currency?

Mr. BARR. The answer to your first question, Mr. Rees, is that the IMF technical staff and executive directors are currently working up the amendments that were agreed to unanimously by the Governors in Rio. Their time schedule is that they should be done by, roughly, the 30th of March. At that time the draft will be submitted to the Governors of the International Monetary Fund for ratification by a majority vote.

That will then trigger the submission of this amendment to the articles to the parliaments of the world, and we will be coming to the Congress, I think, in about April. That is about the date that we hope to bring this legislation, the request for approval to this amendment to the articles, before this committee.

Now, what effect will the SDR's have on reducing—would you rephrase that second part of your question.

Mr. REES. What effect will the SDR's have in lessening the pressure on the use of the dollars as an international reserve currency?

Mr. BARR. I don't think it will lessen the pressure on using the dollar. What it will do, Mr. Rees, let me say it this way. It will act as a supplement to dollars and gold. Most nations of the world hold their reserves in gold and dollars and now they are going to have a third option, SDR's. If by pressures, you mean the can't get enough gold and can't get enough dollars, they have SDR's, yes, in that respect, it will relieve pressures.

Mr. REES. Will SDR's relieve direct pressure on dollars? If we don't have SDR's we would have to make up the reserves by either dollars or gold.

Mr. BARR. That is the real reason for the creation of the SDR. We cannot increase gold production very substantially. As a matter of fact it will probably decline in future years. At least, this is what the miners say. It is hard to predict, but there is some indication in that direction. Gold stocks have not increased in world reserves. We obviously cannot continue to run deficits, forever, to supply dollars to the rest of the world. If you are not going to be able to get more gold, and you are not going to get more dollars, an additional instrument is required to relieve the pressures you note.

Mr. REES. Governor Robertson, many people have intimated that if you take away the gold that immediately the printing presses will be set up and start printing a lot of new money. Isn't it true, though, that the currency that you supply to your banks must be paid for by the banks by using deposits that they have in the Federal Reserve Bank, that really the only creation of money is by specific acts of the Federal Reserve Board?

Mr. ROBERTSON. This is exactly right. The people of the country determine how much they need and the banks of the country, which get the Federal Reserve notes from us, pay for those Federal Reserve notes. So the risk of just the printing of greenbacks, for example, doesn't exist under the Federal Reserve System. That is one reason Congress set up the Federal Reserve System.

Mr. REES. So it has really no relationship, or no need to have any type of gold cover because whatever currency is printed must be paid for.

Mr. ROBERTSON. That is correct, exactly so, and that is all we are asking.

Mr. REES. Mr. Barr, is the restriction on American businessmen investing dollars primarily limited to Europe, and not the underdeveloped countries?

Mr. BARR. That is right.

Mr. REES. Isn't it true in Europe there is a surplus of money which an American company, if they wished to build a plant in Europe, could borrow in that European money market; the President's proposal doesn't mean that the American investor cannot go out and borrow outside of the United States; and isn't the competitive position of the American businessman wanting either to go into Europe or expand in Europe, a little better on the European money market, vis-a-vis the local European company?

Mr. BARR. It is a three-part question. You are correct. We are not saying to the American business, you cannot invest in Europe. We are saying, you can't move funds from the United States to build a plant in Europe at this juncture. We are saying, if you want to build a plant in Europe, as you point out, go into the money market in Europe and borrow your money, and it is also correctly pointed out, there are a few entities any place in the world that have the credit rating of some of our very large corporations, and they can pledge their credit rating in Europe in the money market, and with that credit rating, will probably have an advantage over most European corporations.

Mr. REES. In talking about foreign trade and trade balance, if you take away foreign aid sales and Public Law 480 sales, isn't it true that we still have a positive balance of exports?

Mr. BARR. Yes; but it is, of course, smaller—$650 million in 1966; but nearly $4 billion in the peak year of 1964.

Mr. REES. Isn't it true in the last several years that our increase of exports, especially in the area of exporting technology and sophisticated machinery, has increased?

Mr. BARR. Yes, sir; that is correct. This has been the strongest position, strongest part of our export picture. Sophisticated and highly technical, and heavily research-oriented exports.

Mr. REES. Would a border tax or such hidden type of tariff do nothing but open us up to retaliation by other countries, especially those to whom we export most of the sophisticated goods?

Mr. BARR. This subject is up for discussion. A border tax adjustment is not a disguised tariff, it is an adjustment to reconcile the taxes and prices internally with those that are coming in from the outside. It is legal under GATT and the question we are exploring now is: Was the original GATT thesis correct? It was premised on the assumption that all corporation income taxes are not shifted forward to the consumer, while indirect taxes such as turnover taxes, are shifted forward to the consumer. I don't believe many economists today would say this is a valid thesis and this is what we are exploring with our counterparts in Europe today.

Chairman PATMAN. Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman. I don't think there is any question about the fact that the disease we are trying to cope with today is unfavorable balance of payments. There has been some comment here today about the fact that our citizens who hold currency cannot redeem that currency for gold, and there is no question about it.

Neither is there any question about the fact that the dollars are flowing out of the country, and which are being held abroad, and these dollars can be redeemed for gold.

Mr. BARR. That is correct.

Mr. WILLIAMS. This is the very same problem that we were coping with 3 years ago when the gold cover was taken off the Federal Reserve deposits.

Mr. BARR. That is right.

Mr. WILLIAMS. Because of the fact that the problem has not been corrected in the intervening 3 years, we are back now, considering taking the gold cover off our currency. You made the statement today, Mr. Barr, that we are not going to go so far as to exhaust or closely exhaust our gold supply in this country. Why haven't those steps been taken in the last 3 years?

Mr. BARR. Mr. Williams, I indicated that when Secretary Dillon was before this committee he was putting in place at that time a voluntary program to try to restrain direct investment overseas to what we could earn. He was trying to restrain bank lending to a reasonable pace that we could accommodate, where we could earn enough to met these flows. That was a successful move. Something he did not predict was the outbreak of hostilities in Vietnam, that threw an added burden of a billion and a half on the balance-of-payments picture.

Something he did not predict was that France would continue to hit us for a billion and a half in gold in the calendar year 1965 through September of 1966. Something he did not predict was that in November of 1967 the British would devalue with consequent disturbance to the exchange market.

Mr. WILLIAMS. You have already made the statement, even with the hostilities in progres, such steps can be taken to reduce this gold drain.

Mr. BARR. That is right. The steps are simple, Mr. Williams. Raise taxes and cut expenditures and keep internal discipline in the United States. Don't invest more and lend more or travel more overseas than we can afford. Keep our trade surplus strong. And negotiate with our allies so that they are bearing the fair share of the burden, so that, because of geography, we are not penalizing our payment accounts because of our troop deployment.

Mr. WILLIAMS. If all this had been done a year or two ago, we wouldn't be here on this subject, would we?

Mr. BARR. Perhaps not, Mr. Williams.

Mr. WILLIAMS. Let me say this. As you indicated earlier today, this present requirement of 25-percent gold cover on currency is a restraint in the issuance of currency. You made that statement.

Mr. BARR. It is a theoretical restraint. It has never been an actual restraint.

Mr. WILLIAMS. I think you are correct in this statement. Mr. Robertson indicated it is not a restraint, but let me call your attention, Mr. Robertson, if the provisions of the law are followed and you do take this means of temporary relief from the requirements of the law that you do have to increase your interest or discount interest rates, while you are following this temporary procedure——

Mr. ROBERTSON. I would assume, if we got into that sort of position we would be following such a monetary policy that you wouldn't achieve anything by this means at all.

Mr. WILLIAMS. All I am pointing out is, that even with your assumption that the law as it is presently written, gold cover as it presently stands is a restraint on the issuance of currency.

Mr. ROBERTSON. Almost none whatsoever.

Mr. WILLIAMS. I would like to conclude with a comment that this gold reserve business of this country is a pretty sorry picture. From the figures you have given, we have gone from $23 billion down to $12 billion. We have $1.3 billion in free gold and $10.7 in our reserve. I think we have reached a critical position. I think this matter deserves careful study, and I would just very seriously question whether removing the gold cover at this time is going to help. I really feel that the removal of the gold cover at this time is going to permit the gold drain from this country to continue.

For as long as we have this unfavorable balance of trade, dollars are flowing out of the country, which can be redeemed in gold. Then our gold reserves are going to continue to dwindle, and there is no reason——

Mr. BARR. What would you suggest we do, Mr. Williams? We are asking you to raise taxes, reduce the tourist outflow, curtail direct investments and bank lending. We are asking our trading partners in Europe to adjust. What would you add to the program?

Mr. WILLIAMS. There is no question that faults in our economy have been responsible for helping to develop these conditions. These faults in our economy, many of which are governmental inspired, have to be corrected.

Mr. BARR. That is correct. And this is what we have asked the Congress to do, raises taxes $12.9 billion, and to cut appropriations $10 billion. And this is precisely what we are doing. I couldn't agree with you more.

Chairman PATMAN. Mr. Bingham.

Mr. BINGHAM. First of all, I would like to compliment both of you gentlemen on your excellent testimony; it has been very helpful.

Governor Robertson, as to the Secretary's prediction that we will need this year $2 billion additional in notes, I am surprised that that rate of increase continues, in view of the constant increase in the use of credit instead of cash. Would you comment on that?

Mr. ROBERTSON. Credit takes care of most of it. Currency is a small portion of the total money supply of this country. But currency has been growing about $2 billion a year because the transactions which are financed continue going up. I don't think there is a man living who could say today that the increase next year will be exactly $2 billion, and the next year $2.1 billion. You can't predict with precision because it depends entirely on developing conditions.

If we get to the kind of checkless, cashless, society that some people have been talking about, which I don't think we are going to do, we won't need any change in this. There won't be an increase in currency in circulation.

Mr. BINGHAM. Has the rate of increase in the cash requirement been going down percentagewise?

Mr. ROBERTSON. Currency has been a fairly constant percentage of the total money supply. The transaction figure has been going up, so that the money supply and the amount of currency have also been increasing. And, as I say, currency has grown about $2 billion a year.

Mr. BINGHAM. Mr. Barr, I take it you would agree that since 1934 this 25-percent reserve requirement has really been a pretty theoretical thing.

Mr. BARR. Absolutely.

Mr. BINGHAM. Because it can't be put into practice.

Mr. BARR. That is right.

Mr. BINGHAM. So, its only value, presumably, has been a psychological one, and your position is that psychologically, this is now a disadvantage in terms of the strength of the dollar overseas?

Mr. BARR. That is correct.

Mr. BINGHAM. Now, I would like to bring you back to something that Mr. Moorhead was raising before, about the long-term solutions. I really don't think you answered his questions in the way he meant them, because you are talking about solutions that have to do with the continuation of the Vietnam war, and I hope that this is not the long-range thinking of the administration, that the Vietnam war is going to be with us forever.

I think what he was getting at, and I am certainly interested in this, is: What are we thinking of for the long term, in order to get away from our dependence on gold as the basis, as the sun, so to speak, in the solar system? There are so many disadvantages to gold. We don't produce much. The major country producers are South Africa and the Soviet Union.

Are we really pushing fast enough to get away from our dependence on gold as the center of the international monetary system.

Mr. BARR. Mr. Bingham, we have pushed this as fast as we can. And I might add, we have had able assistance from the Congress—Congressman Reuss and his colleagues, and the U.S. Senate—in trying to bring into being a supplement to dollars and gold. We are very close, as I indicated. You will have before you legislation in April, if we stick on the timetable, that will for the first time create a reserve that we can hold, backed not by the credit of one country, not by a mental, but by the collective credit of every free nation in the world.

That is the way we are moving and I think it is a responsible way to move.

Mr. BINGHAM. Has any thought been given to getting over to a commodity other than gold, something like a particular grade of oil, for example, as a basis for an international currency?

Mr. BARR. I don't believe much thought has been given to that, sir. Mr. Reuss has probed in these areas, possibly more than I. But I am not sure any thought has gone to using oil or wheat, or soybeans, or tobacco, as a reserve. I know one country that does count in its reserves Persian rugs. I think, appropriately so. They are very valuable, but we don't have too many Persian rugs.

Mr. BINGHAM. One final question. As we now undertake to sell gold to central banks at this fixed price——

Mr. BARR. Yes, sir.

Mr. BINGHAM (continuing). We make no distinction between those central banks that sell to individuals, and those who do not?

Mr. BARR. That is right.

Mr. BINGHAM. As I understand it, Great Britain does not, and France does?

Mr. BARR. That is right.

Mr. BINGHAM. Why would it not be reasonable to say that we will not sell gold at the fixed price to central banks that then turn around and sell it to speculators?

Mr. BARR. Mr. Bingham, we cannot figure a way to discriminate between nations. This is a universal system. We discriminate if we say to France we are not going to sell to you because you sell to your individual citizens. France can immediately, without too much difficulty, make an arrangement with some ally some place to move dollars to them, and they put it to us for gold, and France gets the gold back.

Maybe we are not ingenious enough. We cannot figure a way to keep this universal system in operation and discriminate between nations.

Mr. BINGHAM. In other words, there is nothing wrong with such an idea in principle, it is just that you can't see a way to carry it out?

Mr. BARR. That is right. Algeria has put $150 million to us for gold. This didn't make us happy. The Algerians announced it. We didn't announce it. As you know from diplomatic experience, our relations with Algeria vary from warm to lukewarm, and sometimes chilly. We know of no way to discriminate between nations.

Chairman PATMAN. Mr. Wylie.

Mr. WYLIE. This is a very complicated subject for me so I will ask two or three questions to try to help me understand its ramifications.

Mr. BARR. It is complicated for all of us. Don't apologize.

Mr. WYLIE. I understand the purpose of this bill is to add to the supply of gold so that more will be available for exchange to foreign countries?

Mr. BARR. That is right.

Mr. WYLIE. Mr. Blackburn and Mr. Bingham have pursued the thought that the gold cover was put on in the first place for psychological reasons.

Mr. BARR. That is correct. That is our best indication, from reading the record of 1913.

Mr. WYLIE. But psychological or not, it has come to have some value as a reserve or as a backing for the U.S. dollar in the world market?

Mr. BARR. Yes, sir. But what we are doing, Mr. Wylie, is to remove the domestic backing so it will be available for the international market.

Mr. WYLIE. The Indians used the wampum. During World War II I was in Germany. They used the German mark as a medium of exchange but it had very little value. You needed a whole bushel basket full to buy, maybe, a loaf of bread. This goes back again to Mr. Bingham's question. You are in the process of establishing a world note, or world piece of paper, which can be exchanged. But, doesn't it have to really go back to something that has some intrinsic value, to maintain its place as the sun in the solar system?

Mr. BARR. Are you speaking of the dollar, or new reserve assets?

Mr. WYLIE. I am speaking of any medium of exchange, the wampum, the mark——

Mr. BARR. I guess it boils down to, what do people have confidence in. The SDR will be accepted because there will be a solemn commitment to accept it. You won't be able to get your hands on it, but it will be moved back and fourth between nations and it will rest on the economic strength of the 103 nations that are members of the Monetary Fund.

Mr. WYLIE. Now, Mr. De Gaulle has been checking in his claims, so to speak, asking for gold. Are these claims made up of the dollars held by France?

Mr. BARR. That is correct.

Mr. WYLIE. That is all they are?

Mr. BARR. Yes.

They ran out of dollars in September of 1966. They didn't run out completely. They kept a reserve to pay their debts and for transaction purposes. But they ran it down to the point they thought was advisable, and they have not put any claims against us since September of 1966.

Mr. WYLIE. Does France use gold as backing for its franc?

Mr. BARR. No.

Mr. WYLIE. I was thinking that maybe France was trying to become a sun in the solar system, monetary solar system, when they asked for our gold?

Mr. BARR. I can't speak for French policy, especially at the moment; but I know that in the past the French have vigorously objected to any attempt to let the franc become a reserve currency. They don't want to take on the headache of being a reserve currency, and I think they are well advised.

Mr. WIDNALL. Secretary Barr referred to a statement that I made in which I challenged the accuracy of a figure submitted by the Treasury. I didn't challenge the accuracy of the figure, I challenged the comparative advantage shown by those figures when it included AID-tied exports and Public Law 480 as part of trade surplus.

Mr. BARR. Mr. Widnall, we can show you the figures either way, and the only point I was making, sir, was that I am so disturbed. I have fought with this committee over PC's. PC's are finally out of the way and we have a new budget concept, as a result of this wrestling match.

I want to make sure I am not in a statistical argument with you. We keep our books this way because this is an international practice and not our practice. We will be delighted to break them out any way.

Chairman PATMAN. Mr. Galifianakis.

Mr. GALIFIANAKIS. Thank you very much, Mr. Chairman, and thank you, Mr. Secretary, and Governor Robertson.

I admit to the complexity of the problem, and it is a generally known proposition that the United States went off the gold standard in 1934, which leaves me with the notion we didn't have any great need for gold standards and measures any more. Is there any link between the reasons that were applied for going off the gold standard in 1934 and the reasons we now seek to apply for the removal of the gold cover?

Is that too much in one breath?

Mr. BARR. May I supply that for the record? I get a little fuzzy on the 1934 history. As a matter of fact, the history itself is a little bit fuzzy.

(The information requested follows:)

There is, of course, a link between our going off the gold standard domestically in 1933 and the present request to remove the gold cover requirement in the sense that the gold cover has been an anachronism since that time. As brought out elsewhere in the testimony, once our currency was no longer actually convertible into gold domestically, there was no need for a domestic cover requirement.

There would, however, appear to be little similarity between the reasons that lay behind the departure from the gold standard in 1933 and the increase in the price of gold at that time and the reasons we now seek removal of the cover requirement. The world then was in the depths of the depression and it was believed the increased price of gold would stimulate recovery. We are, of course, not in similar circumstances today.

Mr. GALIFIANAKIS. Reference has been made to so much psychological emphasis, and you would hear terms, certainly before 1934—I don't recall them, but I have heard about them—that the dollar is as good as gold. And you hear today that the dollar is as solid as gold, or as good as gold. And we keep making reference to the psychological impact that removes the gold cover. Can't we have an equal psychological impact by saying that gold has never been as good as the dollar?

Mr. BARR. I think there are many who would agree with you, sir; but I can't prove it one way or the other.

Mr. GALIFIANAKIS. With your description of the dollar as being a central focal point around $200 billion international trade, it would seem to me gold has never been as good as the dollar.

Mr. BARR. There is an argument—to which I don't know the answer—there are those who say the dollar gives gold its value. If we didn't buy gold, it might fall to $10 an ounce; and the others dispute it. I don't know the answer, but at least it is a subject of dispute. Does gold give value to the dollar, or the dollar give value to gold?

Mr. GALIFIANAKIS. If we fail to enact this legislation, and I think it is needed, what do you envision the symptoms to be in the next 6 months on our economy?

Mr. BARR. If we fail to enact this legislation?

Mr. GALIFIANAKIS. If the Congress fails.

Mr. BARR. Domestically, I would see no action. Governor Robertson might wish to comment.

Mr. ROBERTSON. I would see no reaction insofar as the domestic economy is concerned. But I would see the possibility of anticipatory takings of gold by those foreign central banks which see the free gold diminishing and, therefore, want to get in fast, while they can. And also, I think it might give rise to further speculation against the dollar in the sense that people will believe that since this free gold is getting down so low there must be something being considered about increasing the value of the gold, which means decreasing the value of the dollar.

This is the farthest thing from the mind of anybody. We want to maintain the value of the dollar in gold and eliminate the speculation against a change in the price of gold. By making clear the amount of gold which is available for our international transactions, we would do exactly that.

Mr. BARR. I want to make it clear that I think our allies in Europe, and the United States are in the same, are in absolute agreement. We will use our gold to the last bar. We are not going to raise the price.

Chairman PATMAN. Mr. Bevill.

Mr. BEVILL. Mr. Chairman, I would just like to ask this question. I believe it was stated earlier that there are only three major countries that have been using the gold reserve.

Mr. BARR. Yes, sir.

Mr. BEVILL. Would you tell me what those countries are, the names of those countries?

Mr. BARR. Belgium, Switzerland, and the Netherlands, among the group of 10 plus Switzerland.

Mr. BEVILL. Is there any precedent for any other country in the world that was on this gold reserve, having the gold reserve and then going off the gold reserve?

Mr. BARR. I will have to supply that for the record.

Mr. BEVILL. And would you name some of these major countries that have never been on the gold reserve?

Mr. BARR. Yes; we will supply that.

(The information requested follows:)

GOLD RESERVE PRACTICES OF OTHER COUNTRIES

If only major countries are considered and if we revert to the pre-World War I period of the gold standard, then it is fair to say that all major countries at one time or another had gold reserve requirements. The majority have, however, long since repealed or suspended these requirements. Also, some countries that do still have reserve requirements allow these to be met by foreign exchange in lieu of gold.

Among the countries which have repealed or suspended requirements are:

Austria	Germany
Australia	Italy
Canada	Japan
Denmark	Norway
France	United Kingdom

Some countries that do have reserve requirements are:

Country	Gold only	Foreign exchange and gold
Belgium	X	
Netherlands		X
Switzerland	X	
South Africa	X	
Mexico		X

Chairman PATMAN. Mr. Halpern.

Mr. HALPERN. I would commend both of our witnesses this morning, Secretary Barr and Governor Robertson, for their very enlightened and most helpful and informative testimony.

Governor Robertson, there is no doubt that the main role played by the gold cover is a psychological one. That has been brought out here this morning. Do you foresee any psychological ramifications on the international scene from the fact we have been forced to move, as a last resort, the removing of these gold cover requirements?

Mr. ROBERTSON. No, I don't. I think the psychological reaction, if any, would be very good, because it would give a truer picture of the amount of gold that is available for exchange for dollars; and the purpose of this is not to enable this gold to go out. What we need to do—and if we don't, we shouldn't be here today—is to employ such monetary and fiscal policies in this country as do establish the kind of economy which can afford to have dollars going abroad. And the trouble is we have too many dollars going abroad.

Mr. HALPERN. I think the psychological effect would be good.

Mr. BARRETT (presiding). I wonder if it would be an imposition to shorten your time and give the other members a few minutes?

Mr. HALPERN. Surely.

Mr. BARR. We are available to the committee this afternoon and in the morning.

Mr. BARRETT. The House will be in session.

Mr. HALPERN. Secretary Barr, you mentioned the retaliation from opposing quotas on imports. Don't you fear retaliation if we enact the restrictions outlined by the President in his balance-of-payments message?

Mr. BARR. To which restrictions are you referring, Mr. Halpern—direct investment? I don't think we will. I don't think that will encourage it. As a matter of fact, there has been, I am sure you are aware, some political feeling in Europe against such investment. I don't look for retaliation in that area. In tourism, we are preparing to discuss with the Ways and Means Committee what we are going to do in this area.

As I have indicated, it is not so much to cut down the total flow of traffic, but to cut down the amount spent overseas. And I think Europeans can understand this objective and sympathize with it, and the best indication that we have is that our sales of airplanes will not suffer.

Mr. HALPERN. The point was made earlier by Mr. Blackburn, I believe, that the removal of the gold cover and various recommendations in the President's balance-of-payments message were temporary measures to shore up the U.S. financial position, as well as the entire international monetary system of the free world.

I gather the ultimate solution, as you see it, would have to lie in maintaining economic stability and simultaneously moving toward a system of international currency. We are, in fact, placing a great reliance on this new development. What if some nation, for example, France, refused to go along?

Mr. BARR. With the SDR?

Mr. HALPERN. Yes.

Mr. BARR. They voted for the amendment at Rio, Mr. Halpern. Negotiations are proceeding satisfactorily at the moment. Fifty percent of the Governors must ratify the agreement, and then 60 percent of the nations having 80 percent of the votes must ratify it. So France couldn't block the adoption.

Mr. HALPERN. Didn't France say they wouldn't ratify it unless we improved our balance-of-payments picture?

Mr. BARR. It is my impression that France is insisting we do not actually issue SDR's until our balance-of-payments position——

Mr. HALPERN. That is exactly right. That is my point.

Mr. BARRETT. Mr. Reuss.

Mr. REUSS Secretary Barr, as you have explained, our direct investment program for continental Western Europe is that American capital investment in 1968 be terminated.

Mr. BARR. Outflows from the United States.

Mr. REUSS. Shortly after the President's message an exception was made for Greece, a country where a democracy was recently displaced by a military dictatorship, and Melina Mercouri has been wondering out loud why we did that.

Mr. BARR. We didn't make an exception for Greece. Greece was included, not being in the same economic strength as the rest of Europe.

Mr. REUSS. There are no restrictions on American investment in Greece?

Mr. BARR. Greece and Finland are in the 110-percent category with Latin America, most of Africa, less developed nations. This was an economic judgment, Mr. Reuss.

Mr. REUSS. And the answer is, Greece is poor?

Mr. BARR. The answer is, it was an economic judgment.

Mr. REUSS. Portugal is poor. Is Portugal exempt?

Mr. BARR. There were economic judgments made in these areas, Mr. Reuss.

Mr. REUSS. Ireland is poor. Is Ireland being given the same treatment that the military dictatorship in Greece receive?

Mr. BARR. Ireland is in the 65-percent group.

Mr. REUSS. Greece is in the 110-percent group?

Mr. BARR. That is right. It goes back, as I understand it—it is linked to the interest equalization tax list. That is the list we use.

Mr. REUSS. Well, I am still mystified.

Mr. BARR. The IET list, as you know, has changed from time to time. But we did not change it here. We took it as it stood, as it applied to less-developed nations, and applied the direct investment program designation of less-developed nations to precisely conform to the IET list.

Mr. BARRETT. Mr. Brock.

Mr. BROCK. I have enjoyed your testimony so far, gentlemen. In the general area of the gold cover, I don't think many of us would really argue the point that there is very little value to the average American in having a 25-percent requirement. We do have a question as to the psychological impact of a related unit of value of some kind, be it gold or—somebody else suggested, maybe soybeans. But we have gold today. I think Mr. Galifianakis raised the point which might be interesting to explore: Which is more valuable, gold or the dollar? I think we could find out if we not only took this step, but then proceeded to sell our gold at whatever price we could obtain on the open market. Just dump $12 billion worth of gold and see what happens, and then go off the gold standard. I think it would make a most interesting exercise.

We are not really talking about gold here today. What we are talking about is a basic flaw in our competitive ability as a nation. That is what concerns me. Because I don't hear enough conversation or answers as to what we are doing to address ourselves to the flaw. I don't think the President's program is adequate. I don't think it addresses itself to the real problem.

For example, he challenges management and labor to exercise the utmost responsibility in their wage-price decisions. And how did he assist them in this process, by abolishing the wage-price guidelines. It is sort of discouraging to see this administration talking about curtailing private investment overseas when our net income from private investment is one of the major factors in us having a balance of payments at all.

We are cutting off our nose to spite our face a few years down the road by reducing our private investment overseas. We talk about reducing loans which are paid back in a very short period of time and which, primarily, go out to finance the export of American goods overseas.

The President says we are going to reduce Government expenditures overseas, the impact of our troop commitment over there, by having them purchase U.S. securities. Well, what is going to happen when we have to pay those securities off? What happens to your balance of payments, 5, 6, 7 years down the road, if we have not corrected this basic imbalance in the competitive structure of the United States, and this is caused by irresponsibility on the part of the U.S. Government, which will have an accumulative deficit of $100 billion under this administration?

I think we should address ourselves a little more to what we are doing about the basic problem, and not worry so much about the gold cover.

Mr. BARRETT. Before Mr. Fino is recognized, I want to say to you gentlemen here this morning, Mr. Barr and Mr. Robertson, we will recess until Thursday morning at 10 o'clock and will have a few other persons who wish to be heard, and you will be here also?

Mr. BARR. Yes, sir.

Mr. FINO. I was just curious, Mr. Barr, as to one part of your testimony here this morning where you said that Algeria had cashed in $150 million for U.S. gold. Are you at liberty to say where Algeria got 150 million American dollars?

Mr. BARR. I would tell you, if I knew the answer. The best answer that we can find is that they had about $175 million in reserves. This is the best we can find. We don't have access, even with the best of intelligence, to all the affairs of other nations. But the best information we have is that they cashed out about $150 of the $175 million holdings that they had.

Mr. FINO. Would you venture to say that it might be some of the bankers of France that are in cahoots, or working together, in Algeria?

Mr. BARR. Well, it would be sheer speculation on my part, Mr. Fino. I don't know. They had $150 million. That is all I know. Where they got it, I don't know. I am sorry.

Mr. BARRETT. Thank you, Mr. Fino.

The committee will stand in recess until 10 a.m. Thursday morning.

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, January 25, 1968.)

89-292—68——6

REMOVAL OF GOLD COVER

THURSDAY, JANUARY 25, 1968

House of Representatives,
Committee on Banking and Currency,
Washington, D.C.

The committee met, pursuant to recess, at 10:45 a.m., in room 2128, Rayburn House Office Building, Hon. William A. Barrett presiding.

Present: Representatives Barrett, Sullivan, Reuss, Moorhead, Stephens, St Germain, Gonzalez, Minish, Hanna, Gettys, Annunzio, Rees, Bingham, Galifianakis, Widnall, Fino, Dwyer, Brock, Clawson, Johnson, Mize, Lloyd, Blackburn, Brown, Williams, and Wylie.

Mr. Barrett. The meeting will come to order, please.

Today the committee continues consideration of H.R. 14743, a bill to eliminate the reserve requirements for Federal Reserve notes and for U.S. notes and Treasury notes of 1890. We have back with us Under Secretary Barr and Vice Chairman Robertson, who are available to answer any additional questions which the members may have.

Following them, we will hear from Congressman Charles W. Whalen, Jr., of the Third District of Ohio.

The committee was also scheduled to hear from Mr. Danielian, president of the International Economic Policy Association, today. However, Mr. Danielian could not appear today, and we will attempt to schedule him next week. In addition, a request to be heard on this legislation has been received from the Liberty Lobby. I understand the staff is in contact with that organization to arrange a mutually agreeable time to be heard.

It is my further understanding from the chairman of the committee, Mr. Patman, that additional proposed witnesses were to be received from the minority for consideration. As yet, it is my understanding that no names or organizations have been submitted by the minority on this matter. It is hoped that the committee will be able to conclude testimony on this bill next week and that the committee will then proceed in executive session to mark up the legislation.

Now, Mr. Barr and Mr. Robertson, if it is not an imposition, we would like to call the Congressman from Ohio, who desires to make a brief statement. This will give us an opportunity to have the other members present who may desire to ask you further questions.

Will the gentleman, Congressman Charles W. Whalen, Jr., of the Third District of Ohio, come forward?

Congressman, we are very happy to have you here this morning. While you have not been in this body too long, you have gained a great deal of affection by not only the Republicans but also the Democrats. And we are very grateful to have you come here this morning and give us your testimony.

If you desire to read your statement, you may do so, or if you prefer to be asked questions, we will do that. Whatever you choose to do, we will abide by it.

STATEMENT OF HON. CHARLES W. WHALEN, JR., A REPRESENTATIVE IN CONGRESS FROM THE THIRD CONGRESSIONAL DISTRICT OF OHIO

Mr. WHALEN. Thank you very much, Mr. Chairman. I will read this statement as it is rather short.

Mr. Chairman and members of the House Committee on Banking and Currency, I appreciate this opportunity to testify on behalf of H.R. 14743 and H.R. 14783, a companion measure which I introduced on January 23.

You also have heard expert testimony urging the removal of the so-called gold cover. Therefore, I will not expose you this morning to a lengthy recitation of the merits of the bills now before this committee. Instead, let me offer three observations for your consideration.

The first, the requirement that gold certificates equal a certain percentage of Federal Reserve notes outstanding is an anachronism. Until the early 1930's the United States operated on the gold standard. Gold circulated as currency. Representative paper money was redeemable in gold by its holders. Dollars held by foreigners likewise were exchangeable for gold.

When our country abandoned the gold standard in 1933, two vestiges of this system were retained. The first was a twofold gold cover requirement. Specifically, the Federal Reserve System was directed by Congress to hold gold certificates as a percentage of, first, Federal Reserve notes outstanding, and second, member bank reserve deposits—held by the Federal Reserve. The latter requirement was repealed by Congress in 1964. The former remains.

Today domestically held American currency is not redeemable in gold. Thus, the provision that gold certificates be held in reserve against Federal Reserve currency is meaningless. It is a throwback to the early thirties. Since the gold cover is not applicable to today's monetary system, it should be discarded on a purely theoretical basis.

As an economist, I often am asked, "Won't repeal of the gold cover remove the discipline from our monetary system?" In this connection, two factors must be remembered. First, Federal Reserve notes represent only a small percentage, approximately 22 percent, of our Nation's total money supply. By far the larger portion is demand deposits held by commercial banks, accounting for approximately $141 billion.

Second, Federal Reserve officials already possess sufficient authority from Congress to prevent creation of an excessive money supply.

These powers, as you know, include the right to, first, adjust member bank cash reserve requirements; second, conduct open market transactions; and, third, establish discount rates.

My second observation, if our Nation is to continue to meet its international commitments, the gold cover statutes soon must be repealed.

The second remnant of the old gold standard is our Government's guarantee to sell gold when presented dollars by foreigners. Our ability to honor this commitment, however, has been inhibited by the previously cited archaic requirements that gold certificates equal a certain percentage of the total of Federal Reserve notes outstanding. Thus, under today's law, we presently guarantee $10.7 billion of our total $12 billion in gold. This leaves only $1.3 billion in free gold to meet the demands of those foreigners who may wish to exchange their dollars for gold.

Elimination by Congress of the last remaining gold cover clause would offer two immediate benefits. First, it would enhance the U.S. ability to honor its international pledges by freeing approximately $10.7 billion in gold.

Second, this display of determination should create a favorable psychological effect abroad. This, in turn, should end the speculative activities, which apparently contributed substantially to our deteriorating balance-of-payments situation in the fourth quarter of 1967.

My final observation, removing the gold cover, however, does not solve our balance-of-payments problem. If Congress repeals the requirement that gold certificates be maintained as a percentage of Federal Reserve notes outstanding, we in effect are buying time. In this context, such action only can be considered as an expedient. It does not address itself to the cause of our gold outflow; namely, the accumulation of dollars abroad as a result of recurring American balance-of-payments deficits.

Thus, upon passage of H.R. 14743 or some similar measure, Congress faces another task. It is vital that we adopt a long-range program which will provide a positive, sound solution to our balance-of-payments problem.

Thank you, Mr. Chairman, for this opportunity to appear before your committee. And I will endeavor to answer questions if there are any.

Mr. Barrett. Thank you, Mr. Whalen. I have no questions to ask you. But I want to say, you have submitted a very fine statement, and I am very grateful for your statement.

Mr. Widnall.

Mr. Widnall. Thank you, Mr. Chairman.

You are certainly welcome here before the committee today. And you have made an excellent statement.

Mr. Whalen. Thank you, Mr. Widnall.

Mr. Widnall. And I personally know that you are well qualified in this field. And it was one of your activities long before you came to Congress, and we are fortunate to have you here.

Do you have any suggestions as to how the speculative activity in gold might be curbed?

Mr. Whalen. As I have indicated in my testimony, certainly one step that could be taken would be to repeal immediately the so-called gold cover. I think that the psychological effect would be such that the speculation would cease. It would indicate to the world our intent to honor the commitment which we now have.

Mr. Widnall. What happens if this does not work?

Mr. Whalen. It is a question, of course, as to how long this speculation would continue, Mr. Widnall. As I have indicated, if this is repealed, certainly we will have additional gold with which to meet our commitments. I cannot foresee the possibility of the entire $10.7 billion of additional free gold being drained from our country in any short period of time.

Mr. WIDNALL. As I understand it, the normal domestic trend is running about $700 million a year, and we have got about $1.3 billion level. So without any unusual circumstances, that could be used up in a 2-year period in this country?

Mr. WHALEN. Without the removal of the gold cover?

Mr. WIDNALL. Yes.

Mr. WHALEN. Yes.

Mr. WIDNALL. That is all.

Mr. BARRETT. Mr. Reuss.

Mr. REUSS. I am delighted to hear your views on the subject of the gold cover, Mr. Whalen.

As regards the solution of the long-term problem, while that is not specifically the purpose of the hearings, that would be enlightening. Would you care to give us some of your ideas?

Mr. WHALEN. Mr. Reuss, I think first we have to determine who the real culprit in this situation is. I believe any analysis will indicate that the balance-of-payments deficit was created largely in the public or governmental sector of our economy. Just using 1966 figures—the 1967 ones are not in as yet—an analysis would indicate that the private sector generated a $4.3 billion trade surplus, whereas the governmental sector created a $5.6 billion deficit, the difference, then, of course, being the $1.3 billion trade deficit which occurred in 1966.

Thus, we should examine many of our commitments abroad in order to determine whether perhaps they, too, might not be archaic. I am referring particularly to our troop commitments in Europe, the United Kingdom, and Japan.

I am not prepared, and doubt that any of us are prepared, at this time, to state that we should remove our troops from these areas. But I suggest that it would be well to establish what I would term a bipartisan, bicameral commission to study this question and report to the Congress in a period, let us say, of about 6 months. Such a commission could provide some of the answers that we would like to have as to whether or not these commitments are as valid today as they were when they were made in the late 1940's. This certainly is one approach.

I, of course, would agree with some of the proposals made by the President, some of the more positive ones, such as our efforts to improve our exports, and our efforts to attract more travelers to the United States from abroad.

Mr. REUSS. When you say that the major cause of our balance-of-payments deficits, which in turn are at the root of our problems, is the governmental account rather than the private account, you are talking very largely about military commitments, are you not? Our foreign aid is very largely covered by the Buy American provision.

Mr. WHALEN. It is spent back in the United States, that is correct.

Mr. REUSS. So that the main problem is caused by our overseas military commitments in Europe and Vietnam, is that about it?

Mr. WHALEN. Yes.

Mr. REUSS. I think you have made a real contribution to our thinking. Thank you very much.

Mr. WHALEN. Thank you, Mr. Reuss.

Mr. BARRETT. Mr. Fino.

Mr. FINO. First of all, I want to congratulate you, Mr. Whalen, for appearing before this committee. We always appreciate hearing your expert testimony.

I think it was about 15 years ago when I first came to Congress that we had a gold reserve of about $24 billion or $25 billion, and now it is down to about $1.3 billion; am I correct?

Mr. WHALEN. Mr. Fino, we had in 1957 approximately $22.7 billion in gold. Of course, this was under the same restrictions that we have today plus the additional 25-percent restriction, which was repealed in 1964. And this, of course, has dropped in the last 10 years by a little over $10 billion.

Mr. FINO. So that actually we have about $1.3 billion in gold that could be moved out without any restrictions?

Mr. WHALEN. That is right, free gold that is not set aside or isolated.

Mr. FINO. But under the present law, that is under this restriction?

Mr. WHALEN. Yes.

Mr. FINO. And from your testimony, I gather that unless we drastically cut excessive foreign spending, we are going to find ourselves without this $10.7 billion?

Mr. WHALEN. Mr. Fino, let me restate the thrust of the argument which I gave in my formal remarks. I feel that this is an anachronism, that the so-called gold cover bears no relationship to the monetary system that we have today. And thus from a purely theoretical standpoint, it should be healed, regardless of the balance-of-payments situation. It is unfortunate, I must admit, that we change the rules somewhat late in the game. But purely on a theoretical basis, since the gold cover has absolutely no meaning in terms of our current monetary system, it should be repealed. But the second argument, as I indicated, is that it should be repealed in the very near future because of the balance-of-payments problem that we have.

And if we are going to meet these commitments, we are going to end speculation. In my opinion, we should certainly take this first step. I think this is a necessary first step. Certainly there are other steps which we must take to go to the roots of the problem.

Mr. FINO. Some of the legislators have suggested that we withhold delivery of gold to these foreign countries in exchange for American dollars, if these foreign countries owe us money, either on World War I or World War II. What do you think about that?

Mr. WHALEN. As far as World War II is concerned, to my knowledge, at least, the countries that owe us are meeting their obligations on time. In fact, some of them are paying in advance due to this situation.

With respect to World War I, it is a fact that nations still in debt to us are not paying on that debt. It is rather fruitless to think in terms of reclaiming that debt. That debt was based primary upon the reparations concept, and since Germany failed to meet its reparations, France, Great Britain, and the others, in turn, could not pay us. I think it basically was a fruitless concept to begin with.

Mr. FINO. You express no fear here this morning regarding this committee reporting out legislation that would remove this lid on the $10.7 billion?

Mr. WHALEN. No, I don't express fear. I do have a fear, however, that unless we take further steps, this balance-of-payments problem will persist. This is what I hope the committee, in its wisdom, will remember, that this step is needed in order to honor our commitments. And from the theoretical standpoint alone, the gold cover should be removed.

But this will not end the problem. Thus, I feel the Congress must certainly look at the overall balance-of-payments problem and come up with some positive, constructive programs.

Mr. FINO. Getting back to my original question, isn't it true that until we do something about our balance-of-payment deficits, we will find that we have dissipated this $10.7 billion?

Mr. WHALEN. Over a period of time; yes.

Mr. FINO. Thank you.

Mr. BARRETT. Mrs. Sullivan.

Mrs. SULLIVAN. I have a very brief question, Mr. Chairman.

Congressman Whalen, for the record, would you favor flexible exchange rates as proposed by Professor Friedman and others, or do you support the existing system of fixed exchange rates?

Mr. WHALEN. Not at this time. I would support the present system.

Mrs. SULLIVAN. Thank you.

Mr. WHALEN. It is worthy of consideration, I might say, but I am not prepared to espouse this course at this time.

Mrs. SULLIVAN. Thank you, Mr. Chairman.

Mr. BARRETT. Mr. Mize.

Mr. MIZE. If we had no balance-of-payments problem, and we enjoyed a surplus balance of payments, would you still recommend this legislation?

Mr. WHALEN. Yes, I would, Mr. Mize. I don't think there would be the urgency about it. Quite obviously, the balance-of-payments problem has brought this to our attention. But as I suggested before, it has no theoretical or even practical value under today's monetary system in the United States, and therefore, it should be discarded.

I say I am a little unhappy. I suspect we all are somewhat unhappy in having to change the rules under these conditions. But I feel that the rules just are not pertinent to today's system.

Mr. MIZE. Let us assume this legislation were enacted, and let us assume that those holding dollars against our available gold would start converting for various reasons. France obviously has some reasons. For example, let us assume that we would withdraw our troops from Germany, and for that reason they might decide that they would like to draw down gold for their dollars. And let us assume that all $12 billion was taken, even though we were assured yesterday by the Treasury Department that that would not be permitted. What kind of a money system could you visualize, with all other countries in the world having gold and we not having any?

Mr. WHALEN. I would not quite agree that all other countries of the world would have gold. And I would agree also with the statement that was made before, I just don't think this is possible. The commitments that we have to foreigners amount to about $30 billion. It is not conceivable to me at this time or in the short run that all of the dollars involved in these commitments would be exchanged for gold. Because, after all, the United States really is the banker of the world. We perhaps didn't want to be placed in this position, but this is the position in which we find ourselves. I can't see the other nations of the world deliberately destroying the bank by exchanging their dollars for gold.

Mr. MIZE. Of course, it was not conceivable, say, 5 years ago, that France could have been as arbitrary as they have been.

Mr. WHALEN. Well, that perhaps is correct. But with De Gaulle, anything is possible.

Mr. MIZE. So for a variety of possible reasons, as improbable as they may seem to be now, the countries might decide that they wanted to convert their dollar holdings to gold.

Mr. WHALEN. I presume this is certainly possible, but I don't think very probable, Mr. Mize.

Mr. MIZE. Thank you.

Mr. BARRETT. Mr. St Germain.

Mr. ST GERMAIN. Thank you, Mr. Chairman.

We want to thank you, Mr. Whalen, for coming to testify before us this morning. We know the background you have in this field.

You mentioned the role of the United States as a world bank. If we would liken this to our domestic banks commercially, they are required to keep a 10-percent reserve against liabilities. In essence, the reserve, as far as our commitments internationally are concerned, and the world bank, would come out to approximately 30 percent, would it not?

Mr. WHALEN. If you assume that the $10.7 billion would be applied against this.

Mr. ST GERMAIN. Nothing further, Mr. Chairman.

Mr. BARRETT. Mr. Williams.

Mr. WILLIAMS. I am certainly happy to see you here this morning, Mr. Whalen. You say that you regard the removal of the gold cover as something which should be done. And you go on further to state that it is unfortunate that we have reached a condition in which we presently find ourselves through an unfavorable trade balance. I believe we both realize the importance of confidence in the American dollar.

Now, confidence is largely a matter of psychology. And we have heard the statement made before this committee that the only value of having a gold cover is a matter of some psychology. I don't see how you can separate the two. And I don't believe that you can remove the gold cover from our currency and continue to maintain the same degree of confidence in the American dollar.

What are your thoughts on that?

Mr. WHALEN. I presume that I presented that information, Mr. Williams, in my formal statement. But let me restate it in another way.

We have carried over from the thirties the commitment that anyone abroad, any foreigner who holds American dollars, may convert those dollars into gold at the rate of $35 per ounce. However, we indicated to our own nationals that we would no longer convert their money into gold as we did when we were operating on the gold standard.

But at the same time, we retained the gold cover clause which stated in effect that the Federal Reserve had to hold a certain percentage of gold or gold certificates technically against the Federal Reserve notes outstanding.

In teaching this in class, for example, I have been asked the question, "What does this mean when Americans cannot convert into gold, why this artificial reserve?" It is very difficult to answer. It has no applicability in the domestic economy. But we have made this commitment abroad. And I feel if we take this necessary step it will indicate to foreigners that we are honoring this commitment, we do intend to follow through with our promise to redeem gold for dollars turned in.

Mr. WILLIAMS. But in spite of the fact that it does not have any effect as far as a practical matter is concerned, just the fact that our currency is backed up with gold to some degree is responsible in some part for the confidence that people here and abroad have in our currency, is it not?

Mr. WHALEN. Mr. Williams, I never use the word "backed," because I think it is deceiving. In my opinion, if you define the term "backed" to mean redeemable, since our currency domestically is not backed by gold, it is not redeemable, as you have suggested, but it is redeemable abroad. What we are saying is that we are going to free this gold so that we can continue to honor this commitment.

Mr. WILLIAMS. Now, suppose we do free this gold, just as gold was freed 3 years ago, when the gold cover was taken off the Federal Reserve deposits, and the unfavorable balance of trade continued. So now we are in the position where we are considering this move to make more gold available so that dollars held abroad can be redeemed in gold. Now, do you think that there is going to be any real stimulant provided to correct this unfavorable balance of trade just by taking this move, or do you think we are going to go on doing business at the same old standard and our gold reserve will continue to be depleted?

Mr. WHALEN. You weren't here, Mr. Williams, when I made some remarks in this area. I did not say that this would solve the problem. This is a necessary first step, but it does not go to the root of the problem, and a second step must be taken. I certainly hope that this Congress will take a hard look at this and come up with some positive, constructive, long-term solutions to our balance-of-payments problem.

Mr. WILLIAMS. If we enact H.R. 14743, to remove this gold cover, aren't we also removing the urgency for taking the second step that you have mentioned?

Mr. WHALEN. I hope not.

Mr. WILLIAMS. But on past experience, wouldn't it indicate that such might be the case?

Mr. WHALEN. I would concede that you have a point. But I certainly hope from this past experience that we would learn for the future.

Mr. WILLIAMS. One more question. As our gold reserve continues to be depleted, and let us assume that we get down in 5 years to $4 or $5 billion unless necessary steps are taken—don't you think that the confidence in the American dollar would be undermined to the point where more and more countries would be converting their dollars into gold?

Mr. WHALEN. This is possible. But I question really the degree of lack of confidence in the American dollar. Some of the movement certainly has been speculative. But, after all, the dollar serves as a reserve currency in many countries of the world, representing about 45 percent of the world reserves.

Mr. WILLIAMS. I ask you, as the ability of the American Government to redeem dollars in gold diminishes, isn't this going also to diminish confidence in the American dollar?

Mr. WHALEN. It could. But confidence in the American dollar is strong, and we in this country tend to be more concerned about confidence than foreigners.

Mr. WILLIAMS. I was addressing myself to the time 5 years from now when our reserve might be more seriously depleted.

Thank you very much.

Mr. BARRETT. Do any other members wish to ask questions?

Mr. Gettys, we recognize you.

Mr. GETTYS. Thank you, Mr. Chairman. I join with my colleagues in welcoming you, and I am aware of the expertise of Mr. Whalen on this subject, and of his excellent background. I believe he was head of the Department of Economics at the University of Dayton.

Would you state, Mr. Whalen, whether or not you feel there is any implication other than psychological that would affect the economy of the United States domestically in this matter if we remove the gold cover?

Mr. WHALEN. I don't think it would have any material effect at all domestically.

Mr. GETTYS. Thank you.

Mr. BARRETT. Mr. Hanna.

Mr. HANNA. Mr. Chairman, I would simply like to extend my congratulations to Mr. Whalen for his fine grasp of this very important problem.

I would like to ask you to let me briefly review this situation. I hope you will not hold me firmly to the numbers that I recite. If I recall correctly, in 1948 the United States had over $25 billion worth of gold. At that time, it had an economy that had a gross national product of something like $286 billion. It had assets abroad of over $29 billion.

Now, in the intervening years, although the gold supply has gone down to something like about $12 billion, the gross national product is reaching for $800 billion, and the assets abroad are something like $85 to $89 billion. So it occurs to me that the strength of the Nation certainly has not diminished in the period of time in which we have allowed the transition from gold holdings. It has, in fact, gained more strength at home and more investment abroad.

Would the Congressman comment on that as an assessment of our situation?

Mr. WHALEN. I would agree. The point that you have made is well taken. And it points up the fact that gold plays only a limited role in both our domestic activities as well as our activities abroad.

Mr. HANNA. I thank you, Congressman.

Thank you, Mr. Chairman.

Mr. BARRETT. Mr. Annunzio.

Mr. ANNUNZIO. Thank you, Mr. Chairman.

All that I want to say is that I welcome my neighbor in the Longworth Building and my friend. I appreciate the very favorable comment on H.R. 14743.

Mr. WHALEN. Thank you, Mr. Annunzio.

Mr. BARRETT. Thank you, Mr. Annunzio.

In a spirit of brevity, let's see the hands of those now who desire to ask questions.

Mr. Bingham.

Mr. BINGHAM. I have no questions. I would just like to compliment my colleague on a fine statement.

Mr. GALIFIANAKIS. I, too, would like to join with the welcoming committee to our colleague, and say that the statement is very succinct, and I agree with both points, the need for the removal of the gold cover, and the need for long-range planning to improve the balance-of-payments problem.

What do you predict will happen to the demand for gold if we enact this piece of legislation? Have you got a judgment as to that?

Mr. WHALEN. When you use the term "demand for gold," do you mean abroad or in our own economy?

Mr. GALIFIANAKIS. Abroad, principally. I am trying to ascertain what are the prospects of gold in the future? You know, right now there seems to be economic thinking that this is all very theoretical, and I am trying to figure out actually what is going to be the prospect of gold in the future.

Mr. WHALEN. As I indicated previously, the point made by Mr. Hanna was well taken. We have expanded world trade at a time when there has not been an equivalent increase in the gold supply of the world. This indicates that gold probably is going to play a lesser and lesser role in international trade, and that some new type of accommodation will be created, probably the special drawing rights, was approved last year.

Mr. GALIFIANAKIS. Do you envision a commodity like gold as replacing gold?

Mr. WHALEN. No. I cannot foresee that.

Mr. GALIFIANAKIS. Thank you very much, Mr. Chairman.

Mr. BARRETT. Thank you, Mr. Galifianakis.

Congressman, we certainly appreciate your coming and edifying all our members here this morning. We appreciate that you are so knowledgeable in this field.

Mr. GONZALEZ. Mr. Chairman, I apologize for being late. But I would like to ask one question.

The only real question I have either the day before yesterday or today is, in your opinion, Congressman, don't you think we are giving the opinion that we are overreacting at this point?

Mr. WHALEN. As I indicated to a previous question, I am not so sure but what there is more of a lack of confidence in the United States than abroad. Foreigners are concerned. But there is some question as to whether the problem really is as serious as perhaps the administration has painted it.

Mr. GONZALEZ. Certainly it should not be made a partisan political issue.

Mr. WHALEN. That is correct. That is why I have taken the liberty of introducing a bill similar to the one the committee has introduced. I feel that this cover is not necessary to begin with and, secondly, it is essential that we remove it in order to meet our commitments abroad.

Mr. GONZALEZ. Thank you, Mr. Chairman.

Mr. BARRETT. Thank you, Mr. Gonzalez.

Mr. WHALEN. Thank you very much, Mr. Chairman.

Mr. BARRETT. Now, will the Under Secretary and Governor come forward, please?

Mr. Secretary and Governor, I certainly want to apologize for prolonging this. And I am very grateful that you gave us the opportunity to have our members heard.

STATEMENTS OF HON. JOSEPH W. BARR, UNDER SECRETARY OF THE TREASURY, AND HON. J. L. ROBERTSON, VICE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM—Resumed

Mr. ROBERTSON. He did a very excellent job, may I say.

Mr. BARR. Mr. Chairman, may I state for the record that I listened very carefully to the colloquy between Congressman Whalen and this committee. And I would like for the record to show that I agree with just about everything that he said, except possibly his point about the seriousness with which we view this situation in the administration.

We think it is extremely serious. This is a matter of judgment. With that possible exception, I would like to associate myself with just about everything that Congressman Whalen offered this committee.

I congratulate the minority on possessing a Member of such astuteness and vision.

Mr. BARRETT. Thank you, Mr. Secretary.

Mr. Secretary, I have no further questions. In the interest of moving the committee forward today to see if we can reach a conclusion that will allow you two gentlemen to return to your respective offices, we will now ask Mr. Widnall if he desires to ask any questions.

Mr. WIDNALL. Mr. Chairman, I do. But if any other members of the committee who were here at the previous time that they testified didn't have a chance to ask questions, I would defer to them first.

Mr. BARRETT. Mr. Gonzalez, were you able to ask any questions of the Governor and the Secretary on Tuesday?

Mr. GONZALEZ. Not really, other than just the same question I asked the Congressman a while ago. And I think that has been answered, and he agreed to what the Congresman said, just a question of timing and whether or not we were giving the impression that we were overreacting to the situation. I just wanted to get their opinion. I have no other specific questions.

Mr. MOORHEAD. Would the gentleman yield for an unanimous-consent request?

Mr. Chairman, in yesterday's Washington Evening Star, the columnist, Sylvia Porter, has an excellent column entitled "More of Gold and the Dollar." I think it states the case for the enactment of this legislation in very clear and readable terms. I ask unanimous consent that this column be made a part of the record at this point.

Mr. BARRETT. Without objection, it is so ordered.

(The article referred to follows:)

[From the Washington (D.C.) Evening Star, Jan. 24, 1968]

YOUR MONEY'S WORTH—MORE OF GOLD AND THE DOLLAR

(By Sylvia Porter)

Q. If Congress approves President Johnson's request to remove the 25 per cent "gold cover" behind paper currency, what will remain to back the dollar? How will the dollar's worth be measured?

A. The dollar, as always, will be backed by the enormous power of the economy to produce goods and services and its awesome capacity to continue expanding jobs, output, paychecks and profits year after year. This power comes from the huge amounts the Treasury collects in taxes. This is the force that underpins the American currency.

As for measuring the dollar's "worth," the answer is, as it has always been during this century, by the total goods and services paper dollars will buy.

These points were as true a year ago as they are today, or five or 10 years ago. But still the fact is that the President in his State of the Union message last week finally did call for legislation "to free our gold reserves" so that the world would be assured "that America's full gold stock stands behind our commitment to maintain the price of gold at $35 an ounce."

Passage of this legislation would break the last remaining link between the precious metals of gold and silver and paper currency. Thus, questions about the background and implications of the move take on new concern. For instance:

Q. What is the gold cover?

A. It's a statutory requirement that there be 25 per cent in gold behind Federal Reserve notes, which represent practically all the paper money in cirulation. This requirement freezes about $10.7 billion of the $12 billion gold reserve, leaving only about $1.3 billion in free gold to meet the demands qualified foreign creditors for gold in exchange for their dollars.

Q. What is the background of this requirement?

A. It is a hangover from the pre-1933 era when U.S. paper money was entirely convertible into gold.

When the dollar was devalued in 1934 and the price of gold was set at $35 an ounce, the law prohibited U.S. citizens from owning gold, and that made any gold cover an anachronism overnight. Still, tradition demanded it and the initial requirement was a fat reserve against both notes and member bank deposits. In 1945 and again in 1964, the cover was substantially loosened—and now it is to be removed in whole or in part.

Q. What would this accomplish?

A. All the gold would become readily available for sale to qualified foreign creditors at $35 an ounce. This knowledge alone should strengthen confidence in the dollar. It should make foreigners less eager to turn in dollars on which they can earn interest instead of gold on which they can earn nothing and which costs money to store.

Q. Would this enourage the Treasury to print more money?

A. It is the Federal Reserve System which controls the money supply through its policies determining the availability of credit. Cash represents only about one-fourth of the total money supply; the balane is "checkbook money." This fear is unfounded.

Q. Is this a sign of weakness?

A. It is certainly another warning to get U.S. budgets under better control.

What the country is doing is buying time to put accounts in shape and to build a stronger world monetary system. The dollar remains the only reserve currency in the world, the only truly international money. Gold is not its strength, the economy is.

Mr. BARRETT. Mr. Widnall.

Mr. WIDNALL. Mr. Secretary, I have in front of me the Senate report on gold reserve requirements that was issued on February 10, 1965, almost 3 years ago, when the Senate subcommittee issued a report on gold reserve requirements to accompany H.R. 3818. This was a bill to eliminate the requirement that Federal Reserve banks maintain certain reserves in gold certificates against deposit liabilities. Under the purpose of the legislation, in the third paragraph, it says:

> The bill would give time to the Government to take firm and effective action and solve our balance-of-payments problems in a sound and growing economy without compelling such drastic measures as to threaten our prosperity and our strength at home and abroad. But it would require that the balance-of-payments problems be faced and solved properly while we still have a large stock of gold, instead of postponing action until our gold is lost and our international financial position has weakened.

Do you think that same paragraph could be used to report on this bill?

Mr. BARR. I think it would be appropriate, Mr. Widnall. And let me say that one of the hazards of occupying the position of Secretary or Undersecretary of the Treasury or Chairman of the Federal Reserve Board is that you make predictions that sometimes do not come about.

May I point out, sir, that shortly after that report was issued, the President of the United States, and the administration, announced the voluntary program. It was designed to restrict investment by U.S. corporations overseas, and to hold down bank loans that caused dollars to leave this country. They did move in that direction, sir. That was the plus side of the factor.

On the minus side, however, a few months later we deployed our troops into Vietnam.

Another minus factor was the fact that we did not realize what the extent of French gold purchases, which amounted to $1½ billion would be.

And the third minus factor, Mr. Widnall, is the fact that the British devaluated on November 18, and the repercussions of that action made some of the predictions look a little bit ridiculous in the light of events.

Mr. Widnall. Of course, all those things had not happened at the time of this report.

Mr. Barr. That is correct.

Mr. Widnall. But still the report said it would give time to the Government to take firm and effective action to solve our balance-of-payments problem. Do you think voluntary restraint is appropriate for effective action?

Mr. Barr. There was certainly a move in that direction, Mr. Widnall. We had to do something to curb the enormous outflow of direct investments that were leaving the United States in the fourth quarter of 1964. We also had to tighten up on bank lending, because this was getting away from us. Now, whether it was firm and effective action or not, it was action, sir, which seemed appropirate and adequate in the circumstances. It did, as I pointed out, bring the United States into surplus in the second quarter of 1965 for the first time since 1961, and the second time since 1957. We were moving in the right direction. The interruption of Vietnam, large French withdrawals, and the British devaluation brought many predictions to naught. And now we are coming back, sir, with, as I have indicated, a vastly more stringent program putting manadatory controls on direct investment, and restraining even further the ability of banks to lend overseas.

We are attempting to get another half billion saving on our Government expenditures; we are asking American tourists to defer, to hold down their expenditures overseas. We are moving in a way today, Mr. Widnall, that I think could be called drastic.

Mr. Gonzalez pointed out that perhaps some people think we might be overreacting. Our position is that the situation we face now is extremely serious, and calls for drastic action, sir.

Mr. Widnall. Then with respect to tourism, as I understand it, you don't want to restrain tourism within our hemisphere, to South and Central America, is that correct?

Mr. Barr. That is correct, sir.

Mr. Widnall. Wouldn't that solve spending hundreds of millions of American dollars overseas that could then be used by those countries to purchase things from other countries?

Mr. Barr. There is that point, Mr. Widnall, although if you will look at the pattern of trade between this country and Canada, Mexico, and South America, you will see that there is a very, very heavy return. If we spend a dollar in those countries, most of it comes back. So we do feel that we can be more liberal in our own backyard, where the dollars we spend will flow back to us, than we can be in Europe and Asia where there is less likelihood of the dollars flowing back.

Mr. WIDNALL. Let me understand something about the sale of gold for commercial purposes. If I as a commercial user want to purchase gold, what is the present procedure that I must follow with the Treasury?

Mr. BARR. Roughly, the way it works is this, Mr. Widnall: First of all, you would come to the Treasury Office of Domestic Gold and Silver Operations. You would apply for a license. They would investigate you as to your general reputation, the legitimacy of your business, et cetera. If this investigation turned out to be appropriate, you would be granted a license. Under this license, you would be permitted to buy either directly from the Treasury or from our domestic producers. Fabricators of gold in small amounts are permitted to operate without a license. The pattern has been that roughly half of our total domestic production of $50 or $60 million is bought from the Treasury, and the other half is bought from the producers under a license from the U.S. Treasury. In addition, of course, the Treasury sells some $150 million from official stock to satisfy total domestic demands.

We do have a staff of auditors who go out and spotcheck the books of these licensees and persons who operate under the authorization for small processors periodically to attempt to make certain that they are living in conformity with the regulations that we have issued.

Mr. WIDNALL. Is an end-use certificate required?

Mr. BARR. Yes; one is required for any purchase from the United States and any over $200 from a licensed refiner. Also we require a system of reporting from these licensees which indicates the level of their inventory, and what they are doing with the gold. This reporting system and the end-use certificates, as I indicated, are backed up by our staff of auditors.

Mr. WIDNALL. How does this differ from the procedure of the sale of gold?

Mr. BARR. How does it differ?

Mr. WIDNALL. Differ.

Mr. BARR. In the London gold market anyone can come in——

Mr. WIDNALL. Except Americans?

Mr. BARR. There are regulations, Mr. Widnall, that vary from country to country. Let me give you a little background. Under the U.S. regulations, residents and citizens are not allowed to hold gold or buy it except under a license. Almost precisely the same regulation applies to the citizens of the United Kingdom.

The Italians have an import and export license of some sort.

The Swiss allow free movement of gold.

We could give you this for the record. But there is a pattern that varies from country to country as to the liberality with which they treat this whole gold question. I think the Swiss and the French have the most liberal attitude in permitting their own citizens to own gold and to buy it and sell it.

But in the London gold market, if you absent the fact that countries have their own laws, this is a market where gold is traded freely. It comes into the market from South Africa, from the rest of the producing countries of the world; and some of it even, occasionally, from Russia. And it goes out to the people who place the orders.

Mr. WIDNALL. In my preliminary statement on behalf of the minority, I mentioned 10 points. One of the points had to do with the extent of the international cooperation in the operation of the London gold pool. And also that which would apply to speculative activities. I think that Congress should, as soon as possible, go into this. I don't know that it should be done in an open meeting; I would advise that it be done in executive session.

Mr. BARR. I concur, Mr. Widnall. And I would be delighted to do this.

Mr. WIDNALL. You would like to cooperate with us?

Mr. BARR. Yes, indeed, sir.

Mr. WIDNALL. Mr. Chairman, you said something about other witnesses to be succeeded by the minority. I can give you some names right now that we would like to have appear.

Mr. BARRETT. You may do so for the record.

Mr. WIDNALL. The following persons will be called as witnesses on Tuesday:

Dr. Danielian, from the International Economic Policy Association;

Howard Piquet, of the Library of Congress;

Judd Polk, from the International Chamber of Commerce.

And I have another one. Dr. Nazarola Patterby, the dean of the graduate school of Farleigh Dickinson University.

And we would like to have Mr. Rutherford Poats, the AID Administrator for Vietnam, testify on the Government Operations Committee charge that there is a $300 million per year leakage from U.S. support assistance to South Vietnam. We are trying to get together a panel.

Mr. BARRETT. Those are the names submitted by the minority. They will be scheduled, according to the chairman of the Banking and Currency Committee, Mr. Patman.

Thank you, Mr. Widnall.

Mr. WIDNALL. Thank you.

Mr. BARRETT. Mrs. Sullivan.

Mrs. SULLIVAN. Thank you, Mr. Chairman.

I would like to ask Mr. Barr how to answer the questions that are being put to me. I don't know the answers. But with the gold cover removed, why will we have to redeem the dollars for gold when they are presented for exchange by foreign governments?

Mr. BARR. Mrs. Sullivan, if you are talking to your constituents, I would hope that you are talking to someone with an international financial background, because it is a complicated issue. As Congressman Whalen indicated, we sort of stumbled into the role of the world's banker. At the end of World War II, the whole world was in a state of disarray. There were few currencies that circulated freely in which people had any confidence. At that time, the International Monetary Fund was created. The United States was the only country in the world which was standing on two feet with any power. We formalized, at that time, a responsibility in the whole system. Our responsibility was to be the fixed point in the solar system. We agreed to hold the dollar at a stable price by continuing to convert dollars put to us by foreigners into gold at a fixed price of $35 an ounce. Other countries took on, at the same time, a parallel commitment that they would maintain the value of their currencies—would specify the value of their currencies in the Monetary Fund and would hold to that value, keep their currencies at that value by intervening in the exchange market with dollars to keep their currency at par or within 1 percent on either side.

So the real reason that I guess you must explain to your constituents, as to why do we convert our dollars for international claims, is that we are the fixed point in the international financial operations of the world, and that it has worked very well since the war, because, as I have indicated, trade has doubled.

I think, Mrs. Sullivan, it comes down to this. You asked the question about the fixed versus the floating exchange rates. Let me give you an example. If you were a coffee producer in Ghana—there are wide swings in the price of coffee. That is one risk that you have to take into consideration if you are a coffee grower or a dealer. But if you have to add to that consideration, Mrs. Sullivan, the fact that not only does the price for the coffee swing, but also the price of the money in which you are going to be paid might be swinging violently back and forth, then I think, Mrs. Sullivan, you might come to the conclusion that the whole business is just too risky, and you can't figure the swings and the odds. And this is the reason, as I said, that unless there is some fixed point in this whole area of the value of money, that risk becomes so great that the results could be devastating, in my opinion, to trade in the world.

I don't know if that is going to satisfy your constituents, but that is the truthful answer.

Mrs. Sullivan. Just one further question. Do we hold the currency of other countries?

Mr. Barr. Yes, we do. We hold foreign currencies in the Exchange Stabilization Fund. We also hold the currencies of other countries through the system of Federal Reserve swaps that Governor Robertson might like to comment on.

Mr. Robertson. Very limited amounts at this time, because we have not been in the practice of obtaining these currencies. There could be a time when we would hold more if our balance of payments was the opposite, if we had a surplus instead of a deficit. But the amount of foreign currencies that are held today are insignificant.

Mrs. Sullivan. And if we wanted to exchange their currencies, turn them back, what do we get for them, dollars?

Mr. Robertson. We eliminate dollars that they hold.

Mrs. Sullivan. And are these foreign currencies in the larger nations backed with any precious metals or anything else except the economy and good standing of the country?

Mr. Robertson. They are backed in large part by dollars, because the dollar is the reserve currency of the world. And that is the reason that we have to be in a position to exchange dollars for gold, so that the stability of that dollar is fixed. Otherwise, they are not willing to hold the dollars.

Mrs. Sullivan. Then would it be true that if we would stop exchanging their dollars for our gold that——

Mr. Robertson. The dollar would no longer be a reserve currency, they would be unwilling to hold it if the value of that dollar was going to fluctuate in terms of gold.

Mrs. SULLIVAN. I see. Thank you very much.

Mr. BARRETT. Mr. Fino.

Mr. FINO. Mr. Barr, the thought that comes to me is that if we clamp down on U.S. tourism, tourist travel, and we start placing restrictions, don't you have the fear that there would be retaliation on the part of these countries which would further create an imbalance of payments?

Mr. BARR. There is that risk, Mr. Fino. And it is one that we have to weigh. We will begin discussions, I think, today with the Congress on the appropriate types of moves in this whole area of tourism and travel. This is definitely something that we must keep in mind.

Our earliest indications are that we probably will not get retaliation from the Europeans if we in effect say to the American traveler, "You can go ahead and travel, but slow down a little bit, and shorten up on your stay and don't spend so much money when you are over there." I think we might get retaliation, Mr. Fino, to be perfectly honest, if we said that no Americans can travel any more. And that could be difficult. So that is the consideration that we are going to take into account.

In direct investment, Mr. Fino, I do not think that we are going to get retaliation. As a matter of fact, many European nations think that we are investing too much in their countries. They put up the cry that we are buying up their industry with their credit. And to the best of our knowledge, we will not get retaliation there.

In the matter of troop deployment, Mr. Fino, this gets over into diplomacy and defense posture. But I think we are putting it to them very straight, that we are willing to tax ourselves to help defend them in mutual security pacts, but they must help us to wipe out the exchange costs of these troop deployments.

So that in that area I don't think we will get retaliation. But you are absolutely correct, in all of these things we have to weigh the possibilities. You move on one side, and there is a tendency to move on the other. We must try to mitigate it.

Mr. FINO. What do you think was the basic reason why Great Britain canceled its contract for the F-111?

Mr. BARR. I am afraid, Mr. Fino, that she came to the conclusion that she could not afford it.

Mr. FINO. Thank you.

Mr. BARRETT. Mr. Moorhead.

Mr. MOORHEAD. Thank you, Mr. Chairman.

Mr. Barr, you testified that for the past 20-odd years the gold exchange system, with the dollar being the currency of reference, has worked well. It has permitted expansion of trade, freedom of movement of capital, freedom of movement of people, and so forth. Therefore, you argue, as I understand it, that we should keep the existing system, because it has worked in the past. But it seems to me that maybe we should be reviewing and studying this system, because the system which has promoted increased freedom of trade and increased freedom of movement of people and capital is the very system that is now requiring us to put restrictions on movement of capital, and restrictions on movement of tourists, and if not restrictions on trade, at least devices that are not consistent with truly free trade.

So that isn't this system now doing just exactly the opposite of what it has done for 20 years?

Mr. BARR. Let me answer your question in two parts, Mr. Moorhead. First of all, I quite agree that there is nothing so immutable in the world that it should not be examined with the idea in mind that perhaps it could be changed. I think an exploration of all other possibilities is certainly in order, and I would recommend that the Congress look at them as we have.

But I do stand by my statement that this system has worked, Mr. Moorhead. I would say that our difficulties today are not the fault of the system. That is not the villain, Mr. Moorhead. The fault of the system has been our inability to correct this parade of deficits that we have lived with since 1951. That is the villain. And I am afraid, Mr. Moorhead, that there is no system that can be devised that would remove the necessity for discipline on the part of this Government to meet its problems. Maybe something might make it easier, but I doubt it. I am afraid, Mr. Moorhead, there is no way to gimmick ourselves out of this situation. The villain is not the system, but the fact that we have been unable to correct this parade of deficits since 1951.

Mr. MOORHEAD. Let me ask you this: Is the Treasury considering the possibility, let us say, in the distant future, that there may have to be a change from the present gold exchange system?

Mr. BARR. Very definitely, Mr. Moorhead, in the sense that, as I have indicated, we are not only considering, but are going to present to you legislative proposals in this area in April when we come to you with the special drawing rights plan.

However, I want to emphasize that the special drawing rights plan is not a panacea designed to make it easier on the United States. This is no solution to the basic problem of our balance of payments. It is designed to meet the problem which rises from the fact that gold production is not sufficient, without the continued deficits in the U.S. balance of payments, to provide nations with increasing reserves. We have never indicated that it is an answer to our problems. And we will continue to make clear that the plan is not a panacea for our current difficulties which arise from the fact that we are spending too much and taking in too little.

Mr. MOORHEAD. You testified, and it was very brilliant and clear, that the system that we set up at Bretton Woods was a solar system, with the dollar being the center of the solar system, and the point of reference for all other currencies.

Mr. BARR. Right.

Mr. MOORHEAD. And the reason that the dollar could hold this position as the center of the solar system is that we were willing to tie the dollar to gold, isn't that correct?

Mr. BARR. That was one of the reasons. And the other reason, of course, was—and still is—the huge economic strength of the United States. There are two reasons. The gold and the enormous economic power of the United States. You know, Mr. Moorhead, that this country accounts for some 40 to 45 percent of the total production of the free world, and about one-third that of the whole world. So it is a combination of those two things.

Mr. MOORHEAD. But as the economic power of the United States vis-a-vis the rest of the world declines in importance, as the total world supply of gold decreases relative to world economic activity, and particularly the gold supply of the United States declines relative to the rest of the world trade, are we not in a position where we have built a system based on one assumption which has now changed?

Mr. BARR. That is true to some extent and the shift to the special drawing rights takes account of that, Mr. Moorhead, because then while the dollar will continue to be a major factor in that solar system, there will also be another sun in there. That is the whole philosophy in this special drawing rights approach.

Mr. MOORHEAD. That is really what I am trying to get at, whether, as the basic assumption of the Bretton Woods agreement shifts, we should be shifting with it.

Mr. BARR. That is correct.

Mr. MOORHEAD. While I am very much in favor of the special drawing rights agreement, I think it is just a little bit of a bite of what we are going to have to face in the future, which is to develop a much stronger international currency of reference. What I am really urging is that the Treasury keep moving ahead toward this, because we are in a much better bargaining position now, with a very large share of the free world's gold, than we will be 10 years hence, when we will probably not have such a large share.

Mr. BARR. I would like the record to show that I concur, completely, with that statement. And I assure you that we are pushing as hard as we can. It seems our allies are a little bit difficult to nudge along—but I agree, this is the time to keep on it. And I assure you we are.

While the first step of the SDR might be small, I think this scheme has within it the seeds of growing rather rapidly, if the world should get into a crisis. In the event of a crisis, such as we had in the early thirties, I think you would see this small germ jumping out into a full-blown scheme almost immediately—if we had anything occur in the world such as we did in 1933 and 1934.

Mr. MOORHEAD. I am most encouraged by your statement. I believe, with my fingers crossed, that our economic system is in sufficient good shape that we won't have a domestically inspired money panic and depression.

Mr. BARR. Right.

Mr. MOORHEAD. However, I am not persuaded that we have arrived at a point where an international money panic could not occur causing a possible international depression which would also be a depression for us.

Mr. BARR. I concur, Mr. Moorhead. And I want to repeat that this is the thrust of the whole SDR scheme, starting small, but it could be expanded rapidly and I think it would be expanding rapidly if we got into such a crunch.

Mr. MOORHEAD. Thank you.

Mr. BARRETT. Mrs. Dwyer.

Mrs. DWYER. No questions.

Mr. BARRETT. Mr. Brock.

Mr. BROCK. Thank you, Mr. Chairman.

I have so many areas, I don't know where to begin.

Thank you for coming back. I appreciate your statement, Mr. Barr, that you don't think we can gimmick our way out of this situation. I hope that signals a major policy shift on the part of the administration. I think we have tried to gimmick our way out of this situation for the last 6 years by SDR's or the interest equalization tax.

May I ask you, have you in the Treasury—or has the Commerce Department in the administration of the figures—done a study of the effect—I know it is hard to isolate—have you done a study of the effect of the interest equalization tax in the first year of application and in the last 12 months?

Mr. BARR. Yes, we have. We can give it to you, Mr. Brock. We will supply that for the record. But I can tell you, to my knowledge, that its effect in stopping the enormous outflow of funds that was running in 1963 was quite dramatic.

(The information requested follows:)

The effectiveness of the IET, in comparison with the period prior to its inception, has continued through the first three quarters of 1967.

In the first three quarters of 1967, there were no purchases by Americans of new foreign security issues subject to the IET. This compares with:

In the year and a half preceding the effective date of the IET, total new issues of foreign securities had amounted to over $2 billion, of which about $700 million were issues of countries later subjected to the tax.

In the 18th months following the effective date of the IET, total new foreign issues declined to $1.3 billion, of which only $130 million was sold by countries to which the tax applied. All of this amount was exempt from the tax because the sales had been arranged before the tax was proposed ($110 million) or under other provisions of the law.

A similar continuing effect can be seen in the figures on net transactions in outstanding foreign securities. During the first three quarters of 1967 there were net U.S. purchases of outstanding foreign securities amounting to $21 million. This compares with:

In the 18 months preceding the effective date of the tax, U.S. residents made net purchases of outstanding foreign securities of about $250 million.

In the following 18 months, Americans were net sellers of outstanding foreign securities to the extent of almost $300 million.

In 1967 unacceptable levels of evasion of the IET on transactions in outstanding securities were discovered and measures were taken, as part of the 1967 legislation to extend the IET, to quench this invasion.

Since mid-1963 net American sales of outstanding foreign securities have been almost entirely in foreign stocks; there have continued to be some net purchases of foreign bonds, in greatly reduced amounts, during most of this period. This pattern continued through the first three quarters of 1967, with Americans selling $12 million of foreign stocks and purchasing $32 million of foreign bonds.

The IET has also continued to be effective with respect to long-term bank loans to foreigners (to which the tax was first applied on February 11, 1965). In the first three quarters of 1967, long-term bank loan commitments to IET countries totaled only $136 million, of which $114 million were exempt from the IET, principally because the loans financed U.S. exports. This compares with:

Long-term bank loan commitments to IET countries totaled $1.2 billion during 1964, and almost $600 million during the period from January 1 to February 10, 1965.

During the remainder of 1965, loan commitments to IET countries came only to $442 million, of which almost $250 million were exempt from the tax because the loans financed U.S. exports and the extraction of raw materials.

The following table summarizes these comparisons:

EFFECT OF IET ON AMERICAN TRANSACTIONS IN FOREIGN SECURITIES

[In millions of dollars]

	1962 and 1st half of 1963	2d half of 1963 and year 1964	1st 3 quarters of 1967
American purchases of new securities issued by IET countries (American purchases (—)) (total)	—699	—130	
American transactions in outstanding foriegn securities (net American purchases (—)) (total)	—247	295	—21
Foreign stocks	—28	326	12
Foreign bonds	—219	—31	—32

EFFECT OF IET ON LONG-TERM BANK LOAN COMMITMENTS TO FOREIGNERS

[in millions of dollars]

	Jan. 1–Feb. 10, 1965	Feb. 11–Dec. 31 1965	1st 3 quarters of 1967
Loan commitments to IET countries (total)	574	442	136
Subject to IET		195	23
Exempt from IET		245	114

Note: Detail may not add to totals because of rounding.

Mr. BROCK. I saw an interesting study just in the last day or two. I think the conclusions were that business investment, trade, international trade, in other words, the private sector of the economy, had produced for this Nation $109 billion in net profit in the last 20 years approximately.

Mr. BARR. I am not sure; we would have to review that.

Mr. BROCK. An inflow of $109 billion. The same study showed that the net outflow due to Government—our military activities, our troops abroad, and so forth—the net outflow was $125 billion in the same period of time. You can't blame the private sector of the economy for our current difficulty.

Mr. BARR. You cannot. And we are not attempting to, Mr. Brock.

Mr. BROCK. Then why in the world do we come up with a program to solve it that addresses itself to the private sector rather than the public sector?

Mr. BARR. Mr. Brock, let me say this. I use a figure of roughly $6½ billion to $7 billion as the price of the Government sector's contribution to payments. Do you want to write it down? These are rough, but in the ball park. Of that amount, about $3 billion net is for military deployment—roughly $1 billion in Europe, one-half billion dollars in Japan, and $1½ billion in Southeast Asia and Korea.

Then, however, you have a factor of about $1½ billion in Public Law 480, food that we shipped overseas. That comes right back in, on the export statistics side. It is not a drain, you can't call it a drain.

Mr. BROCK. It washes out.

Mr. BARR. It washes out, that is correct. And then we got about $900 million last year in Export-Import Bank loans, which similarly gets counted as an outflow from the Government sector, but also comes back in as a receipt in the form of Government-financed exports. Do you agree with that?

Mr. BROCK. Yes.

Mr. BARR. And then we get into aid, about $2½ billion. Now, on the AID accounts, here is where the argument comes down. The AID accounts, most of them, are also tied to U.S. goods and services. There might be a slippage of something around $400 million, but most of it is U.S. goods and services, Mr. Brock. But reasonable men can disagree as to whether or not these AID funds do displace commercial exports which would add to the balance of payments.

But you set that aside, so you get down to one factor that really pulls on the Government account that everybody agrees on. That is our troop deployment overseas, which is about $3 billion net. Now, there we are into the area of mutual security, Mr. Brock. And that is the issue that we are confronted with here today.

Mr. Brock. Does that $3 billion include all the dependents?

Mr. Barr. Yes, indeed. That is total spending, and it is based on good accounting. In the defense sector—as I indicated to you, President Eisenhower tried to bring back the dependents in 1960. He was unsuccessful. Secretary McNamara addressed himself to this issue in early 1961. And here are some of the things he has done. He has run up the Defense Department price standard for foreign procurement from, I think it was about 6 percent, to a current level of at least 50 percent. In other words, Defense won't buy anything overseas unless the advantage runs at least 50 percent.

So, consequently, they buy very, very little overseas. We did have an arrangement with the Germans that they would buy in the United States the arms they needed to rebuild their army, and their military establishment, which would run roughly parallel to the cost of the money that we spend in Germany.

Well, this proved politically unpopular, and it may have contributed to the fall of the Erhard government. They could not get their Bundestag, their Congress, to come up with the money.

Mr. Brock. I can hardly blame the German people. The planes we were building were not flying, they were crashing.

Mr. Barr. Some of the F-104's had a little trouble with them. But that was not the basic issue.

Mr. Brock. They had a lot of trouble.

But the thing that bothers me about this is that every time we get into difficulty we look for somebody else to blame.

Mr. Barr. We are not blaming anybody else, Mr. Brock. These are security arrangements we had.

Mr. Brock. I am very much aware of that. Of course, maybe I disagree with the policy, that is true.

Mr. Barr. Well, that is something else.

Mr. Brock. But whether I do or not, I am questioning today the basic efficacy of this proposed program to solve the balance-of-payments problem, simply because—we had four or five of the best economists in the United States of America here in this building yesterday for a 4- or 5-hour seminar, and we had the top leadership of the chamber, the AFL-CIO, and the international chamber and so forth.

And do you know, there was just one person in the room, one out of this whole group, that advocated the proposed program of the President's balance of payments, just one man. And I would bet a whole lot that he had a part in drawing it up.

Now, why is it that really intelligent people can come in to this room and say, it just won't work? These are not people who are just politicians; these are people who are professional in the field.

It looks to me like, you say, we are going to stop our dollar outflow by telling the banks to stop any further loans. And yet those loans in large measure go to American firms, or their subsidiaries overseas, and the subsidiaries use them to buy American products.

So you have washed a self-defeating thing there. And, frankly, the bank will tell their subsidiary in London or Paris to make the loan even if it is in excess of their reserve ability to get the job done.

Mr. Gonzalez. Mr. Chairman, will the gentleman yield at that point, because it brings up some questions that I think are very important at this point.

We are talking about the $109 billion that have been made in profits over 20 years.

Mr. BROCK. Yes.

Mr. GONZALEZ. But the big question is, how much of that $109 billion has been repatriated to the United States, that is, has come back? That is a question I haven't heard answered.

Mr. BARR. We will have to supply that for the record.

(The information requested follows:)

The repatriated profits from direct private investment amounted to $51,758 million for the years 1946–66, inclusive.

Mr. BROCK. I am talking about $109 billion repatriated from both investment profits and trade. I am not talking about what is left over there in the form of investment which still yields return.

What is your net inflow from investment today per year?

Mr. BARR. I think it would help, Mr. Brock, if we got the thing in perspective.

Can we have the accounting for the balance of payments?

The statisticians behind me will probably all faint, but at the risk of palpitation and heartburn, this is the way I look at it.

Have you got a pencil?

Mr. BROCK. Sure.

Mr. BARR. Here are the receipts that we can look on that go into this pool of exchange. We can look at receipts— this was about where we were in 1967 before the devaluation—in the first three quarters of last year, expressed as annual rates. Receipts on the trade balance, over $4 billion.

Receipts from private investment—this is dividends, royalties, interest, fees, the whole gamut—roughly $6 billion.

Foreign investment in the United States by Government and private citizens, over $2 billion.

And you come out to a total of over $12½ billion.

What were the charges against this country?

The charges against the country were tourism, minus $2 billion. Services and other items, minus $1 billion. Capital outflow from the United States, $5 billion.

Government, about $6½ billion. The Government sector breaks down roughly this way: $3 billion net for troops, and roughly, $3½ billion Public Law 480, Eximbank, and so forth, net, of repayments and other Government capital receipts.

So you had about $15 billion outflow and over $12½ billion inflow, and you had a deficit of over $2 billion, annual rate, in the first three-quarters.

And if you want to look at it the other way, what are your receipts, you have got a $12½ billion pool. The economists can argue back and forth all they want to, but, for instance, in 1963 we had this enormous surge of bank loans going out of the United States, more than we could get out of the pool that we were earning. In 1964 we had this huge flow of direct investments going out of the United States, more than we could get out of this pool, literally more than you could get out.

And I quite agree, the private sector has to earn the exchange that is going to be used mainly in one area, troop deployment. But if we are going to keep our troops deployed, if we are going to try to keep in balance, and earn enough to cover the occasions when there are surges, as we have had in the past, bank loans, in direct investments, or as in Vietnam, the private sector has to show a surplus to keep this whole accounting system from getting out of whack.

The present pool of receipts is not sufficient to meet the outflow of funds.

Mr. Brock. Maybe what I am saying is that I don't think you can afford to have troops everywhere in the world. If you want to put them in Vietnam, all right, but take them out of Europe. If you want to put them somewhere else, OK.

But there are going to be exceptions, obviously. We are not at a point today of the absolute collapse of the dollar. We are a long way from that.

Mr. Barr. That is right.

Mr. Brock. The dollar is perfectly strong currency.

Mr. Barr. That is correct.

Mr. Brock. We are talking about whether it was good as gold. Of course it is. But that isn't important. The point is that what we are saying today is going to dry up our inflow 2 or 3 years down the road, and we are just putting off the problem, and we are going to have more of a problem than last year, and I will bet you dollars to donuts that you are going to be talking about balance of payments 10 years from now, 15 years years from now, because we are a world power and we are going to have to face up to that.

Mr. Barr. One thing I have to say, I sat on this committee 10 years ago when we were discussing precisely these things. As long as we are a world power, we are always going to have to be wary of a balance-of-payments problem.

I would be interested if somebody would supply me with what the solution is, what the economists gave you yesterday. Can you answer that? Did they have a solution?

Mr. Brock. I didn't agree with them on the solution.

Mr. Barrett. The time of the gentleman has expired.

Mr. Hanna?

Mr. Hanna. Thank you, Mr. Chairman.

As usual, Mr. Brock has very lucidly, and I think very helpfully sharpened up our understanding of where this problem lies.

As is so often the case, I am looking a little bit on the other side of the ledger from what Mr. Brock implies. I, too, feel that it is hardly in our long term self-interest to discourage profitable investment.

Mr. Barr. I agree.

Mr. Hanna. However, where I think the departure comes is that there are long-term interests separate and apart from private investment. It has always appeared to me—and I will ask Mr. Robertson if he does not feel that this is also true—that there is a long-term interest in the United States in two ways: In continuing aid flow to underdeveloped countries, No. 1, in that this helps establish stability, which is required by a rich country just as much as it is required by a poor country, if we are all going to be able to live together in a rather troubled world; and, No. 2, is it not in our long-term interest to build markets which inure to the benefit of the private sector as well?

So that if we lag in either of these two things by cutting out a portion of our assets to serve this purpose, we would be doing both the public and the private sector of our country harm.

Am I incorrect in that, Mr. Robertson?

Mr. ROBERTSON. No, you are exactly right. I don't think the United States can isolate itself or live by itself alone without foreign trade. I don't think it can avoid a responsibility to provide aid to less-developed countries.

The amount of it, of course, depends entirely upon the Congress, and the decisions made by Congress. I don't think we can afford not to have military troops stationed wherever the Government in its wisdom decides they should be.

It may be that this deserves greater consideration than has been given to it. But we can't avoid it completely.

Consequently, we have to look, in my opinion, to the private sector in order to get a reduction in the amounts of the dollar outflow. And that is exactly what we have done. I wouldn't want this hearing to close without making it very clear that all parts of the balance-of-payments program have not been failures since 1964.

You may remember that in 1964 there was a dollar outflow of $2.4 billion through the banks. In the same year, there was a $2.4 billion outflow through direct investments. And we launched a program to try to curb the two.

What has happened?

Under the bank program—and I say this with some reluctance because I handled this particular program and I don't mean to take personal credit for it—we had an outflow of only $370 million all told over that 3-year period since 1964.

On the direct investment side we had $7.5 billion outflow.

You don't want to curb——

Mr. BROCK. Would the gentleman yield for one point?

Mr. HANNA. Yes.

Mr. BROCK. Rather than giving all the credit to the Government action, wouldn't a minor factor be the fact that we have higher interest rates than we have had in the last 40 years?

Mr. ROBERTSON. I personally don't put too much emphasis on the interest rate levels in determining what the outflow is. I think that in a case where interest rate levels are higher abroad you will certainly find people trying to borrow in this country where it is cheaper, there is no question about that. It does have a bearing, and does contribute to the solution, there is no question about that at all.

All I am trying to point out is that you have to have some means of leveling down the total amount of dollar outflow through the private sector, without longrun disadvantages, you have to have some means to do it.

And the program we have today is no longrun solution, it is a pure attempt to buy time.

I agree with this completely. And I hope that this committee and everyone else will attempt to find a longrun solution. And if you can't find it on the Government side, you have to find it on the private side.

Mr. HANNA. Mr. Robertson, my personal opinion, and one that I have expressed to our friends in Japan and other places, is that one of the first long-term solutions is to get the European nations to agree that there ought to be the alternative in the IMF that would take a portion of the pressure off the dollar to create deficits.

It seems to me that if there is going to be live and growing trade, there have to be deficits someplace. And when we have European nations which have not been willing to convert their surpluses downward toward the position of the deficit, it continues to put pressure especially upon the dollar, since that is the more desirable medium of exchange.

What I hope we will do with this program is to continue to address it in a manner that will bring the maximum pressure on those people who have been a little reluctant to work with us in this program.

And I ask you, in your view, will we continue to do just that.

Mr. ROBERTSON. If we don't, we are certainly remiss.

Mr. HANNA. I want to go on the record very strongly, Mr. Chairman, that it is my opinion that if we do not do just exactly that—I don't like this medicine any better than anybody else, but I want it to be clear to the countries that haven't cooperated with us—that when we get a bellyache they are going to be uncomfortable in the stomach at the same time, and they are going to continue to be so until they cooperate with us in finding some of these long-term solutions.

Mr. ROBERTSON. I think it requires contributions on all sides, not only by the deficit countries, but by the surplus countries.

And could I just add one thing, Mr. Brock. I was not attempting to take credit for the success of the bank program. The banks deserve the credit. They realize the importance of the problem, and their cooperation has really been the deciding factor.

Mr. BARRETT. The time of the gentleman has expired.

Mr. Clawson?

Mr. CLAWSON. Thank you very much, Mr. Chairman.

Mr. Barr, to the extent that the balance-of-payments program is successful in reducing our deficit from last year by $1 to $3 billion, as has been suggested, would that not relieve the pressure from the Government, the public sector, on our balance of payments, without eliminating the mandatory controls that we are now considering on direct investment?

Mr. BARR. I don't think it will relieve the pressure on the Government, Mr. Clawson. I don't believe that American manufacturers and corporations, American banks, and American travelers will take these restraints forever. We live in a free country, Mr. Clawson, where all these interested parties have a way to get to the Congress and to us and to express their opinion. This is tough medicine. And I don't think that putting this program into effect is going to relieve any pressure on us. I think it is going to increase the pressure, frankly.

Mr. CLAWSON. If it is successful, you think that it will relieve the pressure, and that these controls will be removed?

Mr. BARR. Absolutely, as quickly as we can.

I am not going to sit here and predict, Mr. Clawson—the record of our predictions in three administrations in the past 10 years is dismal in this area. I am inclined to the viewpoint of Mr. Brock, that as long as we are a world power and a great nation we are going to be arguing about this for 15 years, whoever is here. I am not going to predict. But I do say that if this program is successful, a lot of corporations are going to miss investment opportunities. A lot of people aren't going to travel, or won't get to stay as long or do as much as they want. A lot of banks are going to miss loan opportunities. And there is going to be tremendous pressure on this Government to get rid of this program. And if there is the least suspicion that the Government itself is prodigal in wasting exchange, I think there is going to be a storm of protest.

Mr. CLAWSON. It is questionable. If such is the case, why is there a reluctance on the part of our business community to come in and testify in opposition to this?

Mr. BARR. I can't imagine why. This would be the first time I have noticed reluctance on their part.

I tell you this, Mr. Clawson. We have found this much out. They realize, the great multinational corporations, and the great banks that operate all over the world, realize that we are all in this soup together, and it is not very productive to belabor each other as to who is at fault in this area.

I am surprised, however, that they are not willing to come in and testify. I think with a little persuasion they would be delighted to be in here. I don't believe they are happy.

Mr. CLAWSON. I was going to ask you if you think they are satisfied.

Mr. BARR. I would think, on the contrary, it is not a question of being happy. I think that they are in our position. But they don't know what else to recommend.

Mr. CLAWSON. Mr. Robertson, you mentioned the capital outflow of $2.4 billion in 1964 as being much higher than the outflow in 1965, 1966, and 1967. And it has been suggested that perhaps this might indicate that the banks were fearful in late 1964 that the Government was going to impose mandatory controls early in 1965.

Mr. ROBERTSON. I think in 1964 they may have anticipated that some action would have to be taken, because they were quite aware of this balance-of-payments problem. And some of that outflow may have been attributed to that. It was large in 1963, too, however. The whole volume is growing.

Mr. CLAWSON. There could have been some fear on their part that mandatory controls were going to come about?

Mr. ROBERTSON. Yes; anticipatory lending, getting in under the wire.

Mr. CLAWSON. I have nothing further.

Mr. BROCK. In taking the figures you gave me, Mr. Barr, they are accurate, and I agree with the net result. I wonder, though, if we don't use a rather strange kind of accounting in Government, on occasion.

For example, the foreign investment in this country is not really—it shouldn't be considered a net liquid asset; it is an investment on their part in this country, and can be repatriated. Our capital outlay, capital investment overseas, is—if you were in a business and you put it down on the balance sheet, you would put it down as an asset, and you would put it down as a long term—this is an entirely different thing from a liquidity problem.

Mr. BARR. You are quite correct. I indicated that this is the way I look at it. In the balance of payments, it is a dollar in or a dollar out. We, a sort of treasurer for the United States, and like a corporate treasurer, really. As far as his cash flow is concerned, it doesn't make any difference whether it is capital investment or expenditure in his cash flow projections. That is all I am talking about.

Mr. BROCK. What bothers me about this whole discussion is that some people have been confusing liquidity with solvency, in the first place, and I think there is a great deal of difference.

And, No. 2, we are not looking at the basic cause. The balance of payments is nothing more than a symptom, and we are not addressing ourselves to the disease as such.

Mr. BARRETT. The gentleman's time has expired.

I wonder if the chairman may interpose at this time. I believe there are about six members here that are entitled to 5 minutes each. And we hope we can give them the opportunity to have their 5 minutes. And if we continue on that basis without anyone yielding, maybe we can give each of the remaining members their actual 5 minutes.

Mr. Bingham?

Mr. BINGHAM. Thank you, Mr. Chairman.

Mr. Barr, I think in your answer to Mrs. Sullivan's question about how she is going to reply to her constituents, you have forgotten a little bit about the problem of what it is to be a Congressman.

And I think, frankly, the Treasury could come up with a better short answer to that question. I would like to try on for size with you the following three points as to why we have to go on selling gold internationally when we don't do so locally.

First, world trade depends on our having a reserve currency.

Mr. BARR. That is correct.

Mr. BINGHAM. Secondly, the dollar is today the principal reserve currency in the world.

Mr. BARR. That is correct.

Mr. BINGHAM. And, third, the dollar has that status because we do peg it to the gold level.

Mr. BARR. That is a very good answer. I can't dispute any of it.

Mr. BINGHAM. Thank you.

Mr. BARR. I tried to explain this one time in a political campaign, and I got beat. And I don't recommend that you campaign in this area. I couldn't get anybody to understand it.

Mr. BINGHAM. Now, I tend to share a great deal of the concern that Mr. Brock has been expressing, I must confess. I think he points out that this program, this proposed program on the international balance of payments is one which, if continued, is going to be self-defeating, that we simply must not cut off the flow of American direct investment abroad for any long period of time.

Now, my question to you is this: What are the factors which make you and the Treasury feel confident that this program that is proposed is a temporary program?

Mr. BARR. I would say several factors. No. 1, it is a drastic program, so drastic that I don't believe it could be continued ad infinitum, Mr. Bingham, I don't believe it can be.

Secondly, as I have indicated to Mr. Moorhead, while the SDR's—the special drawing rights—are no panacea for the problems that we face at the moment, the SDR's can create a climate where purely speculative movements of gold will be lessened because monetary authorities will have a way to build up their reserves without depending on the dollar deficit. And the concern about the dollar in that immediate sense might tend to decline a little bit, because there are other ways of getting reserves.

Lastly, I think that we have gone through the big surge that hit the economy when we started our troop buildup in Vietnam. And I think that we have a good opportunity in the year or so ahead to establish—especially if we pass a tax bill—a better price-wage policy here in the United States.

You remember that in 1965, just before we went into Vietnam, we did go into surplus in the second quarter. And we had a good record going for us that year. Our prices were relatively steady, our wage rates were not increasing more than the productivity of labor. We had a good program going for us.

I believe now, if Vietnam has leveled off, that we do stand a chance to get back to that situation that we were moving into in 1965, when we were coming close to bringing our payment accounts into balance.

Mr. BINGHAM. I would just like to say that for myself that unless we are going to be able to bring the Vietnam drain down—and I see no prospect of that—we are going to have to cut back our troop deployment in Western Europe.

Thank you, Mr. Chairman.

Mr. BARRETT. Mr. Mize?

Mr. MIZE. There is $30 billion-plus held overseas now; is that correct?

Mr. BARR. That is correct.

Mr. MIZE. What was that figure in 1951, roughly?

Mr. BARR. If you will excuse me a minute, Mr. Mize, I have to find it in the book. It is somewhere in the book.

Mr. MIZE. Will you answer my next very brief question, Mr. Robertson?

What other nations use gold as a backing for their currency?

Mr. ROBERTSON. There are three in Europe: Switzerland, the Netherlands, and Belgium.

Mr. BARR. I have found the table, Mr. Mize.

What was the query you gave me, sir?

Mr. MIZE. 1951.

Mr. BARR. We only go back to 1957 on this table. In 1957 it was $15,825 million, of which $6,170 million was private, and $964 million was held by international organizations, and official institutions held $8,691 million.

Do you want the latest that we have?

Mr. MIZE. No.

Now, Mr. Robertson, though you went over this matter previously yesterday, will you again explain what and how—what effective restrictions of the issuance of Federal Reserve notes will remain when we take the gold restriction off?

Mr. ROBERTSON. I would say none. And I don't think the gold cover is any restriction at all, as I said the day before yesterday.

We will have to continue providing the American people with all the Federal Reserve notes that they need in order to carry on transactions.

The only feature of the gold cover is that it would require an increase in the discount rate which might very well penalize the people of this country by a higher rate level than would be called for by economic conditions.

But, insofar as the amount of notes issued, it depends upon the demands of the people of the United States. The gold reserve requirement itself does not restrict the issuance. Assuming the gold cover is removed, we would be exactly in the same position as we are today in that regard.

Mr. MIZE. Thank you.

Mr. BARRETT. Mr. Galifianakis?

Mr. GALIFIANAKIS. Thank you very much, Mr. Chairman.

Reference has been made to the fact that we are now getting to curing the disease that plagues us. As I look at H.R. 14743, it is certainly not designed to cure the balance-of-payments problem. And it doesn't affect the solidarity of the domestic dollar at all.

But it does improve the solidarity of the international dollar.

Do we have in your present setup in the Government an agency, or a group, or a committee that specifically concerns itself on a long-range basis with the balance-of-payments program?

Mr. BARR. We do, Mr. Galifianakis. It was set up under President Kennedy. It is the President's Cabinet Committee on Balance of Payments. The Chairman is the Secretary of the Treasury. The membership includes, among others, the Under Secretary of State, the Secretary of Commerce, the Secretary of Transportation, the Secretary of Agriculture, the Secretary of Defense, and the Chairman of the Federal Reserve Board also participates regularly. They meet frequently to examine developments and formulate recommendations to the President in the balance-of-payments area.

Mr. GALIFIANAKIS. If this be the case, and they are charged with that responsibility, do you see a further necessity for creating a commission, a special commission?

Mr. BARR. I would doubt, Mr. Galifianakis, if this would help. It might tend to dilute it. The real responsibility here rests on the Secretary of the Treasury. But he shares it—he can't discharge his responsibility unless he gets cooperation from the other Departments, such as Defense, State, Commerce, Transportation, and Agriculture, and from the Federal Reserve Board.

Mr. GALIFIANAKIS. Is the private sector of the economy represented on that?

Mr. BARR. No, it is not.

Mr. GALIFIANAKIS. Has consideration been given to, maybe, embellishing——

Mr. BARR. The private sector of the economy is represented in Mr. Trowbridge's advisory committee, which advises as to the Commerce measures that need to be implemented.

Mr. GALIFIANAKIS. Could we have some response——

Mr. BARR. Incidentally, I might add that we do have one other committee, the Advisory Committee on International Monetary Arrangements, the so-called Dillon committee. It is chaired by former Secretary of the Treasury, Mr. Douglas Dillon. It is composed exclusively of the private sector. It includes Mr. David Rockefeller, Mr. Andre Meyer, Mr. Robert Roosa, who was previously Under Secretary of the Treasury, Mr. Frazar Wilde, Mr. Walter Heller, Mr. Kermit Gordon, Mr. Edward Bernstein, and Mr. Francis Bator.

Mr. GALIFIANAKIS. Do the President's committee and the Dillon committee meet jointly?

Mr. BARR. No, they do not. The Dillon committee advises the Treasury.

Mr. GALIFIANAKIS. Can we suggest a consideration of perhaps adding to the President's Committee maybe the representatives of the industrial and commercial world?

Mr. BARR. They come up to the President's Cabinet Committee, as I have indicated, if they are in any commercial or industrial side, they come up through the Secretary of Commerce.

Now, the banking community, their opinions are reflected usually by the Chairman of the Federal Reserve Board. So they come to the committee through appropriate channels.

Mr. Galifianakis, the problem in this area is that quite often we are dealing with very delicate security matters, and to bring them in as a part of the membership I don't think it would work.

Mr. BARRETT. The time of the gentleman has expired.

Mr. Blackburn?

Mr. BLACKBURN. Mr. Barr, I recall yesterday I was asking, What is the long-term solution to the disease? We agreed the balance of payments is only a symptom of it. And I recall your response was that we must adopt the President's tax increase proposals, and we must cut spending wherever we can.

Well, now, am I to conclude from that that there is a relationship between our domestic financing of fiscal policy and the balance-of-payments problem?

Mr. BARR. Very definitely. That is the most crucial element in the whole area.

The President stressed this in his balance-of-payments message. He says that is the No. 1 thing to do, discipline ourselves.

Mr. BLACKBURN. Can I conclude, then, that basically the proposal to raise taxes and cut spending is to result in a closer relationship between our Federal expenditures and Federal income?

Mr. BARR. That is correct.

Mr. BLACKBURN. To the extent that there is an excess of expenditures over income, what is the effect of that on our domestic economy and our balance-of-payments problems? I am wondering about the mechanics.

Mr. BARR. The theory, Mr. Blackburn, is that an excess of expenditures over income, creating a deficit, stimulates the domestic economy.

Now, there are times when the stimulus doesn't hurt. If you have slack in the economy, unemployment, unused savings, unused plant equipment, it doesn't hurt. At a time such as the moment, though, when the economy is running full tilt, a government deficit throws in a stimulus that gets not more production, but higher prices.

Mr. BLACKBURN. Which is just inflation, is what we are talking about?

Mr. BARR. Yes.

Mr. ROBERTSON. And if I can add to that, as we get the inflation, of course our competitive position in the world market is diminished. And, of course, one of the really big factors in achieving a solution is to increase our trade surplus. You can't do that if you are losing your competitive position in world market as the result of inflation here at home.

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Mr. BLACKBURN. So you have a double-barreled negative effect on balances of payments, in that a booming economy at home encourages imports.

Mr. BARR. That is correct.

Mr. BLACKBURN. And it also discourages exports by increasing prices of goods which we wish to sell on the world market.

Mr. BARR. That is correct.

Mr. BLACKBURN. So, then, these preachments of doom that the minority party has been making for the past several years have proven to come true.

Mr. BARR. I will say this, that there were deficits that we were running in the period 1961 through 1965, Mr. Blackburn, at which time we had an absolutely steady wholesale price index in the United States, at a time when the labor costs of producing our goods were actually declining. Now, at that time the budget deficits did not impair our balance-of-payments position. What we are saying at the moment that the whole situation has shifted, that these deficits are literally intolerable when we are running at full blast. That is the difference.

Mr. BLACKBURN. Just one other question has come to my mind. I recall some figures that I have recently seen which indicate that our cost of labor for goods sold in our exports has remained fairly constant over recent years.

Now, we all know that the cost of labor domestically has been going up because of wage increases, and so forth.

Mr. BARR. That is right.

Mr. BLACKBURN. I am wondering whether or not the consistency of the cost of labor of the goods sold is not more of a reflection of the fact that the things we are selling are those things in which the cost of labor has been maintained through technological advances, and whether or not some study has been made as to the extent to which we have lost out in sales in other commodities in other areas, perhaps, because the cost of our labor has increased.

Mr. BARR. Mr. Blackburn, I think you will find that if you take the period 1961 through 1965—that the cost of labor per unit declined on nearly the whole spectrum of manufactured articles, and probably an important reason was that we put in the investment credit back in 1962. This stimulated a great surge of investment. We gave American labor better tools. And they used these tools. And as a consequence, their productivity increased.

Sure, the wage rates went up, but the production that was coming from the combination of American labor and American capital went up faster than the wage rates.

So the cost of labor in production across the broad spectrum declined.

Mr. BLACKBURN. Then there may be some spots in which we have lost out because of the increase in wages. But overall, do you think that we have been competitive?

Mr. BARR. That was true through 1965, as I said, Mr. Blackburn. It is not as true today.

In 1966 and 1967 there was erosion.

Mr. BARRETT. The time of the gentleman has expired.

Mr. Brown?

Mr. BROWN. Thank you, Mr. Chairman.

Following up on Mr. Blackburn's discussion a little bit, Mr. Barr, do you find any increase in productivity by virtue of the increase in cost of a product that comes with an additional tax?

Mr. BARR. Well, there is that argument, Mr. Brown. But what we are saying literally is that the country can produce just so much. We have just so much labor, and so much plant. And those are the tools of production. When demand starts running, a combination of Government demand and private demand, too strongly, it is incumbent on someone to try to pull that demand down in the form of a tax increase, and the demand down from the Government in the form of expenditure reductions, to make sure that we are not throwing more demand on the country than it can supply. That is what a tax increase does. It takes away demand.

Mr. BROWN. But, Mr. Barr, as I understand it, the proceeds of the surtax is not going to be set aside. Basically, this money is going to be reflected back in spending.

Mr. BARR. It is not going to be set aside. What is going to happen, Mr. Brown, is that instead of going into the market and borrowing the money with the possible inflationary consequences that arise from that, we are going to be taking it away from them. And in that effect we are going to be trying to equate, bringing closer into equilibrium between demand and supply. If we just go to the market and borrow it, there can be a tendency at this time for this to be strongly inflationary; especially if it is taken up with the commercial banks, as it probably would be.

Mr. BROWN. Mr. Barr, if there is a contract today that has not been negotiated between management and labor, and a surtax is enacted, is not the surtax going to be reflected in that contract?

Mr. BARR. I have heard this argument. I don't believe it.

Mr. BROWN. You don't think——

Mr. BARR. Of course, when labor and business have a situation where there is just no unemployment, there is this enormous demand that we have running, more demand than we can accommodate, it will be much easier for labor to get higher wages and business to get higher prices. What we are saying—and labor and business agree with us—is that we will pull off some of that demand in the form of a tax increase to reduce the potential for higher costs being passed on.

Mr. BROWN. Isn't the basic problem in the balance of payments merely a question of building a better competitively valued mousetrap?

Mr. BARR. Absolutely.

Mr. BROWN. Whether it be a tour, a vacation, or a mousetrap?

Mr. BARR. We have had a long discussion here of what we are trying to do long term. Here are the long-term proposals and measures that we have for improving the balance of payments: A tax increase. We are going to have legislation coming to this committee to liberalize the lending of the Export-Import Bank, so that we can go out and compete better with other nations in financing exports.

We are asking the Congress for a $200-million program to promote exports.

We are asking our allies to reduce nontariff barriers to trade.

We are trying in the direct investment program to get increased income from the direct investments abroad.

We are trying to stimulate foreigners to invest in the United States.

We have a program that will be coming to the Congress to try to stimulate foreign tourism to the United States.

On portfolio investment, we have brought in 60 European investment bankers just last fall as part of a wide-ranging program to try to sell American stocks and bonds abroad.

The Congress passed the Foreign Investor Tax Act in 1966, which will facilitate foreign investment in the United States.

And, of course, in the Government area we are asking our allies for military offsets, and we are asking others to help us with aid to less-developed countries.

That is the basis of the long-term program we are looking for.

Mr. BROWN. Just one final question—you probably don't have the answer right now.

Can you tell me whether or not there was stepped-up activity in the areas of investment which were covered by the President's New Year's resolution immediately prior to its announcement?

Mr. BARR. You mean an attempt by American corporations to position themselves to get their money outside the United States?

Mr. BROWN. I mean in anticipation of it.

Mr. BARR. We couldn't find them. This was one of the best security operations we ever ran in the U.S. Government, Mr. Brown. There were only about 11 people that knew about it. And we couldn't find that there was any anticipatory movement.

Mr. BROWN. Thank you.

Mr. BARRETT. The time of the gentleman has expired.

Mr. Secretary, and Governor, many of the members may desire to ask you some questions through the mail, for the record. I am sure you will be willing to respond to their questions.

Thank you very much.

Mr. Williams?

Mr. WILLIAMS. Thank you, Mr. Chairman.

Mr. Barr, I want to say to you that I think you do a tremendous job before this committee. I don't agree with some of the things you say. But I certainly admire your ability in appearing before this committee.

I don't know how you were defeated, whenever it was.

Mr. BARR. Nobody ever understood it, and sometimes I wonder now.

Mr. WILLIAMS. There must have been other factors in the picture.

You mentioned earlier a parade of deficits. Were you talking about our national budgetary deficits, or were you speaking about our deficits in balance of payments?

Mr. BARR. Deficits in balance of payments.

Mr. WILLIAMS. When you were before us on Tuesday you outlined certain steps that could be taken which would correct our unfavorable balance of payments. One of the things that you recommended was to raise taxes, cut expenditures, and keep internal discipline in the United States. And I think in answering Mr. Blackburn you made it clear that the deficits which we are experiencing must be corrected to maintain internal discipline. I think you cleared that up very well.

Mr. Hanna quoted a number of figures: The increase in our gross national product between now and 1948; also the great increase in investments abroad.

Do you have any idea of what the gross national product would be today, and the investments abroad would be, in terms of the dollar in 1948? In other words, how much of this increase is really due to inflation?

Mr. BARR. We can supply that for the record, Mr. Williams. I don't have that information with me.

(The information requested follows:)

Our 1967 gross national product, in current dollars, was $785 billion. In real terms as currently calculated (1958 dollars), it was $669 billion. In terms of 1948 dollars, it would come out to something like $530 billion.

The gross value of all U.S. private investments abroad at the end of 1966 (latest year for which data are available) was slightly over $86 billion. Deflating this figure on the basis of the same U.S. GNP deflators would give estimates of about $76 billion in 1958 dollars and about $60 billion in terms of 1948 dollars, respectively.

The usefulness and significance of these estimates—particularly that for U.S. private investments abroad—is, however, somewhat uncertain. A fully correct conversion of any economic series as complex as these are necessarily involves major conceptual and data problems in selecting and applying the appropriate deflator. In the valuation of our outstanding foreign assets, particularly, involving both financial and physical investments, made over time, at different price levels, in different countries, with differing rates of depreciation, etc., calculation of any correct valuation of the present stock of such investments, in terms of 1948 dollars, is virtually impossible—at least within the limits of data available to the Government. The use of the U.S. GNP deflator is necessarily arbitrary.

Mr. WILLIAMS. Very well.

Mr. Robertson, permit me to congratulate you on your appearance before this committee.

You state that we have an insignificant amount of foreign currency in this country. What is the exact amount?

Mr. ROBERTSON. I would be very glad to provide it. But I would guess it is less than a billion dollars.

Mr. WILLIAMS. Less than a billion dollars.

You also made the statement——

Mr. ROBERTSON. I will give you the exact figure.

(The information requested follows:)

During 1967 the average of month-end figures for convertible foreign currencies held by the Treasury and the Federal Reserve System was $990 million; on December 31, 1967, such holdings were $2,345 million of which $1,604, million was held by the Federal Reserve System.

Mr. WILLIAMS. You also made the statement that this foreign currency is backed by the dollar. Isn't it a fact that the dollar is used as the central point in this financial solar system because the dollar is backed by the gold?

Mr. ROBERTSON. Oh, yes.

Mr. WILLIAMS. So that unless we do take some of the steps as you have advocated to permanently correct this unfavorable balance of trade, unfavorable balance of payments, one of these days we are not going to have any gold, and the gold will no longer be the fixed point in the solar system.

Mr. ROBERTSON. No question about it at all.

Mr. BARRETT. Thank you, Mr. Secretary.

Mr. Barr, and Mr. Robertson, you have been very helpful, and, speaking on behalf of all the members, we are very grateful to you.

The committee will stand in recess until Tuesday morning at 10 o'clock.

(Whereupon, at 12:05 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, January 30, 1968.)

(The following additional questions to Under Secretary Barr were proposed by Congressman Brock for insertion in the record:)

Question 1. Can you supply for the record a breakdown, country by country, of the U.S. securities, government and corporate, held by foreign central banks for the past 10 calendar years?

(See p. 33 for response.)

Question 2. What was the approximate balance of payments impact resulting from the prolonged copper strike?

REPLY OF UNDER SECRETARY BARR TO QUESTION NO. 2 OF CONGRESSMAN BROCK

The 6-month-long copper strike apparently is having an adverse impact on our balance of trade, taking refined copper together with ores, concentrate, blister, scrap, and mill products. The net adverse impact, through December 1967, is estimated as roughly $175 million. A decrease in our exports of about $90 million—principally in refined copper—was accompanied by an $84 million rise in our imports. The rise in imports was also concentrated on refined copper, reflecting the closure of the refineries because of the strike.

These figures must, however, be regarded as rough estimates. Not all the data for December is yet available. Also, these estimated strike effects were computed with reference to the first 9 months of 1966 as a base period. However, this may result in significant understatement. This base period was dominated by increases in inventories and the movement of the domestic economy to very high levels of operation, both of which likely had a considerable adverse impact on our copper trade position. In contrast, during the first months of 1967, some of these pressures probably abated. Further, the copper trade figures for the first half of 1967 probably reflect some accumulation of copper inventories in anticipation of the strike. It should be noted, in addition, that the production of copper involves as byproducts production of small amounts of gold and silver. An allowance for this lost production has not been taken into account.

REMOVAL OF GOLD COVER

TUESDAY, JANUARY 30, 1968

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to recess, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Sullivan, Reuss, Moorhead, Stephens, Gonzalez, Minish, Hanna, Gettys, Annunzio, Rees, Bingham, Widnall, Fino, Halpern, Clawson, Johnson, Stanton, Lloyd, Blackburn, Brown, Williams, and Wylie.

Chairman PATMAN. The committee will please come to order.

Today, the committee continues hearings on H.R. 14743, the gold cover bill.

Witnesses for today include Dr. N. R. Danielian, president of the International Economic Policy Association and Dr. Howard S. Piquet, Senior Specialist in International Economics, Legislative Reference Service of the Library of Congress.

Hearings will continue on Wednesday and Thursday and will include the following witnesses:

Dr. Judd Polk, economist, U.S. Council of International Chamber of Commerce; Eugene L. Stewart, general counsel, Trade Relations Council of the United States; Dr. Leif H. Olsen, senior vice president and economist, First National City Bank of New York; Roy L. Reierson, senior vice president and chairman of the advisory committee, Bankers Trust Co. of New York; and Dr. Leslie C. Peacock, senior vice president and economist, Crocker Citizens National Bank, San Francisco, Calif.

As indicated in the memorandum sent to all members on January 26, following the conclusion of the hearings on Thursday, the committee will meet in executive session to consider reporting out H.R. 14743.

I just wonder, Mr. Widnall, since these witnesses are called at your request—we are very glad to do it, of course—would it be reasonable for you to ask the others to be here tomorrow and they can certainly have a fair amount of time to file their statements. Then we can get through tomorrow and then go right into the executive session on Thursday?

What do you think about that?

Mr. WIDNALL. It depends on the nature of the witnesses. There ought to be more time, Mr. Chairman. Some of them are coming from a very great distance.

Chairman PATMAN. That is all right. We will do it that way. We want to be absolutely fair about it; and then have our executive session on Friday. But if we could get through tomorrow, we could have the executive session Thursday. It might inconvenience your people that way. But I will yield to your request.

However, we have lost 2 days on this. We lost last Wednesday, and then we lost Monday, you know, and we are going along rather slowly for a bill of this type. It is really on the urgent list.

If you insist on that, Mr. Widnall, we will do it and keep you in mind.

We will have an executive session, if we get through Thursday morning, and if necessary we will come back Friday morning, or meet Thursday afternoon, one or the other.

All right, we have as our first witness, Mr. Danielian, president of the International Economic Policy Association.

STATEMENT OF N. R. DANIELIAN, PRESIDENT, INTERNATIONAL ECONOMIC POLICY ASSOCIATION; ACCOMPANIED BY WILLIAM MORAN, EXECUTIVE DIRECTOR AND VICE PRESIDENT, IEPA

Mr. DANIELIAN. Thank you, Mr. Chairman.

I want to express my appreciation to the committee for allowing me to come before them today. I was originally scheduled to appear last Wednesday. The committee found it necessary to shift those hearings until Thursday, which conflicted with an important out-of-town engagement I had and, therefore, I much appreciate this opportunity to come before you.

I appear today on behalf of the International Economic Policy Association in support of the administration's request to eliminate the gold reserve requirement behind the Federal Reserve notes, U.S. notes and Treasury notes in circulation. Our organization stands behind the President in his determination to honor the moral commitments this country has made to pay its external debts in full measure by the sale of gold at $35 an ounce.

At the same time, we urge the Congress to make it clear in firm and binding declarations and specific statutory language that at no time should the Government and its agencies purchase gold at a price higher than $35 an ounce—as shown in table 1 attached to my statement.

Such a limitation will have the effect of abating speculative hoarding of gold. Current production of gold and some reserves have been disappearing into industrial uses and private hoards.

Such demand exceeded the amounts of gold newly available to the market in the past 2 years and had to be met in part by a reduction in world monetary reserves. These are estimated to have declined by a billion dollars in 1967 for this reason. This is indicative of speculation around the world that the price of gold will go up. It is not unrealistic to assume that official withdrawals of gold from the United States have the same motivation.

Once it is made clear that this hope is illusory, it is likely that the speculative interest in buying and hoarding gold will abate. As gold in vaults or in mattresses does not earn a return, it is to be hoped that, once this speculative interest is eliminated, gold may flow back into circulation and be exchanged for goods and services or investments.

In any event, there is no moral obligation on the part of the United States to raise the price of gold now or in the future, thereby giving windfall capital gains to the hoarders of gold, be they private or official. The raising of the price of gold would in effect mean handing to the hoarders of gold claims upon U.S. resources.

If, for instance, we should at any time raise the price of gold by 100 percent, to $70 an ounce, the $30 billion or more of free world official gold holdings abroad could be exchanged for $60 billion. This windfall profit of $30 billion would be a claim upon U.S. goods and services. It is estimated by some that there is $15 to $20 billion in private hoards and undisclosed stocks in Communist hands. An increase in the price of gold would give them, too, an unwarranted and unearned claim upon the resources of the people of the United States.

Better use can be made of U.S. resources than to pay to the hoarders of gold a claim on the United States of this magnitude. Those countries that have acquired this gold have shown little disposition to meet the costs of common defense or foreign aid, nor have they shown an interest in economic and political cooperation with the United States.

Western European countries have plenty of reserves in the form of gold and the dollars they now hold. This is shown in table II. They do not need the additional dollar reserves which would result from an increase in the price of gold. If we should succumb to their pressure in the future to raise the price of gold and thus double the dollar value of their gold holdings, what will they do with the additional dollars?

If they do not wish to buy more goods and services in the United States now, when they can afford it, will they be inclined then to spend the increased dollars resulting from the redemption of gold to buy even more goods and services here? If not, what use will they make of their increased dollar purchasing power? What effect will alternative uses have on the United States?

One use they could make of their unearned capital gains would be to buy goods and services in the United States, by selling back to us gold which they purchased at $35 for a much higher price. Of course, this would be inflationary; it would be uncompensated, in that we would be getting the same gold back at an inflated price; it would be like giving foreign aid to the rich. When you include, in this same club of speculators, the Communist countries and South Africa, this operation loses its attraction completely.

Another use the speculators and hoarders could make of their windfall capital gains would be to invest in U.S. corporate securities, U.S. Government bonds, or real property. This would seem perfectly harmless, but in view of the magnitudes involved, to sell U.S. capital assets, without compensation, would aggravate our future balance-of-payments position, as we would be called upon to pay interest and dividends, not to mention the instability in financial markets due to shifts in such large quantities of liquid assets.

In the third place, Europeans may use the windfall profits on gold revaluation to buy up U.S.-owned investments in their own countries. Those investments have greatly contributed to their postwar economic growth; they are, in fact, the most enlightened expressions of international economic cooperation and, in the future, the most effective means of closing the technological or management gap, with which the Europeans are so concerned. But nationalistic instincts sometimes go contrary to rational economic behavior, and they may opt for disestablishment of American ownership in their countries.

They have already taken the first step in this direction by use of the power they have acquired in liquid assets to force the U.S. Government to limit industrial acquisitions and expansion in Europe. What more could they do with the enormous capital gains resulting from the repricing of gold? If they assert nationalist policies and gradually buy up U.S. investments, they may slow down technological progress and economic growth, and the United States would lose in export markets and investment income, further aggravating balance-of-payments deficits.

If I seem to dwell at some length on the relationship between balance of payments, gold, and investments, it is because I feel that they are inextricably related in this world of cold, and sometimes not too cold, war strategy and this relationship is not understood in the United States.

At least, I have been trying to explain it interminably ever since 1959 in many media, without always achieving measurable success in understanding. But we must understand it if we are to succeed in holding our own in the world. Let us once and for all realize that about one-third of our foreign exchange earnings come from investment-related exports and investment income. Even this has not been enough to pay for the Government's expenditures abroad. If you curtail investments, you limit your external income, and with it your ability to sustain political and military positions abroad.

Disestablishment of U.S. investments is, unfortunately, a political objective all around the world. This finds expression in different forms: in Western Europe, in pleas for partnerships and joint ventures; in the Middle East, through nationalization and renegotiation of existing arrangements; in South America, through limitations on foreign ownership.

U.S. private investments and services abroad add about $6 billion a year to our external income and another $6 billion to our investment-related exports. If we allow this to be whittled away by take-overs, transfers of ownership, foreign borrowings at high interest rates, or sale of assets in the United States to meet our current account Government expenditures, we are going to find that we will be unable to maintain our commitments for collective security and economic development around the world.

There is a historic example of this process. Contrary to currently accepted theories of Great Britain's difficulties, the major reason for the deterioration of the British balance of payments is not the trade deficit. Great Britain has generally had a trade deficit. In the past, she was able to make up the difference in her trade deficit and sustained British presence around the world through income on investments and services. Twice, after World War I and World War II, British investments were liquidated to the tune of £1 billion or more each time. Their external debts increased, and Government expenditures abroad soared. As a result, the invisible income on investments and services has not been sufficient to meet these increased costs.

During the 9-year period, 1958 through 1966, Great Britain had a cumulative surplus of £3,603 million earned overseas by the private sector. No less than £3,588 million of this came from cash inflow from private investments overseas. Even on imports and exports of goods and services, at £41,598 million and £51,613 million cumulative for the period there was a surplus of £15 million.

But in the public sector, during the same period, there were net government expenditures abroad of £5,238 million, simply too much for the surplus in the private sector to overcome. And the country ended the period with cumulative net deficits in its external payments of £1,635 million.

It cannot be substantiated, therefore, that the underlying disequilibrium of Britain's balance of payments has been due to a persistent imbalance of the private sector's trade with the rest of the world. It has been due, on the contrary, to the fact that net Government expenditures overseas have persistently exceeded the surplus earned by the private sector. The insufficiency of foreign investment income was fundamental reason for her retrenchment.

The United States is in danger, if it continues as it has for all but one of the past 18 years to spend more on Government account abroad than it can earn on private account, of losing the capacity to meet its international commitments. Lifting the gold cover will not correct this situation. At best, it will only give us a limited amount of additional time to make fundamental adjustments.

I hope it is realized in the highest policymaking circles of our Nation that in the interests of the long-range security of the United States and its allies, foreign investments are not expendable. They are the very core of our ability to wage war or maintain peace.

Our studies indicate that the private sector of U.S. international transactions, including all items, both current and capital account, are in balance or in surplus. It is Government sector expenditures that throw us into deficit. Furthermore, U.S. deficits are incurred in our economic and financial transactions with Asia, South America, Africa, and international institutions, where military and foreign aid expenditures are largest.

The irony of the present U.S. embarrassment over its balance-of-payments deficits is that the surpluses being acquired by Continental Western Europe are the result of expenditures that we have been making in Europe in the maintenance of our troops for the common defense, with an out-of-pocket foreign exchange cost of $1.5 billion, plus the foreign aid and military expenditures of the United States in other parts of the world, from which Western Europe earns its surplus dollar.

We do not have a balance-of-payments deficit with Western European countries. Our payments deficit originate in the Far East as a result of foreign aid and military expenditures, and in other places where we have foreign aid and military deployments, while the Western European countries are earning their surplus dollars through trade with those areas. Table III analyzes this for the 2 years, 1965–66.

By a tightfisted policy on the part of Continental European countries with respect to meeting the costs of their own defense, and lack of support of our efforts in the Far East and in foreign aid on easier terms, they have acquired surpluses which they are now trying to use against us through withdrawal of gold.

The first impact of this arm twisting has been to force the U.S. Government into undertaking unusual actions in control of U.S. investments, particularly in Europe, as much a limitation on the individual stockholder in a U.S. company as a limitation of travel would be for a tourist.

How we respond to the exigencies of the moment will determine our ability in the future to be masters in our own house.

Coming back to my original recommendations, this country must meet its obligations as promised in the presently acceptable currencies of the world, including gold, but should never fall into the trap of raising the price of gold, thereby giving other nations an additional weapon with which to whip us, particularly by buying out our investments or technology with unearned capital gains. This would be the surest way of pushing us back into fortress America, with a very great loss of freedom.

There must be a firm and unequivocal assertion by the Congress that we are onto this game, and will never allow speculators to gain and use an undeserved windfall profit through future increase in the price of gold to dispossess us at the expense of our taxpayers.

The Bretton Woods Agreement Act of 1945, authorizing the U.S. participation in the International Monetary Fund, made it clear that any change in the par value of the dollar required legislative approval but did not limit the price at which gold could be purchased. Therefore, there is still a limited possibility that the United States could in fact pay a significantly higher price for gold than the par value of $35 an ounce.

Under article IV, section II of the articles of agreement of the International Monetary Fund, the Fund is authorized to fix the margin above and below par value for transactions in gold by members. This could be done by a simple majority and the United States does not have a veto. The International Monetary Fund could set the margin at any percentage above and below parity.

The Gold Reserve Act of 1934, section 734 of title 31 of the United States Code, authorizes the Secretary of the Treasury to purchase gold in any amounts at home or abroad "at such rates and upon such terms and conditions as he may deem most advantageous to the public interest."

Under existing law, the Secretary of the Treasury would be free to buy at the increased price resulting from any higher margin fixed by the Fund. While we cannot by ourselves change the articles of the Fund, the Congress can and should restrict the authority of the Secretary of the Treasury in this legislation to the purchase of gold at a price not to exceed the present margin of 1 percent above the par value of $35 an ounce without congressional authorization.

Furthermore, by amendment of the article, the par value of gold and the dollar can be changed. Now we have a veto over such a change. But one never knows what pressures will develop in the future. To what uses will the continental European countries put their enhanced power after they have acquired more of our gold?

In all fairness, I should make clear that while our organization supports the two specific recommendations with regard to the gold cover and the gold price, the analysis and speculation in support of them are given wholly on my own responsibility and no member of the organization has seen this paper, nor can be held responsible therefor.

Thank you very much, Mr. Chairman.

(The attachments to Mr. Danielian's prepared statement follow:)

TABLE I.—GOLD, NEW SUPPLIES AND USE, 1956–67

[In millions of U.S. dollars]

Year	(A) Newly available gold [1]	(B) Additions to world monetary stock [2]	(C) Estimated industrial and artistic use [3]			Estimated private hoarding [4]
			BIS		U.S. Bureau of the Mint	
1956	1,125	490	165	------------	80	390
1957	1,275	690	195	------------	45	345
1958	1,285	680	200	------------	65	340
1959	1,380	750	220	------------	60	350
1960	1,378	310	265	------------	110	695
1961	1,540	615	285	------------	95	545
1962	1,515	355	330	------------	60	770
1963	1,906	825	325	------------	65	690
1964	1,856	715	430	------------	90	620
1965	1,840	210	465	------------	95	1,070
1966	1,370	−40	------------	[5] 650	------------	760
1967 [6]	1,420	−1,000	------------	700	------------	1,720

[1] New production plus Russian sales less purchases by mainland China.
[2] Data from International Monetary Fund, "International Financial Statistics."
[3] Based on series published by the BIS (annual report, 1966) for 12 countries and by the U.S. Bureau of the Mint for an additional 29 countries not covered in the BIS series.
[4] The residual amount, cols. A—(B and C)=D.
[5] Fund staff estimate.
[6] Estimate from First National City Bank, Monthly Economic Letter, January 1968.

TABLE II.—REDISTRIBUTION OF FREE WORLD GOLD RESERVES, 1958–66

[In millions of U.S. dollars]

	1958	1966
United States	20,582	13,235
United Kingdom	2,807	1,940
Industrial Europe	9,215	19,075
Austria	194	701
Belgium	1,270	1,525
Denmark	48	108
France	750	5,238
West Germany	2,639	4,292
Italy	1,086	2,414
Netherlands	1,050	1,730
Norway	43	18
Sweden	204	203
Switzerland	1,925	2,841
Canada	1,078	1,046
Japan	54	329
Other developed areas	1,260	2,650
Less developed areas	3,035	2,720
Total country holdings	38,030	40,905
IMF	1,332	2,652
EPU/EF	126	51
BIS	−42	−424
Total official holdings	39,445	43,185

Source: International Monetary Fund, International Financial Statistics, September 1967.

TABLE III.—U.S. BALANCE OF PAYMENTS WITH UNITED KINGDOM AND WESTERN EUROPE, 1965–66

[In millions of U.S. dollars]

	United Kingdom		Other Western Europe		Total	
	1965	1966	1965	1966	1965	1966
Exports of goods and services [1]	2,650	2,907	10,214	10,927	12,864	13,834
Merchandise	1,628	1,754	7,268	7,831	8,896	9,585
Transportation	245	258	884	968	1,129	1,226
Travel	71	68	129	142	200	210
Military transactions	56	78	475	490	531	568
Other services	285	302	591	655	876	957
Income on investments	270	447	498	841	768	1,288
Imports of goods and services	−2,508	−3,020	−8,674	−10,183	−11,182	−13,203
Merchandise	−1,140	−1,776	−4,778	−5,871	−6,188	−7,647
Transportation	−394	−441	−1,076	−1,209	−1,470	−1,650
Travel	−142	−167	−653	−679	−795	−846
Military expenditures	−154	−145	−1,304	−1,375	−1,458	−1,520
Other	−408	−491	−863	−1,049	−1,271	−1,540
Balance on goods and services	+142	−113	+1,540	+744	+1,682	+631
Remittances and pensions	−48	−54	−357	−332	−405	−386
U.S. Government grants and capital, net	+26	−60	−43	+148	−17	+88
U.S. private capital, increase (−)	−248	−631	−1,011	−1,241	−1,259	−1,872
Direct investments	−317	−384	−1,162	−1,421	−1,479	−1,805
New issues sold in the United States	−80	−15	−15	--------	−95	−15
Other transactions and redemptions	--------	−6	145	+193	+145	+187
Other long term	+27	20	+111	285	+138	+305
Short term	+112	−246	−90	−298	+22	−544
Western Europe investments in the United States	−525	211	+457	833	−68	1,044
Direct investments	−66	23	23	67	−43	90
Other	−488	188	+434	766	−25	954
Total transactions with the United States (U.S. payments (—))	−653	−647	+586	+152	−67	−495
Total reported increase in European gold reserves and liquid dollar holdings	702	294	473	555	1,175	849
Errors and omissions and receipts from (—) or payments to other countries	−49	+353	−1,059	−707	−1,108	−354

[1] Excludes military grants.

Note.—Detail may not add to totals because of rounding.

Source: U.S. Department of Commerce, Office of Business Economics, Survey of Current Business, June 1967.

TREASURY DEPARTMENT REPLY TO STATEMENT OF MR. DANIELIAN REGARDING AUTHORITY TO RAISE PRICE OF GOLD

There are two reasons why the dollar could not be effectively devalued through action by the Fund to widen the margins above and below par at which gold can be purchased and sold. In the first place, while Article IV, section 2 of the Fund Articles of Agreement does authorize the Fund to prescribe a margin above and below par value for transactions in gold by members (currently 1%), the discretion which it has is effectively limited by another provision relating to exchange transactions, Article IV, section 3 provides that the maximum and minimum rates for exchange transactions between the currencies of members should not differ from parity in the case of spot exchange transactions by more than 1%. Thus, to allow gold transactions under wider margins would be inconsistent with the whole par value system of the International Monetary Fund.

Secondly, the Fund Articles contain specific provisions, Article IV, sections 5 and 7, establishing procedures for changes in par values, i.e., the price for gold in terms of specific currencies. For this reason, it would be inconsistent with the spirit of the Articles of Agreement to change par values or the price of gold by the indirect method of widening the margins on gold transactions.

Furthermore, no change in the dollar's gold parity is possible without U.S. consent. Under Article XVII of the Articles of Agreement of the International Monetary Fund no modification of the Agreement may be made without three-fifths of the members, having four-fifths of the total voting power, having accepted the proposed amendment. Since the United States voting power in the Fund exceeds one-fifth, no amendment to the Articles may be made without the United States having voted in favor thereof. Section V of the Bretton Woods Agreements Act provides that unless Congress by law authorizes such action, the United States shall not accept any amendment under Article XVII of the Articles of Agreement of the Fund. Therefore, the Articles of Agreement of the Fund may not be amended without action by the Congress.

Moreover, Article XVII also provides that acceptance by all members is required in the case of any amendment modifying the provision that no change may be made in the par value of a member's currency except on the proposal of that member. Again, Section V of the Bretton Woods Agreements Act provides that the United States may not propose or agree to any change in the par value of the United States dollar, or approve any general change in par values, unless Congress by law authorizes such action.

It is, therefore, quite clear that the par value of the United States dollar may not be changed without action by the Congress.

Mr. BARRETT (presiding). Thank you, Mr. Danielian.

I just have one very short question here. On page 9, you indicate that—at least, it is my concept—that you are not against removing the gold cover. Is that true or——

Mr. DANIELIAN. We support the President. On page 1, I have stated unequivocally, we support the President in removing the gold cover. We also recommend that a limitation be placed upon the repurchase of that gold at a price higher than $35 an ounce.

Mr. BARRETT. Thank you, Mr. Danielian.

Dr. Piquet, we will let you present your testimony, if you are prepared, and then we will ask you questions thereafter.

STATEMENT OF HOWARD S. PIQUET, SENIOR SPECIALIST IN INTERNATIONAL ECONOMICS, LEGISLATIVE REFERENCE SERVICE OF THE LIBRARY OF CONGRESS

Mr. PIQUET. I appear before you, Mr. Chairman, not as a witness who has asked to be heard, but as one of your own advisers. I have spent over 20 years as a consultant to committees and Members of Congress and I speak only in what I conceive to be the public interest. Although I am the senior specialist in international economics of the Legislative Reference Service of the Library of Congress I do not speak on behalf of that organization.

I am not going to read a paper, although I do have a brief document that I shall let you have. You may want to refer to it as I talk.

Mr. BARRETT. Do you desire to submit that for the record?

Mr. PIQUET. If you wish.

Mr. BARRETT. It may be inserted in the record, without objection, and so ordered.

Mr. PIQUET. First, the overall problem, or series of problems that, in a sort of shorthand, we refer to as the balance-of-payments problem, seems to me to be a misnomer. We cannot separate gold, balance of payments, trade, aid, and other problems, including the domestic economy, the Federal budget, and so on. They are all intertwined, and all are part of the same problem. It is easy to become so enmeshed in details that we fail to see the forest, because we are concentrating on the trees.

That which we call the balance-of-payments deficit, in my opinion, is a relatively subordinate matter. If we examine the balance-of-payments figures for a number of years we find that the so-called deficit was as high as $3.9 billion back in 1960. It subsided to $2.4 billion in 1961 and kept going down generally until 1965, when it was reduced to $1.3 billion.

And in 1966 to $1.4 billion. Obviously, something happened in 1960 that was not happening in the years between 1960 and 1966. That something was speculation, speculation against the dollar in favor of gold.

When President Kennedy made it clear, in his speech via the satellite Telstar, that the United States was not going to raise the price of gold, its price in London declined from $41 an ounce—this is back in 1961—to $35 an ounce, and the balance-of-payments deficit was reduced to manageable proportions.

In 1966 and 1967, if we take the figures that are available—that is, for the first three-quarters of both years, 1966 and 1967—we find that the balance on goods and services, that is, autonomous private transactions, improved by $100 million, from $5.6 billion to $5.7 billion. There was an improvement in the trade balance of $300 million. The balance on investment earnings improved in 1967 over 1966 by $200 million, other services remained constant. The only deterioration was in travel and transportation of $400 million, much of which resulted from travel of Americans to Canada for Expo 67.

Private direct investments—those that the President decided should be curtailed—actually declined from $2.4 to $2 billion.

Portfolio investment outflow increased $500 million and all other capital outflow, including short-term capital, increased $700 million. The dollar outflow in connection with military expenditures increased $500 million, while "all other" transactions improved by $400 million. The sum total was that in the first three quarters of 1967, compared with the first three quarters of 1966, the deficit increased by about $800 million, none of which resulted from any net deterioration in the private sector, except short-term capital.

In other words, what seems to have been happening in the fourth quarter of 1967, we don't have actual figures for the fourth quarter, but we know that the overall deficit was between $3.5 and $4 billion, was a sudden increase in the outflow of funds for speculative purposes.

There is a strong presumption that the deterioration in the fourth quarter of 1967 was not because of an increase in autonomous private investment outflows nor because of a deterioration in the trade balance. The deterioration occurred because of an increased military step-up and because of private short-term capital outflow.

Experts in the Department of Commerce say that when the detailed 1967 figures are released they will show an "errors and omissions" item of approximately $1 billion. This means that dollars were flowing out of the country for some unexplained reason. I conclude, on the basis of the experience of 1960 and 1961 and the figures that are available for the first three quarters of 1967, that there was a sudden outflow of dollars stimulated primarily by British devaluation of the pound and hope and expectation on the part of speculators that "the dollar would be next."

"Devaluation" is a misleading term. It does not signify deterioration in the moral worth of the dollar or in the domestic purchasing power of the dollar. All that it means, in the case of the United States, is that the price of gold is increased. As Dr. Danielian has pointed out such action would play into the hands of the producers and hoarders of gold.

President Eisenhower, you may remember, a few days before the expiration of his term of office, in January 1961, issued a proclamation forbidding Americans to hold gold anywhere in the world. We have not been allowed to hold gold in the United States since 1933. The profitability of gold speculation is easy to explain.

A speculator buys a bar of gold, either in Switzerland or in London for $14,000. At 5 percent interest it costs him at the rate of $700 a year to hold it. Then, if the United States should raise the price to $70 an ounce he makes $14,000 on his $14,000 investment—a 100-percent gain. And all that he loses is his interest cost.

If, however, the United States does not raise the price of gold, and speculators become convinced that it will not do so, what do they do? They return the gold and get their dollars back. Again, all they can possibly lose is the cost of holding the gold.

This is not true speculation. This is one-way speculation. The price can go up, but it can't go down. To make it even simpler, suppose the United States were to guarantee the price of wheat at $1 a bushel—to guarantee to buy or sell at any time at the same price—and then the rumor gets around that it is going to raise the price to $2 a bushel. Speculators would buy wheat until it came out of their ears. If the price is raised to $2 they make a 100-percent profit, less only the cost of holding the wheat. If, however, the price is not raised they return the wheat and get their money back. They can't lose.

Obviously, something is wrong with respect to the way we are managing the relationship between dollars and gold.

If the ailment that needs to be cured is speculation, should we not apply remedies to that part of the problem, instead of penalizing private foreign investment which, over the years, yields more in terms of income than is paid out currently in the form of capital outflow.

If you add the amount of money that Americans sent abroad over the past 13 years in the form of new direct private investment and, in a column alongside of it how much Americans collected over those 13 years on that cumulative investment, in the form of dividends, royalties, et cetera, you will come up with a plus balance of $17 billion. Restricting such investment is truly tantamount to "killing the goose that lays the golden eggs."

The United States, whether we like it or not, has been put into the position of serving as the de facto world reserve banker. We are no longer "just another country." It is to be expected that we should have a reasonable deficit in our balance of payments because we are supplying the world with about one-third of its liquid monetary reserves in the form of dollar exchange. I doubt that even President de Gaulle is going to be foolish enough to wreck the dollar. He has got us "running scared," however. I don't think he wants to wreck it while France's short-term dollar assets of some $1.4 billion equal 25 percent of her total gold reserve—$5.2 billion.

Certainly, the British don't want to wreck it, and other European countries don't want to wreck it, in spite of what they may say, because they have too much at stake in the soundness of the dollar.

The United States, as world banker, has been supplying dollars through its balance-of-payments deficits that are used as monetary reserves by other countries. This has been going on ever since the close of World War II when other countries were short of gold.

After the United States raised the price of gold in the early 1930's gold flowed into the country in large quantities, so large in fact that it came to be known as the "golden avalanche." By the end of 1948 the United States had accumulated over 70 percent of the world's total monetary gold. It was something like the game of monopoly, with the United States winning all the money. Some foreigners ridiculed the United States for being so foolish as to amass such a large stock of the inert metal and thought it might be a good idea to demonetize it.

The British decided to use something to supplement gold as monetary reserves and started to accumulate dollars. They soon discovered that dollars were not only as good as gold, but even better because they earned interest. Other countries did the same. Although they used some of the dollars that they acquired through trade and aid for purchasing U.S. goods and services they kept large quantities of them on deposit in American banks in the form of demand deposits. They have continued to increase these deposits until they amounted to over $29 billion on September 30, 1967, of which $14.4 billion was payable in gold on demand to foreign governments and central banks.

The United States as a central world bank is far from insolvency. Americans had claims against them by foreigners of a little over $60 billion at the close of 1966. At the same time they had claims against foreigners of $112 billion. It is true that a large proportion of our claims on foreigners are long-term claims, whereas over $30 billion of the $60 billion of the claims against us are short-term claims. This is a banking function, to exchange its own short-term liabilities for the long-term liabilities of its customers.

When I go to a bank to obtain a loan to buy a house, I give, say, a 20-year note that I will repay, with the house as security, and the bank gives me in exchange its check, or money, to pay to the seller. This is the international role that has been placed upon us by other countries. We did not choose it and we are not "forcing" it on other countries. Under the circumstances we have little choice but to behave as good bankers.

If a banker tells a depositor who asks for cash, "Oh, no, you don't really want this cash because we don't have much, we are losing it too fast" that depositor wouldn't patronize that bank very long. As a nation, we are foolishly giving the impression that we are nervous about our gold losses. If we are good bankers we will take all of our gold and make it available to pay foreign dollar claims.

I, as an American, cannot get gold for my dollars and no other Americans can get gold for their dollars. Only foreign central banks and foreign governments can convert dollars into gold at the U.S. Treasury.

We have an obligation to pay gold on demand to such holders amounting to over $14 billion, and the important thing is our liquidity ratio. How much reserve do we have against these liquid claims? About 84 percent, provided we remove the 25-percent gold cover against Federal Reserve notes. If we don't remove this cover the ratio is only about 11 percent.

The reason why it is important that the gold cover be removed, and removed promptly, is the psychological consideration that this is good banking. If we equivocate and reduce it from 25 percent to, say, 12½ percent, we shall give the impression that we are being forced to do it. This could do great harm, psychologically.

We should release this inert gold for international purposes and do it with great self-assurance.

In my opinion the U.S. dollar is still sound. I haven't yet detected any actual deterioration in confidence in the dollar. The problem that we face is the psychological one of insuring that there will not be any loss of confidence in the dollar.

This means that we must not "run scared." If there were already loss of confidence in the dollar I doubt that the dollars circulating in the Eurodollar market would have expanded to over $15 billion. These are U.S. dollars that circulate in Europe, and in certain other parts of the world. They are not controlled by any government but are held and loaned by bankers, and borrowed by businessmen. Even Eurodollar bonds are being issued, and the interest rate on them has been increasing. These dollars are not held by central banks or by governments and are not legally convertible into gold. This does not look to me like a loss of confidence in the dollar.

What is the basic key to the problem? Elimination of the gold cover is the obvious first step, but the most basic key is to keep the dollar inviolate in terms of purchasing power. This means avoiding inflation.

There is no economic problem, in my opinion, that the United States faces at the present time that is of any greater importance than maintenance of the purchasing power of the dollar. This means the adoption of fiscal programs to keep the dollars from being inflated. I assure you that—despite attempts to blame labor for cost-push inflation and to blame others for demand-pull inflation are directed at the wrong targets. These are rather high-powered words for simple ideas that are rather meaningless.

Inflation occurs when Government debt is monetized by the central banks and when more money and credit are pumped into circulation than is needed. There has been no important inflation in any country in modern times that has not been caused by the overissuance of money or credit. Once this has occurred labor, consumers, industries, merchants, and others endeavor to make up for the shrinking value of money by trying to increase the prices of the goods and services that they sell. Some are more successful than others because they are organized and can exert strong pressure. Seldom are governments willing to admit that they themselves have caused inflation. It is easier to point the finger of blame at others.

First in importance is removal of the gold cover, and next is to do something about speculation against the dollar. The latter is not in any bill before you, but since 1962 a number of economists have been pushing for an idea which involves some rather subtle reasoning.

It is that the United States continue to convert dollars into gold, when presented for redemption by foreign governments and central banks, at a fixed rate of one thirty-fifth of an ounce of gold per dollar, as long as it has the gold to do so, but that it abandon the advance "guarantee" to purchase all gold presented to it at same fixed price of $35 per ounce. Simply stated, the United States would continue to sell gold at its present price but would leave open the question as to whether, and at what price, it will buy gold in the future.

The United States would thus continue to support the value of the dollar in terms of gold but would no longer promise to support the value of gold in terms of dollars. Under such circumstances, speculators who buy gold would have to assume the risk of loss in order to enjoy the possibility of making a large profit.

As I understand the law, the President has discretionary power over the purchase and sale of gold. A simple announcement, therefore, making it clear to speculators that the United States might not buy back the gold that they hold if they decide to return it to the Treasury would go a long way to deter speculation in gold. The President has authority to refuse to buy gold, or to buy gold only in amounts and from sellers determined by the U.S. Government.

However, since under present law the U.S. Treasury cannot buy or sell gold at a price other than $35 per ounce, proposals that involve a change in the price of gold would require congressional authorization.

Furthermore, refusal by the United States to buy gold would not be in violation of the Articles of Agreement of the International Monetary Fund, which provide that the obligation to maintain exchange rates within prescribed limits may be met either by buying and selling gold freely or by maintaining exchange rates within those limits through exchange operations.

Let me conclude my remarks by saying that the problem we face is speculation against the dollar. Nothing in the facts seems to indicate there has been an abnormal or sudden increase in foreign investment or an abnormal or sudden increase in tourism. Therefore, it would seem to be logical not to penalize trade and investment but to concentrate on speculation. Let us not overlook the fact that for 34 years the United States has been in the forefront of the Western World in pushing for nondiscriminatory trade under the unconditional most-favored-nation policy, and for an open, multilateral payments system. We were the ones who pushed for formation of the GATT and we were among those who, at Bretton Woods, insisted on creating an International Monetary Fund. Now, with a single stroke we have cast doubt on the credibility of the fundamental foreign economic policy of the United States. This is because we have our eye on the wrong ball. We are concentrating on symptoms rather than on the ailment that troubles us.

(The paper prepared by Mr. Piquet follows:)

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 and unrestricted payments system. The Trade Agreements Acts, commencing in 1934 and culminating in the Trade Expansion Act of 1962 and

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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.

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 solution of the "balance-of-payments problem", but also with respect to the nature of the problem itself. Some of the disagreement appears to arise from failure to distinguish between *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 phychological 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 because they can return it at any time to the U.S. Treasury in exchange for dollars. This is not true speculation; it is "one-day 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 over-issuance 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 over-issue. 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.

Mr. BARRETT. You indicate we should not tell them that we will sustain the $35 an ounce, or we will not sustain $35 an ounce.

Mr. PIQUET. You mean in the dollar? In redeeming the dollar?

Mr. BARRETT. That is right.

Mr. PIQUET. We should keep that as is.

Mr. BARRETT. On the question of sustaining the purchase of gold at $35 an ounce, telling them we will or we will not tell you what we will do, would this not cause a run to liquidate gold, anticipating that the United States may desire to lower the price of gold?

Mr. PIQUET. You mean, on the part of speculators?

Mr. BARRETT. Yes; on the part of speculators.

Mr. PIQUET. I think they would not speculate against the dollar. I don't see any harm in speculating against gold in favor of the dollar. Driving the value of the dollar up above the value of gold would increase confidence in the dollar, relative to gold.

Mr. BARRETT. This is an academic question that has bothered me for some time. Some of these countries, that is, the people of these countries, have no confidence in the bank.

Mr. PIQUET. You are thinking of France, I imagine.

Mr. BARRETT. I will mention no country. But they go and they purchase gold in the form of bracelets, or whatever it may be, and then they put that in a private security because they think this is the best way that they can secure their money for their later years.

Now, if we indicate that we would not sustain the price of gold at $35 an ounce, or we may indicate in the future it may be lowered, looking at the speculators' part that you had pointed out, that he anticipates he must win, he can't lose, if he holds his gold; if we sustain the price of gold at $35 an ounce, would this not cause these people then to run and liquidate their gold in these countries because of the fear it may go down?

Mr. PIQUET. I think they would. They certainly wouldn't hoard it, to the extent that they thought it might decline in value. The price of gold would find a level on the open market in line with its value in industrial uses.

Mr. BARRETT. I agree with you implicitly and I think you make a beautiful statement here, very knowledgeable, and very edifying. But I was wondering, because of this turbulent situation we find ourselves in all over the world, if this wouldn't add to this turbulence of those people who have hoarded gold for so many years, now are running to liquidate that gold; would it not give us a really upside-down world?

Mr. PIQUET. I think it might be a very healthy turbulence.

Mr. BARRETT. You do?

Mr. PIQUET. To throw the gold on the market and take it out of hoards would, I think, be rather healthy.

Mr. BARRETT. You don't think the people in the main would lose their confidence in the United States?

Mr. PIQUET. No; I think it would improve confidence in the dollar, and I think we must think clearly on this question: Does gold support the dollar in value, or does the dollar support gold in value? I feel that it is the dollar that supports gold, rather than the reverse. In other words, we are on a world dollar standard, not a gold standard.

Mr. BARRETT. We agree on that. I certainly want you to know that is my feeling, too. But I am wondering about that individual who is not knowledgeable, who does not know the monetary system as the European bankers and these countries, whether or not that gold they put away for their old age, hearing the United States making this expression, "We will tell you what we will do when we are going to do it. We won't tell you we sustain a price of $35 an ounce, or whether we will lower it."

Now, this might cause those people to lose respect for the United States also.

Mr. PIQUET. I think that probably the Frenchman might, the people you are talking about; instead of hoarding gold they would hoard dollars, if the dollars were worth more than gold. I think that the hoarders are not the ones we are primarily concerned about here. It is the speculators who are causing the trouble, not the hoarders. Those persons who have been hoarding gold have been doing so for a long time. This is a characteristic of these particular people. I don't think this is a major consideration, compared with what we have been talking about.

Mr. HANNA. Would the gentleman, before we start questions, address a few remarks to the relationship between the guarantee and the ability to borrow to speculate in gold?

Mr. PIQUET. You mean, on the part of speculators?

Mr. HANNA. Yes.

Mr. PIQUET. It is very important.

Mr. HANNA. Do we not need to put our attention a little bit on this particular aspect?

Mr. PIQUET. Of the pyramiding?

Mr. HANNA. Yes.

Mr. PIQUET. Let me call your attention to a paper that I wrote in 1962 that appears in the Joint Economic Committee volume called, "Factors Affecting the U.S. Balance of Payments." In it I gave figures to show how much you could pyramid this thing. Here this morning, I simply said you buy one bar of gold and you make 100-percent profit. But by borrowing for the purpose of buying gold, you can pyramid up to almost 10 times the figures I gave here, and I call your attention to them on page 321 of the 1962 report referred to.

Mr. HANNA. May that be included in the record at this point, Mr. Chairman, and this answers my question.

(The document referred to follows:)

SOME CONSEQUENCES OF DOLLAR SPECULATION IN GOLD

By

HOWARD S. PIQUET

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CONTENTS

SOME CONSEQUENCES OF DOLLAR SPECULATION IN GOLD

I. Introduction

This paper questions the traditional conception of the relationship between international transfers of gold and deficits in the balance of international payments. Usually the balance of international payments is discussed first and, if there is a substantial excess of international payments over receipts, accompanied by an appreciable outward flow of gold, it is assumed that the former caused the latter. In consequence, solution of the problem of the loss of U.S. gold is made to hinge upon prior elimination of the balance-of-payments deficit.

It is proposed that it might be as logical to consider the problem of gold first, and to relate its loss to the balance-of-payments deficit. If so, it is inappropriate to conceive of the problem of the "balance-of-payments deficit" as central, and the problem of gold as subordinate. Two problems of equal importance need solution, namely (a) the loss of gold, and (b) the persistent balance-of-payments deficit. It is true that they are interrelated, but there is no reason to assume that the solution to either problem automatically will provide a solution to the other.

One of the difficulties in the way of finding solutions to these problems is that even experts do not agree as to the nature of the problem to be solved. There is even failure to agree upon the size of the balance-of-payments deficit itself. The experts differ as to what should be included in computing the deficit, and some even suggest that there is no deficit at the present time.

More and more it is becoming clear that what is really troublesome is not so much the balance-of-payments deficit as the loss of gold and the undermining of international confidence in the dollar as the free world's monetary standard. It is contended in this paper that a persistent outward flow of gold can, in effect, be a cause, as well as an effect, of persistent deficits in the balance of international payments.

THE THESIS

The thesis of this paper may be summarized as follows:

1. Some of the gold losses of the United States may be attributed to recent and current deficits in the Nation's balance of international payments. Some of them, however, may be attributed to speculation in gold, in anticipation of dollar devaluation relative to gold (that is, an increase in the dollar price of gold). Such speculation is encouraged by the huge accumulation of foreign dollar balances that have arisen out of past deficits in the balance of international payments. The outflow of gold during any given period of time, however, is not necessarily directly related to the balance-of-payments deficit during that period.

2. To the extent that the gold losses are being caused by speculation in gold, there is little that can be done to prevent them by increasing interest rates.

3. An important factor encouraging speculation in gold is assurance by the U.S. Treasury that, at all times, it will buy all gold presented to it by foreigners at the predetermined price of $35 per ounce. This assurance provides a price floor below which the world dollar price of gold cannot fall.

4. One way of helping to curb speculation in gold would be to remove this price floor. Without such protection, speculators in gold who are betting that the United States will raise the price of gold, would face the prospect of losses, as well as gains.

5. Such action, particularly if taken in conjunction with proposals already made that the United States issue gold certificates to guarantee its pledge to redeem in gold the dollar balances held in the United States by foreigners, would go far toward preserving international confidence in the dollar.

SOME BASIC PRINCIPLES RESTATED

There is danger, in the world of affairs, of losing sight of fundamental principles and, without realizing it, of substituting for them preconceptions that impede logical thinking and intelligent action. In no problem area is it more important that principles be clearly understood than in the area of gold and the balance of international payments.

1. *Value of gold not intrinsic.*—Nothing, not even gold, has intrinsic value. Value is a quality that humans attribute to something. Value is economic in nature when the importance attributed to something relates to a human desire to possess it. It is not a physical characteristic of an object, but rather a subjective appraisal by man.

Gold, like other things, is valued by man for various reasons. Gold has long been valued for purposes of ornamentation, for use as jewelry, for industrial purposes including dentistry, and as a means for hoarding wealth. The physical characteristics of gold, its virtual indestructibility, coupled with its limited supply, caused it to acquire a position of preeminence as the ideal money material, superseding other materials for this purpose, such as silver, tobacco, and paper.

The many uses of gold, including its use as reserve money, give it value, not only in terms of U.S. dollars, but in terms of everything else. When gold came to be the monetary standard of most countries in the 19th century, its value increased. If nations were to cease using gold as reserve money, its value would decrease. If each nation sought to accumulate gold without regard to the requirements of other nations, its value would rise. Like everything else, the value of gold depends upon the desire for it, on the one hand, and its physical scarcity on the other. There is nothing more mysterious about the value of gold than about the value of anything else.

2. *Relationship between the value of money and the value of the material of which it is made.*—A central question regarding national and international monetary systems is the degree to which the value of money should be related to the value of the material of which it is made. At one extreme is gold, and at the other extreme is paper. Historical experiences of many nations with paper money, the supply

of which is determined by man-made decisions alone, have not been happy ones. This is why many students of monetary affairs hesitate to break the few remaining ties between money and gold.

As long as a country is on a free gold standard, in the sense that its currency is freely convertible into gold at a fixed ratio, and gold is freely convertible into its currency at the same ratio, the value of its currency cannot differ from the value of gold. No country has been on the free gold standard since the United States abandoned that standard in the early 1930's.

Once a country abandons the free gold standard its currency becomes "managed," and its money supply comes to depend upon decisions of its governmental and banking authorities. In most of the famous inflationary experiences of history the supply of money was limited only by the speed with which the printing presses could be operated. In more recent years the supply of money has become practically synonymous with the supply of bank credit which, in turn, is determined by central banking and governmental policies with respect to central bank interest rates and open market operations and the requirements of government financing.

The temptation to expand the supply of money is great, particularly when economic recession and unemployment threaten. Because, thorughout history, this temptation so often has led to runaway inflation, conservative students of monetary history and policy are not sanguine as to mankind's capacity to regulate the supply of money unless there are some built-in safeguards against overissue. For quite a while the use of gold in the form of the free gold standard performed this function reasonably well.

3. *Importance of confidence.*—The value of paper money that is not convertible into gold depends entirely upon its power to command goods and services in exchange. It continues to be acceptable as a medium of exchange only as long as there is general confidence in its ability to do so. Without public confidence paper money is worth no more than the paper upon which it is printed. Unlike gold and other precious metals, there is no minimum value of the money material itself below which the value of the money cannot fall. This is why, by definition, paper money is known as credit money (Latin: credo, credere, meaning "to believe," or "to have faith").

Loss of confidence in the ability of an inconvertible currency to perform the purchasing power function causes it to lose value. Its loss of value, in turn, brings about a still greater loss of confidence, a process that can continue until the currency loses all value. At present, international confidence in the dollar depends, in part, upon the ability and willingness of the U.S. Treasury to exchange gold for all dollars presented to it at 0.89 gram per dollar (1 ounce of gold for $35). It might be that international confidence in the dollar would be maintained even if the United States were to cease redeeming dollars in gold. It can be generalized, however, that gold is more acceptable throughout the world than paper currency because of deep-seated historical and psychological attitudes regarding it. The advantage to the United States would seem to lie in continuing to pay gold for dollars, upon demand.

II. International Balance Under the Free Gold Standard

Prior to World War I, when the leading countries of the world were still on the free gold standard, the international financial balancing mechanism was largely automatic. Currencies were readily convertible into gold at fixed parities of exchange, and gold moved freely from country to country.

Freely moving prices within countries, together with the free international movement of gold, provided the world with a multilateral payments systems which worked so well that, by the close of the 19th century, it was looked upon as "natural" and "permanent." This almost-automatic system came to prevail largely because of the United Kingdom's position in the world economy. The ready convertibility of the pound sterling into other currencies and into gold, and the strong international creditor position of the United Kingdom, made it convenient for traders everywhere to carry on international trade in pounds sterling. Convertibility meant that the British pound could be exchanged for gold at a fixed ratio at the will of the holder, regardless of his nationality. The fact that the United Kingdom maintained convertibility made it easier for other countries to do so also.

GOLD PARITIES AND PRICE LEVELS

Under the free gold standard currencies were legally defined in terms of their gold weights. The U.S. dollar was 23.22 grains of pure gold and the British pound sterling was 113.0016 grains. The ratio of the weights of the two currencies ($4.866+ to £1) was known as the par of exchange. Individuals anywhere could convert gold into currency, or currency into gold, at the legal ratio or convert either currency into the other at the current exchange rate. Gold was the standard of value, both domestically and internationally, and also provided a mechanism for keeping currencies in line with each other at approximately their gold parities. In consequence, gold was distributed throughout the world according to need, as determined by changing prices and foreign exchange rates.

If commodity prices in the United States, for example, increased relative to prices in the United Kingdom there would be a tendency for U.S. imports from the United Kingdom to increase, and for U.S. exports to the United Kingdom to decrease. This increase of imports, relative to exports, would cause the dollar to weaken, in terms of pounds sterling. The decline could not go beyond the "gold export point," however, which was the level at which it becomes profitable to convert dollars into gold and to ship the gold to the United Kingdom.

Since the supply of money and credit in both countries was directly dependent upon gold reserves, the exportation of gold from the United States to the United Kingdom had the effect of curtailing credit in the United States, and of permitting it to expand in the United Kingdom. As a result, prices in the United States would fall, while prices in the United Kingdom would rise. As prices in the United States ceased rising, and started to decline, there would be a tendency for merchandise imports from the United Kingdom to decline, and for U.S. exports to the United Kingdom to increase.

Before long, price levels in the two countries would come into balance with each other and there would be international financial equilibrium, with the two currencies exchanging for each other at a point close to parity.

Usually, long before the gold export point was reached, the decline in the value of the U.S. dollar, in terms of other currencies, in the foreign exchange market would attract short-term capital, which would tend to bring the international payments and receipts into balance. The system worked well largely because the British Government and the Bank of England pursued liberal trade and monetary policies and served as world banker.

As long as countries operated under free gold standard conditions they were not conscious of any balances, or deficits, in their international receipts and payments because money inflows and money outflows never were far out of line with each other. Movements of capital and gold provided the automatic correctives which distributed gold among nations.

Essential to the functioning of this system was willingness of countries to allow their economies to adjust to each other. Fluctuations in exchange rates, although relatively narrow, were sufficiently sensitive to cause international capital and gold transfers. The inflation or deflation that resulted from international gold movements usually was gradual and mild. Difficulties appeared, however, when countries that had departed from the free gold standard, and experienced marked inflation, tried to return to the gold standard at previous parities of exchange. The United Kingdom tried to do this shortly after World War I with disastrous consequences. Once functioning, the free gold standard leads to economic stability, provided that the principal countries of the world do not try to insulate their economies against outside influences.

ILLUSTRATION OF INTERNATIONAL FINANCIAL ADJUSTMENT UNDER THE FREE GOLD STANDARD

The steps in the process of adjustment under the exchange rate mechanism of the free gold standard may be summarized as follows:

1. An excess of U.S. commodity imports over commodity exports causes dollars to become more plentiful in terms of British pounds sterling, so that dollar exchange drops from $4.866=£1 (parity) to, let us say, $4.87=£1.

2. In consequence, £1 will now purchase more dollars than previously and it becomes profitable to convert pounds into dollars for short-term investment in the United States.

3. The ensuing flow of short-term capital into the United States will increase the supply of short-term capital relative to the demand for it and cause the short-term interest rate to fall, thus tending to neutralize the effect of the decline in the exchange rate.

4. Meanwhile, since the dollar is now cheaper in terms of pounds sterling it becomes more profitable than before for foreigners to buy merchandise in the United States. Hence, U.S. exports will increase relative to imports, thereby tending to correct the excess of imports over exports. The effect will be to raise the value of the dollar in terms of pounds and tend to bring it back to parity.

Observe that these correctives (capital movements and merchandise trade) were brought about by fluctuations in foreign exchange rates without any manipulation of interest rates and without any shipments of gold.

5. If the adjustment mechanism just described fails to work promptly the value of the dollar in terms of pounds sterling will continue to fall until it reaches \$4.886=£1. This is the "gold export point." Since it costs—or used to cost—approximately 2 cents to ship 1 pound sterling in gold from New York to London it will be more profitable to ship gold than to pay more than \$4.886 for £1 in foreign exchange.

6. The movement of gold from New York to London decreases U.S. monetary reserves and increases those of the United Kingdom thus serving to contract credit in the United States while expanding it in the United Kingdom.

7. In consequence, commodity prices in the United States will tend to fall relative to prices in the United Kingdom, thereby making the United States a better market in which to buy and the United Kingdom a better market in which to sell. U.S. exports, therefore, will be stimulated while imports will be retarded.

8. Generalizing the illustration, changes in exchange rates, by inducing short-term capital movements, by making it profitable to ship gold, and by changing the relationship of exports to imports served to distribute the world's gold among the nations in accordance with their needs and to prevent prices in all countries from getting out of line with each other. This is what economists mean when they refer to the "automatic equilibrium under the free gold standard."

III. International Balance Under Conditions of Inconvertibility

Two World Wars and a major economic depression shattered this world payments system. Currencies are no longer based on the free gold standard, but are "managed," in that the quantity of money and credit in circulation is determined by the fiscal and monetary policies of governments and central banks. The nexus between commodity price levels and gold has been broken. Monetary gold is now used only to settle international balances as a matter of government policy. In practice, the U.S. Government buys gold at the fixed price of \$35 an ounce and sells it at the same price to foreigners, on demand. The U.S. dollar is not freely convertible into gold domestically, and the United States is no longer on a free gold standard.

Now that the automatic correctives of the gold standard are no longer operative, countries watch their international payments with a keen eye so as to be in a position to intervene whenever weakness develops, meaning by "weakness" a tendency for outward payments to exceed receipts from abroad.

A country's balance of international payments is a barometer of its economy vis-a-vis the outside world. Adjustments that used to be prompt, and usually near painless, under the free gold standard now require considerable effort, time, and strain. Strong pressures develop, therefore, to prevent them from occurring. As soon as there are unfavorable developments in a country's balance of international payments, efforts are made to "correct" them, usually by preventing adjustment.

In foreign exchange rates were allowed to fluctuate freely and widely there would be a persistent tendency for price levels to adjust to each other through changes in imports and exports of goods and services. Thus, if prices in the United States should rise to higher levels than in the United Kingdom, imports into the United States from the United Kingdom would increase, thereby causing the value of the dollar to fall in terms of pounds sterling. As the dollar falls in value, relative to other currencies, it becomes profitable for foreigners to convert their money into dollars and to use them to buy certain goods in the United States, which would tend to correct the rising prices. This reasoning, known as the purchasing power parity theory, because it emphasizes the attainment of international equilibrium through international price adjustments, rather than through gold movements, probably would work if countries were willing to allow their economies to adjust to each other.

However, since adjustments sometimes cause deflation by forcing certain wages down, governments resist. The home currency is not allowed to fall on foreign exchange markets, and steps are taken to introduce exchange controls, export subsidies, quotas limiting imports, and other devices designed to prevent adjustment. In the absence of a free international gold standard, wide variations in uncontrolled foreign exchange rates would make international commercial transactions hazardous and would be a serious deterrent to international trade.

Notwithstanding worldwide abandonment of the free gold standard and freely fluctuating foreign exchange rates, there are still deep-seated pressures for economic forces to adjust internationally. What has been eliminated is the sensitive mechanism of the gold standard, which made it possible for national competitive economies to adjust to each other quickly and with a minimum of friction. Although gold is still used to settle international balances, it no longer brings the purchasing power of national currencies into line with each other in any sensitive way. Prices, wages, and other economic variables can now be out of line with each other, internationally, for a long time.

The automatic correctives of the old payments systems served to insulate the basic factors of production (principally labor) against sudden shocks from abroad. With the automatic correctives no longer operative, the factors of production become more sensitive internationally, unless governments intervene to prevent outside influences from being felt through such devices as the curbing of imports.

It is conceivable that the leading countries of the free world could agree upon an international monetary system that would approach the automaticity of the free gold standard. There was hope, as World War II drew to a close, that the United Nations would be able to establish an international currency and a world reserve bank. The most that could be agreed upon, however, was establishment of an International Monetary Fund which, though constituting an important step toward international monetary stabilization, is not an adequate substitute for the free gold standard.

Under the free gold standard, international gold movements were residual and passive, in that gold was shipped abroad to reestablish international equilibrium whenever other economic variables, such as exchange rates, merchandise trade, services, and capital movements failed to balance. Although gold is still used to settle international balances, it no longer moves automatically as a corrective. At the present time, gold can be more than a residual item in the balance of international payments. Independent movements of gold, such as those caused in 1960 by speculation against the dollar in the free gold market in London, can be the symptom of a cause, as well as a direct result, of a deficit in the balance of international payments.

IV. Recent Changes in the U.S. Balance of International Payments

Between 1951 and 1956 the United States incurred an overall deficit in its balance of international payments, each year, of between $0.3 and $2.1 billion. The excess of international payments over receipts took the form of additions to dollar balances in U.S. banks to the credit of foreign banks and foreign nationals and aroused little concern in the United States.

In 1957, because of the Suez crisis, the deficit was transformed into a surplus of $0.4 billion. But in 1958 the United States suddenly exported $2.3 billion of gold, and immediately the balance-of-payments deficit problem loomed large in the eyes of many Americans. The principal European currencies became externally convertible at the end of 1958, since which time short-term capital outflows have been of more than usual significance. In 1959 gold exports receded to $0.7 billion, but again reached a high level of $1.7 billion in 1960. In 1961 the gold loss again declined to $0.7 billion, but during the first half of 1962 was at an annual rate of $2 billion.

The stock of U.S. monetary gold now amounts to almost $17 billion, which is about one-third below the 1949 peak of $24.8 billion, when the United States held approximately 70 percent of the free world's total monetary gold. Its present stock accounts for over 40 percent of the free world's total gold supply and to over 150 percent of the $10.5 billion short-term dollar assets of foreign central banks (as of March 1962). Thus, notwithstanding the steady loss of gold during the past few years, the stock of U.S. monetary gold is still large, considered in historical perspective and in relation to U.S. short-term liabilities to foreigners.

An outstanding characteristic of the U.S. balance of international payments during the past few years has ben the phenomenal increase in short-term capital outflows. If these outflows are excluded from the balance of international payments, the overall deficits in 1960 and 1961 are reduced from $3.9 to $2.5 billion, respectively, to $1.8 and $0.6 billion. In other words, about one-half of the large balance of payments deficit in 1960, and about three-fourths of the somewhat smaller deficit in 1961, are accounted for by short-term capital outflows. Stated differently, if it had not been for the large increases in short-term capital outflows, the international accounts of the United States would have been practically in balance.

The overall balance of payments deficit of the United States between 1951 and 1962, together with short-term capital outflows and gold movements, are shown in the accompanying table.

During the first half of 1962 the overall deficit declined to an annual rate of $1.2 billion. Recorded outward short-term capital movements declined to $0.8 billion (annual rate), but gold exports were running at an annual rate of $2 billion.

U.S. balance of international payments: The overall deficit, short-term capital movements, and gold movements, 1951–61

[In billions]

Year	Overall deficit [1]	Private short-term capital movement	Gold movement (+ equals outward flow)	Year	Overall deficit [1]	Private short-term capital movement	Gold movement (+ equals outward flow)
1951	−$0.3	−$0.1	−$0.1	1957	+$0.4	−$0.3	−$0.8
1952	−1.1	−.1	−.4	1958	−3.4	−.3	+2.3
1953	−2.1	+.2	+1.2	1959	−3.8	−.1	+.7
1954	−1.5	−.6	+.3	1960	−3.9	[2] −2.1	+1.7
1955	−1.1	−.2	+.04	1961	−2.5	[2] −1.9	+.7
1956	−1.0	−.5	−.3	1962 [3]	[3] −1.2	[3] −.8	[3] +2.0

[1] Sometimes called the conventional balance, to distinguish it from the basic balance (which excludes private short-term capital movements).
[2] Including approximately $600,000,000 in 1960 and $600,000,000 in 1961, shown officially as "errors and omissions." The official assumption has been that large negative errors and omission figures reflect unrecorded short-term capital outflows.
[3] Annual rates based on figures for 1st half of the year.

SPECULATION IN GOLD

Recent deficits of international dollar payments over dollar receipts have taken the form of increasing balances to the credit of foreign banks or nationals in U.S. banks. An outstanding fact is that although sales of gold to foreigners have increased, there has been no net decline in foreign-held dollar balances. If there had been an appreciable loss of confidence in the U.S. dollar, the foreign-held dollar balances would have decreased as foreigners deserted dollars in favor of gold.

Maintenance of confidence in the U.S. dollar is vital because the dollar has become the world's reserve currency. Confidence depends upon both its convertibility into gold and the stability of its purchasing power. At present the dollar is convertible into gold—in practice, though not required by law—for the settlement of international balances at the fixed price of $35 per ounce. If the price of gold were to be raised, that is, if the dollar were to be "devalued" with respect to gold, or if there were what appeared to be well-founded rumors to that effect, there could be a stampede to convert dollars into gold. Heavy speculation in gold on the free gold market in London during the latter half of 1960 ran the price of gold to a temporary high of $41 per ounce.

It seems highly probable that an important reason for the substantial withdrawal of gold during the latter half of 1960 was the purchase of gold from the U.S. Treasury by the Bank of England to replenish the gold that it had been paying to those who were exchanging dollars and other currencies for gold for speculative purposes. The assurance that the United States stands ready to buy gold at the fixed price of $35 per ounce encourages speculation in gold. A person having, or obtaining, gold abroad who believes that the United States will devalue the dollar has only to sell dollars short and to sell his gold to the U.S. Treasury after devaluation occurs, thereby reaping large dollar profits. The cost and risk of the transaction are small since the speculator can lose no more than the cost of the transaction itself. If the United States does not devalue the dollar the speculator can always present his gold to the U.S. Treasury and receive dollars for it at the fixed price of $35 per ounce.

If the United States, while continuing to redeem foreign-held dollars in gold at $35 per ounce, were to terminate the implicit guarantee to purchase gold for dollars at that price, speculators would have to take a chance of loss since they would no longer be assured of the minimum price of $35 per ounce. Such action by the United States would discourage speculation in gold and should stimulate the return of substantial quantities of gold to the United States.

Stated succinctly, the United States would give assurance that, although it intends to support the dollar in terms of gold, it has no intention of continuing to support the world gold market in terms of dollars. The United States, of course, would purchase gold at the world market price whenever it deemed it necessary to do so to replenish its gold reserves.

The conversion of foreign-held dollar balances into gold, whether by foreign central banks for the purpose of replenishing their gold reserves, or by foreign nationals in anticipation of a rise in the dollar price of gold, has no effect upon the U.S. balance-of-payments deficit. In such cases the loss of gold is balanced by an equal decrease in foreign dollar balances.

It is when short-term capital leaves the United States for the purpose of buying gold that the effect is to increase outward payments, thereby aggravating the balance-of-payments deficit. When these dollars (short-term capital) are used to purchase gold abroad to be hoarded in anticipation of dollar devaluation, the effect is to withdraw gold from the free gold market (in London or Switzerland). To the extent that the gold purchased is not newly mined gold, but is supplied by the gold market, it ultimately comes from the Bank of England's reserve. The Bank of England, in turn, replenishes its reserves by converting some of its dollar balances into gold at the U.S. Treasury.

Thus, the loss of gold which was made possible by the outflow of short-term capital is a cause, rather than a result, of an increase in the U.S. balance-of-payments deficit.

WHAT IS SHORT-TERM CAPITAL?

Short-term capital transactions are a more or less miscellaneous category in which are placed, for the purpose of constructing a balance-of-payments statement, all dollar outflows that cannot otherwise be accounted for. Short-term capital is sometimes thought of as "a stock of footloose money hopping from country to country only because relative interest rates vary, or in search of gains from exchange rate speculation."[1]

The concept of short-term capital is vague. The definition that is followed for balance-of-payments purposes was determined primarily by the need for a criterion that is statistically manageable. Short-term capital, thus defined, is "capital which is held in the form of assets (including bank deposits) with an original maturity of not more than 1 year." A number of transactions that are classified as short term are more in the nature of long-term transactions because

[1] Cf.: Monthly Review, Federal Reserve Bank of New York, July 1962, article entitled "Short-Term Capital Movements and the U.S. Balance of Payments," p. 94. According to this article, "short-term capital transactions are among the least understood items in our balance-of-payments accounts."

they are regularly renewed at maturity. Similarly, some of the capital flows between parent companies and their subsidiaries may, in fact, represent only short-term financing, although in existing statistics they would be shown as direct investment.

Confusion arises from failure to distinguish between capital and dollars. Capital is a financial concept, whereas the dollar is a monetary concept. Private short-term capital movements that arise from import needs are true capital movements. They represent an investment of funds for the purpose of acquiring gain in the form of income on principal. Similarly, if short-term funds move from one country to another because of international differences between interest rates, there has been a movement of capital. In both cases, dollars (or other funds) are used, as principal to obtain a right (or power) to receive future income.

In all probability, an indicated above, a large number of dollars moved from the United States to other countries in 1960 and 1961, not for the purpose of securing a right to receive future income on those funds as principal, but rather in anticipation of a change in the value ratio between the money unit itself and gold. Dollars that move in response to this motive do not represent an investment of capital, and are not financial transactions. They represent rather, money manipulation, or speculation against the dollar, itself, with respect to its gold value.

Although investment, on the one hand, and manipulation on the other, are not separated by a clear line of demarcation, it is clear that the transfer of dollars from the United States in anticipation of an increase in the dollar price of gold is the realm of monetary speculation, rather than in the realm of investment. Dollars that move in response to this motive should not be included in the category of short-term capital, but should constitute a separate category. Unfortunately, there is no way of ascertaining how many dollars move in response to the motive of monetary speculation.

Unlike ordinary international transfers of short-term capital, where differences between rates of interest here and abroad are casual, the outward flow of dollars for the purpose of speculating in gold is influenced little, if at all, by interest rates. For, if it is anticipated that the dollar price of gold will be doubled, from \$35 to \$70 per ounce, the interest charges incurred by holding gold are insignificant compared with the large speculative gains to be made.

V. The Mechanics of "One-Way" Speculation

Some persons find it difficult to think of a ratio from the point of view of both elements comprising it, simultaneously. Thus, the ratio 2:3 can be thought of either as 2 being two-thirds as large as 3, or as 3 being 1½ times 2. In the same manner, some persons find it difficult to distinguish between the price of gold in terms of dollars, and the price of dollars in terms of gold.

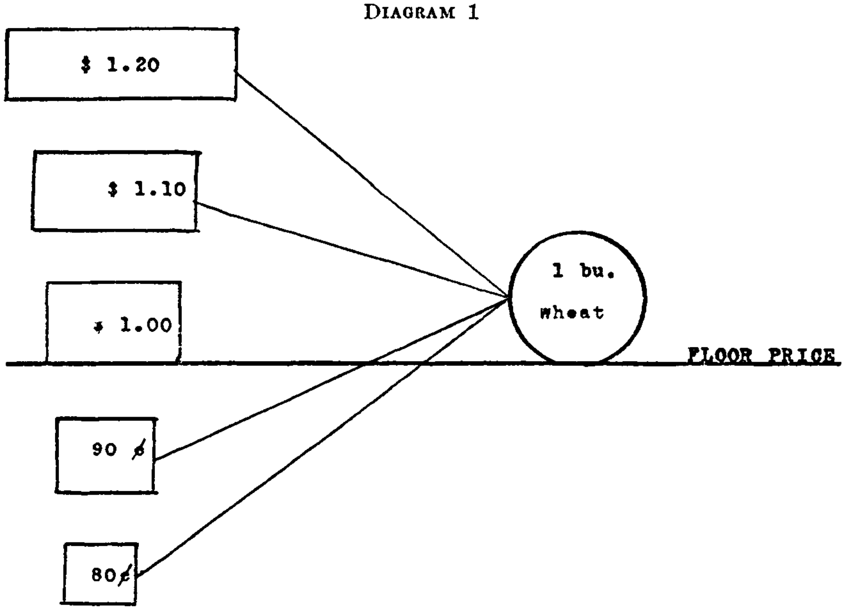
At the present time the U.S. Treasury supports dollars in terms of gold, and gold in terms of dollars, at the fixed ratio or 0.89 gram one-thirty-fifth of 1 ounce of gold per dollar. Or, as more commonly stated, it buys and sells gold at the fixed price of \$35 per ounce. It does it by paying 0.89 gram of gold for every dollar presented to it by foreigners, and by buying all gold presented to it by foreigners at $35 per ounce.

SPECULATION IN WHEAT

The accompanying diagrams might help clarify thinking on the subject. But, instead of delving directly into the relationship between dollars and gold, let us first consider the relationship between dollars and some commodity other than gold, say wheat.

Assume that the U.S. Government is supporting the world price of wheat at $1 per bushel, by selling it to foreigners, and buying it from them freely at that price. Assume, further, that rumors spread to the effect that the United States is about to increase the price of wheat.

DIAGRAM 1



Speculators will waste no time in buying all the wheat that they can lay their hands on at $1 per bushel in anticipation of the price rise, withdrawing dollars from bank accounts, and borrowing on wheat as collateral, so as to buy more wheat for future delivery. As long as they know that the United States will continue to buy all wheat presented to it at $1 per bushel, they can lose nothing more than the interest charges of borrowing the dollars to buy the wheat futures. For, if the U.S. Government does not raise the price of wheat to something higher than $1 per bushel, or if the world price should fall to less than $1 per bushel, they can always sell their wheat to the U.S. Government at $1 per bushel.

This kind of speculation is highly profitable. The speculators can make a financial killing if the Government raises the price of wheat, but will lose practically nothing if the Government does not raise the price, or if the world price should fall. This might be called one-way speculation. Under the circumstances, the speculators will exert every effort, through propaganda and political pressure, to induce the Government to raise the price of wheat.

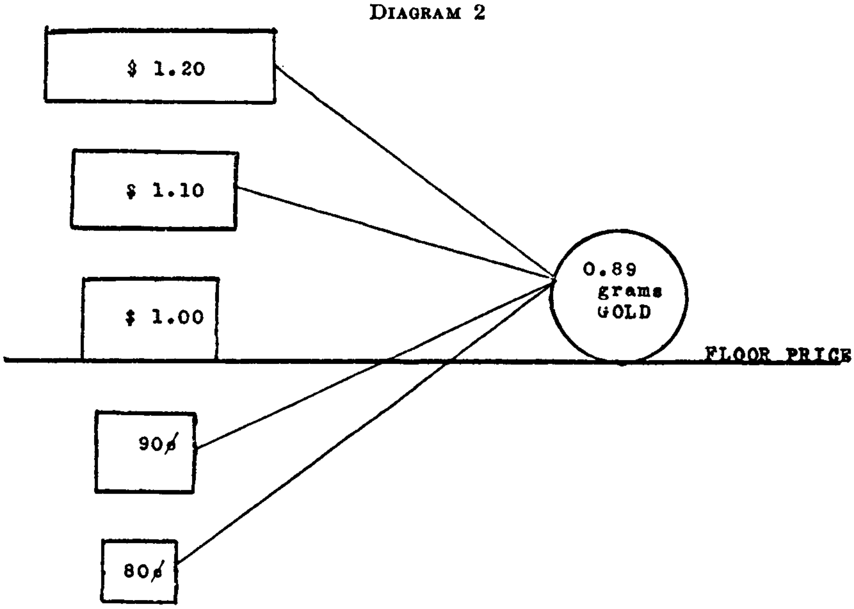
To reduce the profitability of such speculation, all that the Government has to do is to announce that it no longer will guarantee to buy all the wheat presented to it at the predetermined price of $1 per bushel. Once the guaranteed floor price is removed, speculation becomes a two-way street. The speculators can then lose, as well as gain, because the future price of wheat is indeterminate. Speculation then assumes its normal, proper role in the economy, which is to absorb the risks of price fluctuations. Two-way speculation performs a useful function; one-way speculation does not.

GOLD SPECULATION

Gold is a commodity, and the same reasoning applies to it that applies to wheat. The U.S. Treasury (not by statute, but by administrative practice) supports its price at $1 per 0.89 gram. Substitute gold for wheat in the diagram, and the same reasoning applies.

As rumors spread that the U.S. Treasury is about to double the price of gold, speculators waste no time in buying all the gold that they can lay their hands on at $1 per 0.89 grams in anticipation of the dollar devaluation, withdrawing dollars from bank accounts and borrowing on gold as collateral, so as to buy more gold for future delivery. As long as they know that the U.S. Treasury will continue to buy all gold presented to it (by foreigners) at $1 per 0.89 grams, they can lose nothing more than the interest and premium charges involved in borrowing dollars to buy the gold futures. For, if the U.S. Treasury does not raise the price of gold to something higher than $1 per 0.89 grams, or if the world price of gold should fall to less than $1 per 0.89 grams, they can always sell their gold to the U.S. Treasury at $1 per 0.89 grams.

DIAGRAM 2



This kind of speculation is also highly profitable. The speculators will make a financial killing if the Government raises the price of gold, but will lose very little if the price of gold is not raised, or if it should decline. This, too, is one-way speculation, and the speculators will exert every effort to induce the U.S. Treasury to raise the price of gold.

The U.S. Treasury could reduce the profitability of such speculation by announcing that it no longer will guarantee to buy all gold presented to it by foreigners at the predetermined price of $1 per 0.89 grams (or any other predetermined price). Once the implicitly guaranteed floor price is removed, speculation in gold will become a two-way street. The speculators can then lose, as well as gain, because the future price of gold is indeterminate. The fact that since January 1961, it has been illegal (by Presidential order) for Americans to hold gold abroad hardly deters the unscrupulous from engaging in the practice.

Nothing herein is intended to suggest that the U.S. Treasury should cease paying gold for all dollars presented to it by foreign holders at the fixed price of 0.89 grams per dollar. U.S. dollars are instruments of credit and ultimately are backed by the real wealth and productivity of the U.S. economy. The requirement that they be redeemed in gold serves the useful purpose of limiting their volume, thus restraining the temptation to over-issue.

The President of the United States has made it clear, upon numerous occasions, that the United States has no intention of raising the dollar price of gold. But, by silence, he has implied that it also has no intention of allowing the dollar price of gold to drop below $35 per ounce.

THE SWISS GOLD MARKET

There are free gold markets in London and Switzerland, where gold and gold for future delivery can be bought and sold freely. Contracts for future delivery can be bought in London or Zurich and can be purchased by anyone paying for them in hard currency, including U.S. dollars. Because the Swiss market offers complete facilities for the acquisition of bar gold and gold coins, it is probable that more of the speculation in gold has been carried on there than in London. Although it is illegal, under U.S. law, for Americans to buy gold abroad, there is nothing in Swiss law to limit such transactions. Anyone, whether a Swiss resident or a foreigner, can buy, sell, and import gold, or store it, without formality. Furthermore, Swiss banks observe secrecy, which prevents them from divulging information about any transaction. The identity of the owner under the system of "numbered accounts" is known only to one or two persons within the bank, so that shrewd investors from all over the world can own such accounts. According to a well-known expert on the subject,[2] gold bars and gold coins can be acquired as easily as groceries in a supermarket. No questions are asked and any hard currency is acceptable in payment.

No official statistics are available to indicate the actual volume of gold bought and sold in the Swiss gold market, but it has been estimated that at least $3 million worth has been traded in per working

[2] Pick, Franz, "Gold: How and Where To Buy and Hold It." Pick Publishing Corp. New York City. 1961.

day. It has also been estimated [3] that during the hectic days of October 1960, when the world price of gold was soaring to over $40 per ounce, more than 50 percent of the buying orders were of U.S. origin.

A TYPICAL TRANSACTION

On December 30, 1960, a speculator, wanting to buy gold for delivery in London or Switzerland at the end of June 1961, would have had to pay $36.54 per ounce (the price of gold which was $35.65 per ounce, plus a premium of 2½ percent).

By purchasing 1 bar of gold (400 ounces) outright, he could use it as collateral for a bank loan to buy 10 additional bars for future (6 months) delivery. If, during that period, the price of gold should be increased to $70 per ounce, the speculator would make a profit of over $147,000 on an original investment of less than $15,000. The mechanics of the transaction are as follows:

On Dec. 30, 1960: Buys 1 bar of gold (400 ozs.), at $35.65 per oz	−$14, 260
On. Dec. 30, 1960: On the basis of the 1 bar of gold, as collateral for a loan, buys additional 10 bars for future delivery (6 months) at a premium of 2½ percent. Two and one-half percent of 4,000 ounces at $35.65 per ounce. Uses the original bar as collateral to borrow from bank at 6 percent interest. (6 percent on $3,565 for 6 months)	−107
Total outlay	−14, 367
On June 30, 1961: Sells 4,400 ounces gold at $70 per ounce	+308, 000
Less original outlay	−14, 367
	+293, 633
Buys (under the futures contract) 4,000 ounces gold at $35.65 per ounce	−142, 600
Difference	+151, 033
Repays bank loan	−3, 565
Net gain	+147, 468

If the price of gold does not rise, or even if it should fall, the most that the speculator could lose would be $6,532, which is the total of the 2½ percent premium cost of the futures contract ($3,565), the difference between the buying price of gold under the futures contract ($35.65) and the selling price to the U.S. Treasury ($35) on 4,400 ounces ($2,860), and the small interest charge on his bank loan ($107).

This is what is meant by one-way speculation. The speculator can make a large profit on a small investment, but because the United States will buy all gold at the predetermined price of $35 per ounce, he can lose very little. Small wonder that a rumor to the effect that the United States is about to raise the price of gold can start a speculative stampede on the free gold market.

VI. Probable Effects of Abandonment of the Gold Price Guarantee

Some have misinterpreted the proposal that the United States abandon the assurance that it will buy all gold offered to it at the predetermined price of $35 per ounce to mean that the United States

[3] Op. cit., p. 37.

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would no longer buy any gold. The proposal does not imply this. The United States is a sovereign nation and will continue to buy gold, or any other commodity that it wants, at the world market price. Gold, as a commodity, will command a world price whether the United States guarantees it, or not. Whether, under the circumstances, the price would be higher, or lower, than $35 per ounce is indeterminate.

Action of this kind by the United States would amount to the demonetization of gold. It has been asserted that if the United States were to do this: (a) the value of gold would decline precipitously and, at the opposite extreme, (b) the value of gold would rise because there would be a scramble for gold in anticipation of eventual remonetization. Although it is conceivable that either of these diametrically opposed predictions could come to pass, it seems unlikely. It is more probable that, after a few temporary price flurries—both downward and upward—the price of gold would settle back to somewhere in the vicinity of $35 per ounce. It is unlikely that many persons would hold gold once the United States had decided to tear loose from it. Some other country, of course, could remonetize it, but it is not probable that it would do so without the cooperation of the United States.

Finally, one might ask what difference it would make if gold did cease to be the standard of international payments. Gold is no longer the monetary standard within the United States, even though it continues to serve as nominal backing of U.S. currency. It is not real economic backing, however, because holders of currency cannot obtain gold for it. The most that the gold does is to act as a restraint against overissue.

If the international gold standard (or whatever one chooses to call the present system) collapses it would be necessary to evolve a new system of payments. In fact, gold is a relative newcomer on the world's monetary stage. In ancient times silver was the standard, and it was not until the 19th century that gold attained a preeminent position. Abandonment of gold as an international standard would soon result in the adoption of some other standard. It might even hasten the adoption of rational liquidity arrangements, such as those recently proposed by Under Secretary of the Treasury Roosa, under which various currencies would be held and used to settle international balances.

However, countries will not be willing to keep the bulk of their reserves in one another's currencies as long as the price of gold can go up, but not down. Such a plan would be more likely to succeed if the floor price supporting gold were removed, for unless there are safeguards against the flight of currencies (U.S. dollars and the currencies of other countries as well) into gold, there is not much likelihood that the monetary authorities of many countries will be willing to hold their reserves in each other's currencies.

VII. Gold Speculation and the Balance-of-Payments Deficit

It should be noted, again, that a deficit in the balance of payments does not necessarily result in an equivalent withdrawal of gold in the same period of time during which the deficit was incurred. Throughout the period 1951–57 foreign banks and foreign nationals were building up their dollar balances in U.S. banks in preference to withdrawing gold or buying U.S. exports.

These dollar balances have become very large and they are subject to conversion into gold at any time, as long as the United States continues to redeem dollars in gold (for foreigners, though not for Americans). The extent to which, and the rapidity with which, foreign central banks convert their dollar balances into gold depends, not only upon their own monetary requirements, but also upon an awareness that if they withdraw too much gold, too quickly, it will have a bad effect upon international confidence in the dollar. For this reason, the Bank of England and other central banks are cautious about how much of their dollar balances they convert into gold. It is in their own self-interest that the dollars to which they have a claim be "as good as gold."

A current deficit in the balance of international payments may, or may not, result in a corresponding gold loss, and it is not necessary that a deficit in the balance of payments be incurred before foreigners can withdraw gold. Like any other bank balance, the foreign dollar balances are redeemable in cash—in this case gold—at any time.

What is not always appreciated is the direct and close relationship between dollar-gold speculation in Europe, in anticipation of a rise in the price of gold, and the U.S. balance-of-payments deficit. Dollars that are sent from the United States to Europe for the purpose of buying gold for speculative purposes take the form of short-term capital outflows and, as such, add to the payments side of the U.S. balance of payments. They undoubtedly accounted in large part, for the balance-of-payments deficit in 1960.

The dollars that leave the United States to buy gold in Europe are added to the dollar balances of the banks supplying the gold to the open market in London or Zurich (principally the Bank of England). As dollars accumulate, the bank finds its gold reserve diminished by an equivalent amount. It therefore converts some of its dollar balances into gold to replenish its reserves, which has the effect of increasing gold exports from the United States. In this indirect manner, speculation in gold through the exportation of short-term funds from the United States causes both an increase in the U.S. balance-of-payments deficit and an increase in the exportation of gold.

Gold that is purchased for speculative purposes with some currency other than dollars, however, or with dollars that have not been withdrawn from the United States for the purpose, do not affect the U.S. balance-of-payments deficit directly because such transactions do not depend upon new outward flows of dollars. The fact that the large outflows of gold from the United States in 1960 and 1961 were accompanied by substantial increases in short-term capital outflow would seem to indicate that U.S. dollars from the United States were being used to speculate in gold.

During the first 6 months of 1962, however, the large gold outflow was not accompanied by large short-term capital outflows. In fact, the outward movement of short-term capital during the first 6 months of 1962 was about half of what it was in 1961. The presumption is that the gold that has been leaving the country in 1962 has been in response to speculation in terms of currencies other than dollars.

As long as the U.S. Treasury assures speculators that it will continue to buy gold at any predetermined price there will be a temptation for holders of dollars to speculate against the dollar whenever there are rumors to the effect that the United States is going to devalue the dollar in terms of gold. If the dollars are withdrawn from the U.S. economy the speculation will result in stepped-up outward short-term capital movements and in aggravation of the U.S. balance-of-payments deficit. Those who are prone to speculate will do so whenever they see a gambler's chance to make something on a "sure thing."

Mr. WILLIAMS. As I understand your statement, Dr. Piquet, you will continue to value the dollar at one thirty-fifth of an ounce of gold. But the only thing that you would suggest is that this country make a statement that we do not guarantee that in buying gold to redeem our dollars, that we would continue to pay $35 an ounce?

Mr. PIQUET. We don't buy gold to redeem dollars; we sell it at $35 per ounce. The proposal is that we continue to do this, but that we no longer guarantee to buy the gold back at the same price.

Mr. WILLIAMS. On price. But not the guarantee on the dollar?

Mr. PIQUET. No, you wouldn't affect that. Just one way. In other words, we continue to support the dollar in terms of gold, but we would not continue to support gold in terms of dollars.

Mr. BARRETT. Mr. Widnall.

Mr. WIDNALL. Mr. Danielian and Dr. Piquet, we certainly appreciate you coming today and spending this time with us, as it is one of the most important subjects we have to consider this year, and we want to get all the light we can on it.

Back in 1965 the Senate issued a report at the time that Congress eliminated the requirement of the Federal Reserve banks maintaining certain reserves in gold against deposits.

In the third paragraph, the purpose of the legislation, it says:

> The bill would give time to the Government to take firm and effective action to solve our balance of payments problems in a sound and growing economy without compelling such drastic measures as to threaten our prosperity abroad, but would require the balance of payments problem be faced and solved while we still have a large sack of gold, instead of postponing action until our gold has been lost, and our international financial condition has weakened.

Here we are, 3 years later. To what extent has the situation deteriorated during the intervening period?

Mr. PIQUET. The basic situation has not deteriorated, Mr. Widnall. In 1964, our balance-of-payments deficit—on the liquidity basis—was $2.8 billion, in 1965 it was down to $1.3 billion, and in 1966 to $1.4 billion. It was improving, not deteriorating, until 1967. A balance-of-payments deficit of a billion to a billion and a half is not to be worried about too greatly because it supplies the liquidity that other countries need. If we were to get the deficit down to zero, the same foreign banks and others who are now criticizing us for our deficit would be criticizing us because we no longer had a deficit.

Mr. WIDNALL. If there is nothing to worry about, why are we moving against tourism and investment overseas?

Mr. PIQUET. New direct private investments overseas strengthen our balance of payments; they do not weaken it.

Mr. WIDNALL. The administration is taking steps to do things to weaken our investments overseas.

Mr. PIQUET. It would damage our balance-of-payments position, if it is anything more than very temporary. Direct investment, you mean?

Mr. WIDNALL. Yes. I just want to point out that 3 years ago a warning was given, and it doesn't seem to me that necessary steps have been taken, and these necessary steps aren't being taken. Some of the steps that are sponsored by the administration are going to hurt it and become permanent, rather than temporary, as they suggest.

If the United States maintains its present world commitments, do you regard these temporary controls as tending to become permanent?

Mr. PIQUET. I am afraid I did not hear your question.

Mr. DANIELIAN. May I comment on this question that Mr. Widnall has raised, as well as some other points that Dr. Piquet has brought up?

I must say I have great respect and admiration for Dr. Piquet's scholarship and I have been one of his ardent admirers for many years. I do disagree with him on a couple of points, however.

The first, that the balance of payments has improved in the last 3 years. I think this: We have improved our statistical treatment of the balance of payments, but not the balance of payments.

The improvements in 1965 and 1966 were illusory. They were the result of changes in the nature of the accounts from short- to long-term obligations, and instead of outflows they looked like inflows. But the basic balance-of-payments deficits during those years were still in the order of $2.9, $2.8, $2.9, $3 billion. So there were not improvements, really, in the terms of real resources.

There was a shortfall in real resource transfer to accomplish the things we want to accomplish abroad.

Secondly, I would agree with Dr. Piquet on his recommendation that we do not give any guarantee on the repurchase of gold.

I thought a great deal about it, but unfortunately we have treaty obligations and this is not a unilateral decision that we can make.

We have an obligation in the IMF to buy and to redeem dollars presented to us, either in the currency of the other country or in equivalent gold at $35 an ounce. And so what he is recommending is that we really get out from IMF, and I am not sure that this is feasible, without really creating even greater chaos in the world.

So that is the reason why I am limiting my recommendations to a firm assurance that we are not going to raise the price of gold.

Now, I don't know whether we have the freedom to say we may pay less for it, because I think we are bound by the IMF charter.

The general theory, that we don't have to worry about the balance-of-payments deficits, and that we can just unload paper dollars on other countries, I think, suffers from one simple debility.

In the United States, the Government is in position to print, directly, and usually indirectly, through the sale of Government bonds to the Federal Reserve, Federal Reserve notes which really are paper money. The Government, under a deficit condition, can force the American public to accept these paper currencies because they are legal tender; they can force the acceptance of these dollars in payments of debts.

Unfortunately, we do not have that power internationally. We cannot force these other countries or the people in other countries to accept paper dollars. There is no international machinery that says dollars in international transactions must be accepted in payment of debts. Lacking this kind of authority, we cannot just blithely go on, saying we are going to run a $3 or $4 billion deficit because we want to do this and that, all over the world, and whether you approve of our objectives or not, you must accept and hold these dollars.

So, lacking this kind of international authority to enforce the acceptance of dollars, I think we put ourselves in the control of those countries that are financing our debts—the increasing current liabilities of the United States. We have been financing our deficits, in part, by the export of about $1 billion or more of gold, on the average, in the last 10 years, and in part by increases in our current liabilities of about $2 billion or so.

Suppose one of these days when the Secretary of the Treasury is trying to sell a foreign government or central bank some $500 million worth of bonds, because he has to pay troop expenses in Germany or war expenses in Vietnam, these potential lenders shake their heads and say, "Now, you haven't been a very responsible borrower in the past and we are not going to buy them any more."

Then, how are we going to finance these activities? We cannot, just because we are a rich country, force other people to lend their resources to us. And this is actually what we are concerned with.

When other countries have a balance-of-payments surplus with us, it means they have given us resources to carry out some of the objectives that we have been undertaking and we have been borrowing resources from them, giving them dollars in return for them.

Suppose one of these days, they said, "We are not going to accept dollars for that purpose." So until we have a world government or world organization that says dollars must be accepted in payment of international debts, we do not have, completely, the freedom that Mr. Piquet suggests we exercise.

I think we would do better if we think in terms of the resource transfer problem in trying to do things abroad.

The Government of the United States has been spending approximately $8 to $10 billion a year in foreign exchange abroad. That is about 30 percent of our total earnings abroad. And this has been spent for political and military purposes. The private sector is not earning enough to offset this, and the only way you can solve this problem is either increase your earning power or find somebody who is going to lend you the money, or reduce your expenses.

Now, have we done all of these things effectively in the last 6 or 7 years to bring our payments into balance? I must say that if we had, we would not be in this situation now. We would not be subject to the pressures and, really, the arm twisting that has been going on in Brussels and Paris, and Basle. This is really arm twisting, because they are our creditors and they hold our dollars and they are asking for payment.

What kind of payment are they asking for? First, gold, because they hope they can make a capital gains out of it; and next, I think, they are going to have some political objectives. Whether they want us to get out of Vietnam or whether they want to buy our investments, I don't know what it will be, but we are really in the midst of some of the toughest political jockeying that is going on in the world, and I am not sure that Eastern Europe and its interests are not involved in this at the present time.

Mr. Widnall. What you are saying, as I gather, is that there is some sort of international blackmail taking place at the present time to force us in this position. I would like to refer to certain statements that were made in December by the top Treasury and Federal Reserve officials, and I would like to quote them, "The dollar is now on the frontline and we will sell our gold down to the last bar."

I feel that disturbed confidence and stimulated some of the speculation. How do you react?

Mr. DANIELIAN. Well, there are two aspects of gold hoardings that must be separated. First, I think there is a native-village-type gold hoarding, which is not necessarily speculation against the dollar. It may be speculation against their own currency. They are all afraid of the inflation of their own currencies and I don't believe an Indian snake charmer, or maharajah is holding gold, thinking of its conversion to the dollar. He doesn't have faith in the rupee, and therefore he holds gold. Then there is more knowledgeable hoarding that is going on on an international basis that is definitely directed against the dollar.

Mr. BARRETT. The time of the gentleman has expired.

Mr. PIQUET. I would like to make one point, if I may, and that is, we are under no obligation in the International Monetary Fund, as far as I have been able to ascertain, to support the price of gold. We have to support the dollar; but we don't even have to do that, according to the Fund agreement, by direct conversion. We can do it through exchange operations, as other countries do.

Let me call your attention to a recent—1966—monograph by Dr. John Parke Young "U.S. Gold Policy: The Case for Change." In Dr. Young's opinion, the proposal that we have been discussing would not necessitate our violating the International Monetary Fund Agreement.

Mr. DANIELIAN. May I, just to correct the record?

Mr. BARRETT. Mr. Danielian, we are very desirous of getting your help, and Mr. Piquet's help. We want to, if we may, give the other members a chance to ask you some questions.

I am sure the other members are very anxious to ask you some questions. We usually operate on a 5-minute rule, and we are hoping we can get your stored-up knowledge and exhaust your warehouse of knowledge by the time we have finished asking these questions.

At this point, before I recognize Mrs. Sullivan, I would like to insert in the record the speech of Chairman Patman on the floor on May 25, "The Dollar Is Stronger Than Gold."

(The material referred to follows:)

[From the Congressional Record, May 25, 1967]

THE DOLLAR IS STRONGER THAN GOLD, INSISTS BANKING AND CURRENCY COMMITTEE CHAIRMAN WRIGHT PATMAN

(Mr. Patman (at the request of Mr. Montgomery) was granted permission to extend his remarks at this point in the RECORD and to include extraneous matter.)

Mr. PATMAN. Mr. Speaker, gold is universally recognized as a means of settlement of international financial transactions for the principal reason that the world price of gold is supported by the world's strongest full faith and credit obligation—the U.S. dollar. Gold has very little intrinsic value and its glitter is more psychological than anything else.

Still, we find gold useful as a medium of exchange and a store of value internationally speaking simply because the United States of America supports the price of gold by promising to pay foreign holders at a fixed rate of exchange of $35 per ounce.

Therefore, it should be clear to all that the usefulness of gold is utterly dependent upon a fixed rate of exchange for some hard currency, and our dollar has assumed that role because we have the largest, steadiest, and strongest economy in the entire world. Thus, it is our economic power, coupled with our Government's taxing power, that stands behind the dollar. It is the full faith and credit of the United States specifically guaranteeing our dollars that protects and supports the value of gold—not the reverse, Without fixed hard-currency support, I suspect gold would have some substantial value as a mere commodity, but not a whole lot in comparison with its present monetary value.

So as long as we continue to successfully strive toward the great national goals clearly set forth in the Full Employment Act of 1946 of maximum production, employment, and purchasing power we will have a sound economy and a sound dollar, with or without gold.

Probably our main problem as world banker is due to an excessively rapid foreign investment program by our large banks and large corporations seeking to carve out profitable positions for themselves in the Common Market countries and other international markets.

If we decide to continue indefinitely to prop up the monetary price of gold, it will probably be necessary to impose stricter controls over the huge outward flow of dollars for investment in Western Europe.

In this connection, Mr. Speaker, I insert at this point in the RECORD a very intelligent letter to the editor, written by Mr. Walter C. Louchheim, appearing May 23 in the Washington Post newspaper:

"GOLD FOR DOLLARS

"Your financial editor, Hobart Rowen, was perpetuating a fallacy when he wrote in his article of Sunday, May 14, about the apprehension of European bankers as to a possible suspension of gold purchases or sales by the United States. I must also take issue with his statement that "there isn't a country in Europe that wouldn't like to buy gold for dollars."

"Mr. Rowen is really referring to a few central bankers in a few European countries. Anyone who has visited Europe recently and has discussed the dollar with bankers in a broad sense knows that confidence in it has never been higher. They also learn that this confidence is not dependent upon how much gold there is in Fort Knox but rather upon the resources and prosperity of our economy, the stability of our government and the free convertibility of our currency at all times, for all purposes and in any amounts.

"Apparently Mr. Rowen's article was based upon the views of a malcontent member of the French Embassy staff who has been using his office to spread financial Gallism around Washington. It ill behooves a representative of France to imply, as this man does in the story quoted by Mr. Rowen, that the United States is a defaulter on its international obligations while history is still so recent and so clear as to what countries have failed to pay their foreign debts.

"If we had a representative in France who was engaged in spreading such unjust and unfriendly allegations as this Frenchman is reported to be doing we would, I believe, call him home.

WALTER C. LOCHHEIM."

Mrs. SULLIVAN. Just a comment that I had. The point was made by the witness that we are not legally or morally obligated to support the price of gold at $35 per ounce. I think it would be good to have Dr. Young's statement that you referred to put into the record at this point.

Mr. BARRETT. That may be done, without objection, and it is so ordered.

(The article referred to follows:)

ESSAYS IN INTERNATIONAL FINANCE

No. 56, October 1966

UNITED STATES GOLD POLICY: THE CASE FOR CHANGE

JOHN PARKE YOUNG

INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

Princeton, New Jersey

This is the fifty-sixth in the series ESSAYS IN INTERNATIONAL FINANCE *published from time to time by the International Finance Section of the Department of Economics in Princeton University.*

The author, John Parke Young, was for several years Chief of the Division of International Finance in the Department of State. He was Chief Economist to the Senate Commission on Gold and Silver; Director of the Senate Foreign Currency and Exchange Investigation; member of the United States Committee which drafted the original Articles of Agreement for the International Monetary Fund and the International Bank; and member of the International Secretariat at Bretton Woods. He is author of The International Economy *and other books and has taught economics at Princeton University, the University of California at Los Angeles, and Occidental College. At present he is Visiting Professor of Economics at the Claremont Graduate School.*

The Section sponsors the essays in this series but takes no further 'responsibility for the opinions expressed in them. The writers are free to develop their topics as they will. Their ideas may or may not be shared by the editorial committee of the Section or the members of the Department.

FRITZ MACHLUP, *Director*

UNITED STATES GOLD POLICY: THE CASE FOR CHANGE

The international-payments system has not lacked attention during recent years. While a great deal has been said, there is much to be settled, and it does not necessarily follow that much will be settled soon. The appropriate function of gold in a revised international monetary system is a matter of debate. What the United States does about gold has an important bearing upon the developing system. This paper discusses the gold policy of the United States, particularly the policy of unlimited sales of gold at the option of foreign governments.

I propose that the United States sell gold only at its own discretion, as do all other governments, at the same time firmly maintaining the exchange rate and convertibility of the dollar. Such discretion is needed in the interest of an orderly utilization of our gold reserve, and especially to prevent erratic gold outflows from leading to further misconceptions regarding the strength of the dollar, and perhaps a gold crisis.

The proposed move, by reducing excessive dependence upon the gold element in our monetary reserves, would relax the limitations imposed by gold over desired domestic and foreign policies. It would provide greater flexibility for government policies directed toward goals such as economic growth, stable full employment and production, and foreign economic and political objectives. It would be another step in the evolution of money where gold is supplemented or replaced by credit arrangements—a development which has gone a long distance in domestic monetary systems in all countries. The move would be part of a program of international monetary reform that takes account of the declining role of gold in monetary systems. The pros and cons of restricting gold purchases by the United States are also considered, but such action is not recommended, at least for the present.

PRESENT GOLD POLICY OF THE UNITED STATES

The gold policy of the United States has throughout this country's history undergone two major changes excluding small reductions in the gold content of the dollar in 1834 and again in 1837, which made it profitable to bring gold to the mint for coinage. The country was legally on bimetallism, but the mint ratio of 15 ounces of silver to one ounce of gold favored silver and little gold was coined. The new ratio, after 1837, of 15.988 to one favored gold. Changes have been made from time to time in the percentage of gold reserve required to be held behind the country's money and bank deposits.

The first major change was the well-known shift from legal bimetallism to the gold standard by the law of 1873. This law abolished free coinage of silver into dollars—a measure which at the time attracted little attention, since the price of silver discouraged its presentation for coinage. For a quarter of a century thereafter, however, as the price of silver declined, the merits and demerits of the gold standard were subject to heated, and often not very illuminating, political debate.

The second major change in gold policy came in 1933 when gold was withdrawn completely from domestic circulation, concentrated in the hands of the Government, and its price raised substantially. The Administration under Franklin D. Roosevelt suspended redemption of all money in gold, made illegal the holding of gold by the public and banks, prohibited the export of gold except under license, and commenced buying gold at higher and higher prices. The price was finally fixed by the Gold Reserve Act of January 1934 at $35 an ounce, compared with the previous price of $20.67. These are the only basic changes that this country has made in its gold policy.

According to present policy, the U. S. Treasury will sell gold in unlimited amounts at $35 an ounce to friendly foreign governments and their central banks wishing to use the gold to add to currency reserves or settle international accounts. It will not sell gold to private persons, although there are exceptions for domestic buyers with legitimate use for gold in industry or the arts. American citizens are in general prohibited from holding gold either at home or abroad. The United States, conversely, will buy gold freely in unlimited amounts at $35 an ounce from foreign governments or central banks, and lawfully acquired gold from private persons, such as gold from domestic mines. (The Treasury collects a handling charge of ¼ of one per cent, so that the purchase price is actually $34.9125 and the selling price $35.0875.) The United States thus maintains unlimited convertibility internationally of dollars into gold or gold into dollars on the above basis. No other government maintains convertibility of its currency into gold on any basis.

DECLINING ROLE OF GOLD

A positive long-range gold policy for the United States must recognize the fact that gold has long been losing ground in monetary systems. For generations there has been a progressive substitution of credit for commodity money, first domestically and more recently internationally. The trend has been irregular but unmistakable. After the First World War and during most of the interwar period gold lost much of its influence over monetary policy and domestic economic conditions, also disappearing completely from circulation in virtually every country of the world. Gold played little part in monetary affairs during the Second World War. After the war, various restrictive devices were used to maintain exchange rates. Gold continued relatively inactive during the early postwar years.

During the past decade gold has regained monetary importance as the payments deficits of the United States and the removal of payments restrictions by major countries have focused attention on the role of gold in international reserves—its principal surviving function. Proposals for reforming the international monetary system generally downgrade gold.

The demise of gold, however, does not seem imminent. It is possible to ridicule the digging of gold from the ground only to bury it at Fort Knox, but the glitter of gold remains, and holds the world in its spell. It is universally accepted by central banks in settlement of accounts. It is widely regarded as an assured means of payment and considered to be the most conservative type of reserve. Predictions regarding the final demonetization of gold are precarious.

But events could move further against gold. If it were not for this country's policy of buying gold freely at $35 an ounce—a policy criticized by many economists—the price of gold would probably decline. The future of gold as a monetary metal is to a considerable extent in the hands of the United States. As the owner of the world's largest gold hoard, as well as for other reasons, it has an important stake in the future role of gold.

The United States supported the price of silver, under pressure from silver producers, long after silver had ceased to be a monetary metal—except in China and a few outlying parts of the world, and as the material used in fiduciary coins. The U. S. Treasury was finally bailed out of this costly project, in which huge and unneeded hoards of silver were accumulated at high prices, by the rise in industrial demands for silver and by demands for subsidiary coinage.

Is gold going the way of silver in the foreseeable future, with this Government in similar fashion supporting the price of gold through unlimited purchases at $35 an ounce? Is the United States likely to find itself the owner of large stocks of a cheapening metal, a decline concealed by its own artificial support? Will increasing industrial demands for gold spare the United States from possible losses in the value of gold, as they did in the case of silver? So long as the United States is selling rather than buying much gold, and with gold apparently firmly entrenched in the public mind as an immutable article of value, these questions may seem irrelevant. Perhaps they are looking too far into the future; perhaps not. At the present time it seems unlikely that other countries will alter their link to gold in the foreseeable future, or cease to desire it as a reserve component, particularly so long as the United States continues to buy it freely. It would, moreover, be unrealistic to assume that this country is about to refuse to accept gold. (This subject is discussed below.)

In light of the long-term downtrend of gold, however, it could be argued that the United States, as part of a long-range gold policy, should gradually and by orderly process reduce the large gold element in its currency reserves, converting part of this gold into other forms of liquid reserves available to support the dollar internationally. These might consist of holdings of strong currencies of leading nations, the relative amounts to be varied according to demands and developments affecting these currencies. The United States also could repay in gold its outstanding drawings from the International Monetary Fund, thereby reinstating reduced drawing rights available to meet balance-of-payments needs. A possible undesirable aspect of such repayment is some loss of independent control over available reserves, since access to the gold tranche requires action by the IMF. Such action, however, is largely a formality, as the Fund does not deny drawing of the gold tranche.

Repayment by this country in gold would eliminate the need for technical transactions between the Treasury and the IMF, in which the United States draws foreign currencies, such as Canadian dollars, and sells them for U. S. dollars to countries desiring to repay drawings to the Fund. Such countries are debarred from paying U. S. dollars to the Fund because the latter is overstocked with dollars—that is, Fund holdings of dollars exceed 75 per cent of the United States quota. Such transactions make it unnecessary for foreign countries to use their U. S. dollars to buy gold for repayment to the Fund. Outstanding drawings by the United States in August 1966 totalled $1.510 billion, but, because of drawings of dollars by other Fund members, the amount repayable to the Fund was only $881 million.

Several years ago the United States bought $800 million of gold from the Fund, with a Fund right of repurchase. The Fund received interest-bearing U. S. Treasury bills and short-term notes, which it considers as investments and not holdings of dollars.

A deliberate reduction of gold reserves, the timing and amounts involved, would depend largely upon (1) judgments regarding the prospects for a further decline in the importance of gold, (2) consequent risks in holding large amounts of gold as compared with risks in holding a larger share of reserves in currencies that might depreciate, (3) possible repercussions upon confidence in the dollar and its use as a reserve currency, and (4) the effect upon international financial markets. There is also the question whether a guarantee of currencies held as reserves should be sought and, if so, in what form—in gold, the escape from which was the reason for holding other currencies, or perhaps in terms of a composite of leading currencies.

Views regarding gold and its future run the gamut from shock at any thought that gold is not the ultimate measure and safest storehouse of value to belief that gold is an obsolete and primitive monetary base, whose days are definitely numbered. Keynes, writing in 1923, said, "In truth the gold standard is already a barbarous relic."[1] Under present conditions it appears safe to say that the United States, apart from the effect of its own possible but improbable actions against gold, need not be unduly concerned over the large gold element in its reserves.

SALES OF GOLD ONLY AT THE DISCRETION OF THE UNITED STATES

Regardless of views as to the future of gold, the United States, I believe, needs to exercise full control over disposition of its gold reserves. I propose, therefore, that the United States sell gold only at its own discretion—the practice of all other countries. Gold would be sold when foreign exchange was needed to maintain exchange-rate stability, at such times and in such amounts as the United States deemed expedient.

The case for cessation of free sales of gold rests largely on three grounds: first, that erratic gold sales lead to misconceptions as to the basic strength of the dollar; second, that a run on the gold reserves of the United States, with unfortunate consequences, is possible under present free convertibility of dollars into gold; and, third, that maintenance of unlimited access to its gold hampers this country in pursuing policies directed toward economic needs and present-day goals.

Gold Outflow and Misconceptions Regarding the Dollar

The weakness of the payments position of the United States has been magnified by world focus on gold exports from this country. These exports are commonly regarded as a gauge of the strength of the dollar. Doubts as to the ability of the United States to maintain free sales of gold have thus been a major factor in world confidence in the dollar. They have also, unfortunately, been reflected in attitudes within the United States regarding its own currency, thereby contributing to the adoption by this country of restrictive and other inherently undesirable policies.

The United States is actually an economic giant and the dollar the strongest currency in the world; in world markets the dollar is in extensive and usually preferred demand. The purchasing power of the dollar

[1] John Maynard Keynes, *Essays in Persuasion* (London: Macmillan, 1931), p. 204.

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has remained relatively stable for over a decade. While there is no assurance that such stability will continue, in contrast with other currencies the record of the dollar is excellent.

The large amount of liquidity, actual and potential, which is behind the dollar is being obscured by undue focus on gold exports, often capricious. The defensive position of the United States in international financial affairs has been nurtured by erroneous views regarding the real strength of the dollar. Erroneous views regarding the dollar have hurt the United States in its position of world leadership. These misconceptions regarding the dollar have been abetted by uncontrolled movements of gold.

A Gold Crisis

Predictions have been made that the United States will be confronted with further large and accelerated outflows of gold, and that prospects for restoring balance in external payments without imposition of stronger capital controls, and even some controls on current transactions, are not bright. Gold reserves have declined from $22.9 billion at the end of 1957 to about $13.4 billion in August 1966. The loss of several billion dollars more in the next year or two is foreseen in a number of quarters and is expected to lead to public nervousness, and perhaps a financial crisis. Heavy gold losses, it is said, could trigger a run on the dollar, fears of dollar depreciation or formal exchange restrictions, stock-market collapse, forced suspension of free gold sales, and other untoward events. The dollar exchange rate would doubtless survive intact (the support given the pound sterling in recent crises illustrates what can be done to sustain a currency in a situation far more precarious than would be likely to confront the dollar). But any events of the sort mentioned would involve economic loss and other difficulties. Such events are not necessarily dependent upon payments deficits, but could take place regardless of progress in restoring balance. Whether these forecasts are right or wrong, and I believe them overly pessimistic, the possibility of a gold crisis cannot be dismissed.

Control over sales of gold would make it impossible to have a run on gold and a crisis leading to involuntary suspension of free sales of gold. A run on the dollar as distinct from gold would, of course, continue to be possible but would be more orderly than if there were a scramble to get gold while the gold vault was still open. Withdrawal of the right accorded foreign governments to purchase gold at will from the United States would permit this country to regulate the outflow of gold in orderly fashion, to utilize holdings of foreign exchange in place of gold, and to sell gold as the United States itself considered desirable. It would remove whatever possibility there is of foreign attacks on the dollar through gold withdrawals for political ends. The possibility of a sudden outflow of gold, with accompanying consequences, would no longer hang over this country. A controlled reduction in our gold reserves might be necessary but would be less disturbing than erratic outflow. If the United States controlled the outflow of gold this country would have less interest in preventing premiums in the free gold market, which at present tend to increase the demand for gold. Operations in the free gold market through the gold pool could, of course, continue if considered desirable.

The United States might wish to build up its holdings of foreign exchange substantially, so as to be prepared to meet possible demands without large and untimely exports of gold. For this purpose it could export gold gradually at its own initiative, or could acquire additional amounts of foreign currencies through credit arrangements.

A useful device that has been employed by the United States for this purpose is the sale of nonmarketable bonds to the monetary authorities of a country whose currency is basically strong and convertible. These so-called "Roosa bonds," named after Robert V. Roosa, former Under Secretary of the Treasury who developed them, are often denominated in the currency of the foreign country, thereby providing an exchange guarantee for the owner. Their maturities have generally been about two years. The holder of the bonds has the option of converting them into 90-day Treasury bills, which in turn can be converted into dollars upon two days' notice. The bonds carry an interest rate comparable to that on U. S. Government obligations of similar maturity. Through the sale abroad of obligations of this and other types the United States could enlarge its holdings of foreign exchange as it desired, thereby obviating sales of gold.

Desired Policies Hampered by Gold Convertibility

The United States has been hampered in domestic and foreign policies by undue dependence upon gold and maintenance of gold convertibility, namely, by fears lest desired measures add to the outflow of gold. An adequate attack on the sluggishness of the American economy and low growth rates during the early 1960's was considerably delayed by such fears. Indicated measures would, it was anticipated, encourage capital outflow, lack of confidence in the dollar, and other consequences leading to loss of additional gold. Foreign policies such as aid to developing countries, encouragement to foreign investment, and trade liberalization have similarly felt restraining pressure from gold losses.

While the payments deficit is the underlying problem and responsible for most of the limitations on policies, gold outflow is a matter of considerable official concern. To many persons the loss of gold looms large and is the visible culprit. Newspapers refer to the "gold gap." Policies such as tied aid, "Buy American," and limitations upon capital exports have to a considerable extent been adopted in order to prevent an undue outflow of gold. Control over gold outflow would help to remove excessive concern over the dollar because of payments deficits. Control over sales of gold would, of course, not promote balance in international payments, which is the underlying problem, except perhaps indirectly through its effect upon capital flows. Measures to promote balance in international payments would still be needed.

Although the United States would under the proposed policy still need to export gold to help finance the payments deficit, control over gold exports so as to avoid psychologically disturbing movements, and possession of greater ability to utilize foreign-exchange holdings in settling accounts, would provide more flexibility and strengthen this country's international position. The proposed policy would not only prevent disorderly outflow of gold, but would lessen dependence upon gold by facilitating settlements in means other than gold, as noted above. The United States could develop further its various foreign-credit arrangements as substitutes for gold.

Withdrawal of free access to our gold reserves would thus reduce gold's influence over monetary, fiscal, and other policies. It would be an extension into the international field of measures taken in 1933 affecting this country's monetary and banking system, when domestic redemption of U. S. currency in gold was abolished. This removal of the obligation to redeem currency in gold domestically provided needed latitude for monetary and fiscal policies. Continuation of gold redemption internationally, however, constitutes a loophole in control over gold. If large payments deficits continue, convertibility in gold can be the source of serious difficulty. So long as our gold reserves were more than ample no problem arose. In recent years, however, when large payments deficits have persisted and our gold reserves have shrunk, the handicaps and dangers imposed by unlimited convertibility internationally have become clear. (A corollary is that the legal limitations upon the amount of gold to be held as reserves behind U. S. currency should be removed, thereby permitting all of our gold to be available for international settlements. The knowledge of this availability would be a positive factor in this country's payments and dollar position.)

Many persons doubtless would not consider the weakening of the so-called discipline imposed by gold an advantage. They would regard gold as a check upon irresponsible policies, and a means of forcing more rapid external adjustment. Opponents of the proposed policy who do not have confidence in government would note that removal of gold's restraining influence opens the door to mismanagement, a complaint similar to the "managed currency" outcry heard during the 30's. The record of Federal Reserve policies since then, however, does not lend much support to such fears. Moreover, external adjustment need not be subjected to a mechanistic and perhaps unduly harsh schedule.

The proposed policy would be a move in the direction of an international monetary system in which the excessive importance of the gold element in reserves would be reduced. Reduction of reliance upon gold would provide more leeway for the creation of an amount of international liquidity appropriate for growing world trade and an expanding world economy. Maintenance of gold convertibility places a limit upon the volume of liquidity, and sooner or later can be a deflationary force. International liquidity cannot yet be expanded in response to needs as readily as can domestic credit by central banks. We are still waiting for a mechanism to provide the necessary amount of elasticity in the supply of international money. Plans currently under discussion will, hopefully, be a constructive step toward meeting this need. The proposed policy would be in furtherance of the developing trend of international monetary reform. It would continue the historic trend toward diminution of the power of gold.[2]

In addition to these points there are other related considerations which make desirable the withdrawal of unlimited convertibility of the dollar into gold. The size of the gold element in the reserves of the United States has been left almost entirely to decisions in which this country has had little or no part. Foreign countries, presently in a position to put pressure on the dollar via gold, can reduce, perhaps substantially, the gold holdings of the United States. Until a stronger international monetary system has been established and financial nationalism further reduced, the amount of this country's gold reserves is a matter of consequence. With control over sales of gold, the United States might decide, for example, that it is wise to keep gold reserves approximately at their existing level, at least for the present, and meet demands for foreign exchange by means other than gold exports whenever feasible.

Free sales of gold by the United States have permitted foreign central banks to build up their gold reserves by drawing down the gold reserves of the United States. From the standpoint of redistribution of this country's abnormally large postwar gold holdings, this transfer of gold from the United States to foreign countries, thereby strengthening depleted reserves of Europe, has been a healthy development. The question is raised, however, how far this outflow should go. From the stand-

[2] A typographical error in a draft of this paper omitted the letter "l" in the word *gold*. Persons desiring to dethrone gold completely might consider the abbreviated spelling appropriate for some who worship the gold standard.

point of those who wish to reduce the gold element in this country's reserves, continued outflow of gold would not be a misfortune.

The transfer of gold reserves to foreign countries reduces the total liquidity of the United States, unless the gold establishes a credit balance in favor of this country in a foreign bank. The latter has not generally been the case since exports of gold have been used largely to help pay for the importation of goods and services and the exportation of American capital, particularly heavy private foreign investment and government outlays abroad. Gold reserves of the United States have, therefore, been supplemented by swaps and various other credit devices as substitutes for gold lost, a constructive development.

The United Kingdom has generally sought to maintain some 90 per cent of its reserves in gold, recognizing its special responsibilities and recalling the devaluation of the dollar in 1933. France not long ago decided to increase the gold portion of its reserves. A number of other countries having confidence in the dollar exchange rate prefer to maintain the major portion of their reserves as liquid earning assets in New York.

The large gold reserves of the United States have enabled this country to meet major obligations abroad, and to achieve particular foreign policy objectives, especially military and foreign-aid objectives. They have helped it finance payments deficits and maintain dollar stability at a time when large foreign expenditures by the United States are of special importance. The amount of this type of assured liquidity is at present largely subject to foreign decisions. While the trend of monetary affairs is away from gold, and the United States at some stage might wish to liquidate much of its gold, this country should be in a position to make its own decisions. The proposed policy would permit this.

FREE SALES OF GOLD UNNECESSARY

Unlimited sales of gold by the United States at the option of foreign central banks are unnecessary for maintenance of the exchange rate of the dollar at $35 an ounce of gold. (Even if the United States were to introduce wider exchange-rate margins, control over gold sales would in no way interfere.) Numerous countries have shown that, given appropriate monetary and fiscal policies, exchange-rate stability can be maintained through purchase and sale of foreign exchange by the central bank and without gold movements. Nor are free sales of gold essential to world confidence in the dollar (apart from an initial jolt if present policy were to be changed), to the free convertibility of the dollar into other currencies, and to the functioning of the dollar as a reserve currency.

Maintenance by the United States of unlimited access to its gold reserves by foreign governments not only promotes a false judgment of the strength of the dollar, making possible a gold crisis and limiting desired policies, but it is not an economically significant objective in international monetary policy. The meaningful objectives are: (a) stability of the dollar in the foreign-exchange market, (b) free convertibility of the dollar into other currencies, (c) strong foreign-exchange reserves to assure continuance of convertibility and exchange stability, (d) maintenance of stable internal purchasing power of the dollar, and (e) avoidance of prolonged and unwieldy payments deficits—a basic objective underlying all of the above. Success in achieving these objectives facilitates use of the dollar as a reserve currency. Free sales of gold, however, are unnecessary for the attainment of any of these objectives.

Since the world is largely upon the dollar-exchange standard, wherein foreign central banks aim to provide convertibility of their currencies into dollars, and since the United States maintains free interchangeability of gold and dollars in either direction for such banks, the United States is indirectly maintaining gold parity for world currencies generally. It is primarily dollar parity, however, rather than gold parity, in which countries are interested. They wish to maintain their exchange rates at the official parity with the dollar. Since their currencies and the dollar are both defined in terms of gold, gold parity and dollar parity are identical. This identity is recognized in Article IV Section 1(a) of the IMF Articles of Agreement, which reads: "The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944."

Gold parity has become largely symbolic. It can, moreover, be effectively maintained by the United States without free sales of gold. Control over sales of gold would place the major task of maintaining exchange parity (also gold parity) on this country's total reserves, gold plus foreign exchange, without putting undue emphasis upon the gold element. Control over gold sales would not eliminate gold parity of the dollar. The dollar would also continue to provide such parity for other currencies convertible into dollars.

The United States has gone a certain distance toward the substance of control over gold exports by obtaining restraint and cooperation of principal central banks. The restraint, however, varies from country to country, is uncertain, and of limited scope. Moreover, in the event of serious fears abroad regarding the dollar, even though unfounded, foreign central banks could not be expected to refrain from asking the United States for gold or to subordinate their personal responsibility in order to help the dollar. Experience to date indicates that central bankers are not necessarily immune to rumors and to the influence of actions by others, rational or irrational. Central bankers understandably do not wish to take chances with their own currency for the sake of the dollar. In meeting a central bank's request for gold under a system of controlled gold exports, the United States would be conferring a favor rather than asking one, as it must when it urges restraint on other countries in taking its gold.

Cessation of free sales of gold need not await possible modifications in the international monetary system, such as expansion of the functions of the International Monetary Fund, liberalization of automatic drawing rights on the Fund, wider exchange-rate margins, creation of a composite reserve unit (CRU) with or without a tie to gold, or procedures to facilitate external adjustment. These modifications are not dependent upon free sales of gold by the United States. Control over gold outflow, and resultant elimination of the need for foreign cooperation regarding gold withdrawals, would strengthen the hands of the United States in negotiations regarding international monetary reform. Less dependent upon European restraint in taking its gold, this country would be better able to exercise the degree of leadership warranted by its economic strength.

The abolition in 1933 of domestic access to monetary gold was a far more drastic step in view of public opinion at that time regarding the function of gold, together with fears of paper money and of a "managed currency," than would be abolition of free access internationally. Domestically, the purchasing power of the dollar was the significant factor, rather than the ability of a private citizen to obtain gold.

In regard to charges that the United States would be violating a moral obligation to countries which have chosen to maintain reserves largely in dollars instead of gold, these countries would suffer no loss since the exchange rate and convertibility of the dollar would be maintained. Furthermore, the United States would still export gold, and could provide gold to any central bank to which this country had an obligation. The official price of gold would be unaffected, and holders of gold would still be able to sell their gold to the United States at $35 an ounce. Whether the United States should alter its gold-buying policy is a separate question.

CONSEQUENCES OF CONTROLLING SALES OF GOLD

Immediate Impact

Announcement that the United States would henceforth sell gold only at its own discretion would doubtless cause public nervousness. Since the function of gold is often not well understood, strong reactions might be expected, with forecasts of inflation, dollar devaluation, and other consequences. The move would be interpreted in some quarters as a sign of weakness. This country's foreign-currency reserves might thus be under pressure.

The United States would need to be prepared to meet a possible immediate withdrawal of funds by foreign holders of dollars. Private holders do not have access to gold and would thus not be directly affected, but nevertheless might sell their dollars because of general nervousness. Central banks, recipients of dollars sold, might decide to convert some of their dollar balances into other foreign currencies. Under certain conditions they could require payment either in gold or their own currency at the option of the United States (IMF Articles of Agreement, Article VIII, Section 4).

Large withdrawals of dollars by central banks, however, would appear unlikely. In the first place these banks would be confronted with the question of where they could place their funds with greater security than in the United States. Some funds might go into Swiss francs and other strong European currencies, but none of these currencies is freely redeemable in gold and in this respect would offer no attraction over the U. S. dollar. Official holders of dollars would find little benefit in shifting to other currencies.

In the second place, central bankers, although perhaps unhappy over the change, would doubtless recognize that the exchange rate and free convertibility of the dollar were the significant factors, and that the U. S. Government was pledged to continue these unchanged; moreover, that the Government was in a strong position to make good on this pledge. Furthermore, dollars are needed to finance current international transactions. This policy regarding gold sales would also be similar to that of their own governments.

Additional factors discouraging withdrawal of dollars by foreign holders, official and other, are the needs for dollar working balances, the availability of liquid earning assets, and the extensive facilities offered by American financial institutions, particularly in New York. A large or sustained withdrawal of funds as a result of this Government's action would appear improbable. As the days passed and no untoward results appeared, and as public discussion clarified the issue, the business and financial community would doubtless settle down to business as usual.

The Dollar as Reserve Currency

Insofar as one of the present attractions of the dollar as a reserve currency is its free convertibility into gold, cessation of such convertibility would be a handicap. On the other hand, the facts that no other country offers gold convertibility, nor greater security, liquidity, and access to such extensive financial facilities necessary for a reserve center, would be compelling incentives for central banks to leave reserve funds in dollars.

The strengthened ability of the United States, as a result of control over gold outflow, to deal with payments deficits and possible dollar crises, coupled with renewed pledges of exchange stability and dollar convertibility, might well result in even greater confidence in the dollar. It is unlikely that the basic position of the dollar as a reserve currency would be impaired.

Liquidity

Cessation of convertibility of the dollar into gold would have little or no direct effect upon international liquidity. An additional portion of this country's gold would, however, become effectively available to it for settling balances. Apart from the 25 per cent legal-reserve requirement, which locks up most of its gold, the United States under the present policy of free sales of gold would find it difficult to use most of the free gold without causing public fears and possible economic disturbances. Such fears would be intensified if the Federal Reserve Board were compelled to exercise its right to suspend temporarily the reserve requirement. The free gold's effectiveness as a working reserve is thus limited.

If gold exports could take place only at the discretion of the United States, the likelihood that gold exports would suggest to the public a possible gold crisis would no longer exist. The United States could use its gold in an orderly manner, and with fewer newspaper headlines raising fears of trouble. This country's liquidity would in substance be increased.

To the extent that the proposed action led to greater use of credit as a supplement to gold for reserve purposes, it would add to world liquidity. If the move caused governments to negotiate more bilateral credits or currency swaps, perhaps in order to avoid selling gold in view of uncertainty as to whether gold could later easily be acquired, international liquidity would thereby become greater.

International liquidity would be reduced if the proposed action led to a withdrawal of foreign balances from the United States and their conversion into the currency of the holder. If France, for example, converted dollars into francs, international liquidity would be contracted. If, however, France converted the dollars into Swiss francs or some other currency available as international reserves, no net reduction of international liquidity would take place.

Inflation

The proposed action would in itself be neither inflationary nor deflationary. To the extent, however, that it indirectly resulted in an expansion of liquidity, or to lessened confidence in money and a flight into goods, it could increase inflationary pressure. If, for example, it led to arrangements for increased international credit as a supplement to gold, the tendency would be in the direction of monetary inflation. In view of the relatively small probable increase in liquidity or flight to goods as a result of the cessation of gold convertibility of the dollar, together with continuous growth of world trade, any inflationary consequences would be negligible.

Conversely, there would appear to be no incentive for contraction of credit arrangements as a result of the proposed action. If, however, it were to lead to withdrawal of dollars and their conversion into the currency of the holder, such withdrawal would reduce liquidity, as noted, and tend toward monetary deflation. Since large dollar withdrawals appear unlikely, for reasons discussed, no serious deflationary consequences seem likely. Moreover, any deflationary contraction of liquidity could be offset by arrangements for the expansion of international credit. Discussions in the Group of Ten and in the International Monetary Fund of means to accomplish any needed expansion of credit are well advanced, despite lack of agreement. The amount of credit contraction, if any, would doubtless be small.

Effect Upon Gold

The effect of the proposed action upon gold itself would probably be different in the short run from the long run. The free market for gold might consider the action as indicating a scarcity of gold, with a resultant husbanding of gold and increased prospects for a rise in the price of gold. This could result in upward pressure on the price of gold in free markets.

The United States would not wish to encourage preference for gold or to have the action interpreted as upgrading gold. It should be considered rather as a means for orderly utilization of this country's gold. A statement by the United States that it would not hesitate to utilize its gold, perhaps coupled with an actual export of gold at its own initiative, would probably suffice to avoid misinterpretation. If necessary, a hint that it regarded its gold reserve as large in relation to other forms of reserve, would probably put matters in proper perspective. The United States could avoid having the action increase the appetite for gold by public statements geared to the necessities of the situation. For example, a statement noting proposals to reduce the price of gold, and stating that these did not represent official policy, would have a depressing effect upon gold demand by merely raising the possibility of such action. In any event, since the United States would be controlling gold exports, a possible increase in the demand for gold would not harm this country.

If there were public discussion and substantial support for the proposals that the United States should not buy gold except in selected cases, and that the price for purchases should be less than $35 an ounce, such discussion would tend to weaken the demand for gold. It would dispel some of the aura surrounding gold.

Discontinuance of free redemption of dollars in gold by the United States, the last country to maintain such redemption and this only for governments, could hardly be considered as strengthening the role of gold. It would be pushing gold farther into the background and weakening what influence it still retains. It would be limiting even further the effect of gold upon this country's monetary, fiscal, and economic policies. The implications of the move would sooner or later become evident.

INTRODUCTION OF DISCRETIONARY SALES OF GOLD

The time for introduction of a policy of selling gold only at the discretion of the United States is when gold outflow has slowed down and no disturbing economic events have occurred. If such action were taken during a period of large gold losses, public apprehension, or economic difficulties, it would be likely to accentuate any loss of confidence in the dollar. The action would then be misinterpreted and regarded as a sign of weakness.

Announcement would presumably be made on a week-end when markets were closed. In order to minimize misinterpretation, the announcement should state emphatically that (1) exchange rates for the dollar vis-à-vis leading currencies would be unaffected by the move, (2) large resources were available to maintain the dollar exchange rate and that gold would be exported as necessary, (3) convertibility of dollars into other currencies would continue without restriction, (4) private commercial exchange operations would be unaffected, and (5) Congress was being requested to remove restrictions on utilization of the country's entire gold reserve. The last would involve political difficulties which might preclude or suggest deferment of such a request.

The advantages of control by the United States over sales of gold appear substantial, particularly in light of the dangers inherent in the present policy of maintaining unlimited gold sales. Possible difficulties which might accompany such a move appear manageable and, in fact, minimal. Subsequent control and limitation on the purchase of gold—much more of a departure from present policy—merits study, as discussed in a later section.

OTHER PROPOSALS REGARDING THE GOLD POLICY OF THE UNITED STATES

A Rise in the Price of Gold

A number of proposals have been made in recent years for changes in the gold policy of the United States. A proposal widely discussed is that the official dollar price of gold be raised substantially—from the present $35 an ounce to perhaps twice this level. A main purpose would be to increase the monetary value of existing reserves by writing up the value of gold, thereby adding to world liquidity. Other purposes include stimulation of the production of gold, assistance to foreign countries by increasing the value of their gold holdings, and financing aid to developing nations through utilization of the "profit" from writing up the value of reserves, thus reducing the burden on taxpayers.

There are strong arguments against such a measure. The resulting large increase in the supply of money, including extensions of credit based upon expanded gold reserves, could be seriously inflationary. Moreover, the additional amount of liquidity accruing to the international monetary system would be arbitrary and not well-related to needs; these needs grow year by year. Revaluation of the dollar, as well as that of the pound sterling and other currencies that would doubtless follow a change by the United States in the dollar price of gold, would be disturbing to trade, investment, financial markets, and the business community generally. Principal beneficiaries would be the Soviet Union, with its large gold production and reserves, and the Union of South Africa, the major producer of gold. The developing nations as a group own relatively little gold. Speculators against the dollar and pound would be rewarded, whereas those who accepted in good faith official assurances regarding the stability of these currencies, and who thereby helped avert a collapse, would be penalized. Stimulation of gold production would result in a wasteful expenditure of labor and other resources, since less costly means of increasing liquidity are available.

Proposals to reduce the gold content of the dollar—that is, to devalue the dollar for external payments—refer similarly to a rise in the price of gold, but in a different context. These proposals have as their objective a reduction in the payments deficit by making American goods and services cheaper to foreigners, assuming that other major countries would not devalue their currencies by similar percentages—an unrealistic assumption. Dollar devaluation would be a drastic and unsettling move with far-reaching consequences. Under present and prospective conditions it offers more disadvantages than advantages. It has been firmly rejected by all recent Administrations.

Flexible Exchange Rates

Related to the proposal for dollar devaluation is that for flexible exchange rates, wherein rates would be allowed to move in response to market supply and demand. If rates were allowed to move without limit, the dollar would have no effective gold par. Under such a system no reserves would be needed, although exchange-rate fluctuations could be wide. If, however, exchange-rate movements were to be confined within established limits, such as a fixed margin either side of par, reserves would be necessary in order to maintain these limits. Under such a system of wider exchange-rate margins, a tendency for the dollar to fall below the limit would be met by sales from reserves. Any intervention by government to prevent excessive instability within the limits would similarly require use of reserves.

According to requirements of the International Monetary Fund's Articles of Agreement, exchange rates for spot transactions must be confined within a margin of one per cent above or below par. Liberal interpretations of this requirement, however, have enabled countries, such as Canada, to employ a system of flexible exchange rates for an extended time. A system of wider exchange-rate margins has substantial support as a means of promoting external adjustment, whether the problem be deficit or surplus. It is, however, not free from disadvantages, such as greater uncertainty and risk for exchange transactions.

Proposals for a rise in the price of gold, dollar devaluation, completely flexible exchange rates, and wider exchange-rate margins have received extensive discussion elsewhere. To enter into further discussion of these questions here would take us far afield.

Gradual Reduction in Price of Gold

Another proposal, offered originally in 1960 by Professor Fritz Machlup of Princeton University, is for a gradual and periodic preannounced reduction in the official price of gold.[3] He proposes that the United States reduce the dollar price of gold by small amounts, perhaps two or three per cent, in a few instalments spread over a period of time. The first reduction might be two per cent, followed a year later by a previously announced two or three per cent. The objective would be to discourage a flight out of key currencies into gold; the future reduction in price would be definitely known. The plan would presume prior and essentially open negotiations with other countries—especially those with leading currencies—under the auspices of the International Monetary Fund, so that these countries could reduce the price of gold in their currencies by similar percentages and at the same time.

Machlup points out that lack of confidence in the dollar and concern by foreign central banks over their large dollar balances is based upon fear that the dollar may be devalued. Demands for gold thus represent a hedge against the contingency that the price of gold may rise. If, how-

[3] "Comments on the Balance of Payments and a Proposal to Reduce the Price of Gold," *The Journal of Finance* (1961), pp. 186-193. See also his *International Payments, Debts, and Gold* (New York: Scribner, 1964), pp. 240-244, 347.

ever, it were definitely known that the price of gold was going to fall, this knowledge would reverse the trend and lead to a conversion of gold into dollars and other currencies; the gold could later be bought back more cheaply if desired.

Speculators operate upon the principle that the price of gold can move only in one direction, and that is up. Their expectations are supported by the facts of history. Announcement that the price of gold will go down by a certain amount and at a certain date would cool their ardor—provided that the future price reduction is credible. The Machlup Plan, therefore, provides that in order to remove any doubt whether the announced price reduction will take place and the lower price continue, the Government should sell gold freely and without hesitation at the lower price. Hoarders would not wish to buy something which they know will have a lower price later.

Offerings of gold to central banks, he notes, would increase. Central banks, desiring to avoid a loss in their reserves, would tend to switch from gold back into dollars and other key currencies. Gold drawn out of hoards and deposited in central banks would add to international liquidity. It would not be necessary to continue the periodic reductions indefinitely, since the chief objective would be to make clear that the price of gold can go down as well as up, and that hoarders can lose money. An incipient run on gold reserves could be averted by announcement of a forthcoming price reduction, which would force a retreat of speculators. The Machlup Plan was proposed as an intermediate measure until the international monetary system is strengthened. It could serve a useful purpose if governments were prepared to cooperate sufficiently to make it effective.

Gradual Rise in Price of Gold

Proposals have been made to raise the price of gold periodically and by such small amounts, announced in advance, that speculators would find little or no advantage in hoarding gold. Such proposals, made independently by Kiyojo Miyata in 1962 and Paul Wonnacott in 1963, are based on the thought that if the annual percentage increase in the price of gold is less than the current rate of interest, the costs of carrying the gold are in excess of the profit. An announced plan to raise the price of gold about two per cent a year would, they believe, discourage hoarding. The objective would be to increase the value of international reserves by raising the price of gold but avoid some of the disadvantages accompanying a single large increase. An unanswered question is whether speculators would be convinced that the rise would be confined to two per cent, especially since there would doubtless be agitation for a substantially higher price.

Removal of Price Floor for Private Transactions

In order to discourage speculation on the price of gold, L. Albert Hahn in 1963 suggested that when central banks bought gold from private individuals and from the free market they should buy only at reduced prices. The official price for transactions among central banks would remain unchanged. A small reduction for private purchases, he believes, would be sufficient to discourage speculation. Alternative proposals of Hahn are that central banks should neither buy from nor sell to hoarders and speculators, that central banks should sell gold only to other central banks, and that private ownership of gold should be prohibited by all countries.

A variation of the alternative proposals of Hahn was made in 1965 by Professor James Tobin of Yale University. He proposed that the London gold pool, which buys and sells gold in the free market in order to confine price fluctuations within narrow limits, should never buy gold in the free market. The pool would thus not place a floor under the price of gold. At present the pool in effect guarantees speculators against loss. The United States, which participates in the pool with other countries, should, he suggests, seek agreement of the others that none of them will buy gold in the free market, and that none will buy gold from any government that does buy gold in the free market. If the others do not agree, he believes the United States should seriously consider putting the plan into effect unilaterally.[4]

Refusal to Buy Gold Freely

A number of proposals have been made to the effect that the United States should refuse to buy gold or buy only on a restricted basis. The earliest such proposal with which I am familiar was made by Lord Keynes back in 1923. He wrote,

> . . . The present policy of the United States in accepting unlimited imports of gold can be justified, perhaps, as a temporary measure, intended to preserve tradition and to strengthen confidence through a transitional period. But, looked at as a permanent arrangement, it could hardly be judged other wise than as a foolish expense. If the Federal Reserve Board intends to maintain the value of the dollar at a level which is irrespective of the inflow or outflow of gold, what object is there in continuing to accept at the mint gold which is not wanted, yet costs a heavy price? If the United States mints were to be

[4] The proposals of Miyata, Wonnacott, and Hahn are discussed in Machlup's book (fn. 3); that of Tobin in *Guidelines for International Monetary Reform, Part 2, Joint Economic Committee,* Hearings Before the Sub-Committee on International Exchange and Payments, Eighty-ninth Congress (Washington 1965), pp. 597-598.

closed to gold, everything, except the actual price of the metal, would continue precisely as before.

Confidence in the future stability of the value of gold depends therefore on the United States being foolish enough to go on accepting gold which it does not want, and wise enough, having accepted it, to maintain it at a fixed value. . . . (*Op.cit.*, p. 204.)

The London *Economist* in its issue of December 24, 1960, contained an article entitled "Where the Rainbow Ended," which was a parody representing what the memoirs of Per Jacobsson, then Managing Director of the International Monetary Fund, might be as written ten years in the future. In these imaginary memoirs Per Jacobsson describes a decline in 1961 in the gold reserves of the United States, and general nervousness leading up to a short statement by the Federal Reserve Bank of New York, agent for the Treasury, to the effect that its undertaking to buy and sell gold at $35 an ounce, or at any price, lapsed forthwith. The memoirs added, "In three sentences the Fed had demonetized gold."

The memoirs then state that the International Monetary Fund promptly announced it would buy gold from central banks, giving in return deposits at the Fund, but that after December 31 it would assume no obligation to buy gold; it would continue, however, to sell gold to anyone. At one stroke, the memoirs said, the International Monetary Fund became a central bank for central banks. The price of gold fell sharply, and was about $2.50 an ounce when the International Monetary Fund decided to put all its gold out for public tender.

A proposal to withdraw the present undertaking to buy gold freely from foreign governments was offered in the Minority Views on the Annual Report of the Joint Economic Committee on the January 1962 Economic Report of the President, 87th Congress, 2nd Session. Such a proposal had been discussed in 1961 by Howard S. Piquet in a study prepared for the House Foreign Affairs Committee. The Minority Views, presented by three members of the House of Representatives and three members of the Senate, contain the proposal that the United States "terminate its guarantee to buy gold from foreigners at $35 an ounce or at any other predetermined price." The United States, according to the Minority proposal, should avoid devaluation of the dollar and, therefore, should continue to sell gold to foreigners at $35 an ounce.

A guarantee to buy gold at fixed prices, the Minority Views note, encourages speculation. If the speculator is wrong and devaluation does not take place his loss is slight, whereas if devaluation does take place he collects a profit. Removal of the guarantee would reduce speculation and, according to the Minority Views, lead to a return flow of gold to the United States.

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The Minority Views do not state that the United States should cease to buy gold, but merely that it should no longer agree to buy gold in unlimited amounts at any predetermined price. Unless the United States, however, actually refused to buy gold at $35 an ounce, or unless withdrawal of a guarantee were interpreted as a genuine threat of such refusal, it is questionable whether speculators would be greatly deterred. Moreover, if other governments continued to buy gold at the equivalent of $35 an ounce, speculators would still have an outlet for their gold with little risk to themselves.

A carefully developed proposal, somewhat similar to that presented in the Minority Views (pages 548-561), was offered by Professor Emile Despres of Stanford University in 1965. He believes that the dollar is not merely as good as gold but better than gold, and that only because the United States is willing to buy gold freely at $35 an ounce is gold kept as good as the dollar. Despres proposes that the United States deprive gold of its present unlimited convertibility into dollars, that is, that it cease to buy gold except on its own terms. This action, he believes, would cause gold to depreciate and reveal the true strength of the dollar. He would continue unlimited sales of gold for dollars. His aim would be to remove the "tyranny of gold" and build a strong international monetary system based upon credit. A strengthened dollar-reserve system, he feels, would result from his proposal.

Despres would establish on a country-by-country basis ceilings on the amount of gold the United States would be prepared to buy from each country at $35 an ounce. At the same time the United States would provide countries with firm lines of credit in substitution for their gold made redundant by the ceilings. Foreigners' access to dollars would thus remain unimpaired, since countries selling gold to the United States would simultaneously draw upon these credits in an agreed ratio to the sales of gold. In this manner, while a substantial portion of their gold holdings would no longer be a potential source of dollars, credit would take the place of this gold. International liquidity would not be reduced.

Professor Gottfried Haberler of Harvard University has suggested that in the event of a run on our gold reserves, the United States should pay out gold freely and announce that it will no longer buy gold at $35 an ounce, or in fact at any price. The United States should at the same time declare that if and when the gold is exhausted the dollar would be allowed to float. It would thus be permitted to seek its own level in the foreign-exchange market. He believes that the value of gold would probably depreciate in terms of foreign currencies, and that the dollar might depreciate in terms of gold and in the foreign-exchange market. These prospects, he notes, would not be attractive to foreign monetary authorities.

Haberler believes that the dollar problem has been allowed to become needlessly difficult for the United States. He describes the official American attitude as "frozen into a position which exposes the country, quite unnecessarily, to the blackmail of foreign dollar holders."[5] He reasons that a hint by the United States that it was prepared to undertake the proposed action regarding gold would place this Government in a position to negotiate international monetary reform in accordance with this country's real strength.

A view similar to that of Haberler regarding the course the United States should follow in the event of a run on its gold reserves was set forth by Emile Despres, Charles P. Kindleberger, and Walter S. Salant in an article in the London *Economist* (February 5, 1966). They note "The real problem is to build a strong international monetary mechanism resting on credit, with gold occupying, at most, a subordinate position." They state that the United States could by itself bring about this change, in several ways, namely, by widening the margin around parity at which it buys and sells gold, reducing the price at which it buys gold, and otherwise depriving gold of its present unlimited convertibility into dollars. The resulting system which they visualize would be one based upon the dollar.

Refusal by the United States to purchase gold, or willingness to purchase gold only in limited quantities, would have far-reaching consequences for the international monetary system and the status of gold as a monetary metal.

GOLD PURCHASE BY UNITED STATES ONLY AT ITS OWN DISCRETION

The policy of purchasing freely unlimited quantities of gold at $35 an ounce has been criticized as supporting an artificial value for gold, harmful to the dollar, and perpetuating a role for gold in the international monetary system not adapted to modern conditions. Were it not for this country's maintenance of unlimited convertibility of gold into dollars, the price of gold would probably decline. The dollar, in strong world demand, is considered by a number of economists to be basically more valuable than gold.

Possible Consequences

It has been suggested that the United States should withdraw support from gold and either refuse to buy gold, or buy gold only in amounts and on a basis determined by the United States, perhaps at less than $35 an ounce. Such a policy, insofar as it caused gold to depreciate, would

[5] Haberler's views are set forth in a paper entitled "The International Payments System," presented in a Symposium sponsored by the American Enterprise Institute, Washington, D.C., September 1965.

reveal the underlying strength of the dollar. Dollars, it is said, would be in even stronger demand than at present for international reserves, being commonly preferred to gold in view of the depreciation and uncertain position of gold. Dollar balances would thus serve as the base for a dollar-reserve system, already in existence to a large extent. (The less developed countries have for a number of years been reducing their gold reserves and operating largely on the basis of the U. S. dollar or the pound sterling. Gold holdings of the Latin American countries have steadily declined from a total of $1.955 billion at the end of 1951 to $1.050 billion at the end of 1965. Foreign-exchange holdings of these countries, on the other hand, increased over the same period from $1.025 billion to $2.235 billion.) The proposed action, if the results were as expected, could be a stepping stone to further development of the international monetary system. The bargaining position of the United States in international monetary affairs would be strengthened if the dollar were in a stronger position.

If other countries continued to buy gold, while the United States refused gold, and their currencies continued to be convertible into dollars, such countries could be a channel for the conversion of gold into dollars. So long as any major country with a convertible currency accepted gold at a price equivalent to $35 an ounce, gold could readily be converted into dollars at this present price. The world price for gold, moreover, would not fall below this level.

The crucial question is what action other countries would take, and whether they could long continue to accept gold at the present price in the face of the refusal of the United States to accept gold freely. A strong world demand for dollars, whether because of a payments surplus on the part of the United States or because of increased world trade and the consequent need for more dollar reserves, would result in other countries with convertible currencies receiving gold that would otherwise have gone to the United States.

These countries, therefore, might receive large amounts of gold because of (a) growing world demands for dollars and the fact that their currencies were a means of obtaining dollars for gold, or (b) lack of confidence in the price of gold and the desire to convert gold into strong currencies. They could experience increased demands on their dollar and other foreign-exchange holdings, gold being offered in payment. At the same time, these countries would experience an expansion of their own currency, which would be paid out to persons wishing currencies instead of gold. The receipt of gold and resulting loss of foreign-exchange reserves could become a problem, because of the possibility that other countries would close their doors to gold and because of inflationary consequences of the currency expansion. What would these countries be likely to do under such circumstances?

If the situation became serious they could restrict the sale of dollars and other exchange convertible into dollars, or they could refuse to accept gold, as did Sweden during the First World War. Exchange restrictions would check the indirect conversion of gold into dollars and the consequent loss of foreign-exchange reserves, but would not restore confidence in the price of gold and halt resulting gold offerings. Exchange restrictions have a number of well-known difficulties. If refusal to accept gold became widespread, particularly if a few leading nations refused gold, any country which held out and continued to accept gold would probably receive larger amounts, and sooner or later be forced to refuse gold. In the event of a general refusal by central banks to accept gold, many countries, including the United States, would find themselves the owners of large amounts of gold for which no monetary outlet, or a limited one, existed. The free-market price of gold would decline.

If the United States continued the present policy of buying all gold offered, but only at a lower price, and would also sell at the lower price, this would amount to appreciation of the dollar exchange rate, with repercussions on trade and the balance of payments. The consequences would depend largely upon whether the new price were fixed or open to further decline, and upon the actions of other countries regarding their exchange rates, that is, whether they made similar exchange adjustments. This is not the proposal of those suggesting that the United States refuse to buy gold, except perhaps at its own discretion.

If the United States reduced its buying price but not its selling price, whereas other countries with convertible currencies accepted gold at the equivalent of $35 an ounce, gold would not be offered to the United States at the lower price. The situation would be similar to its refusal to buy gold. Apprehension over the $35 price could reduce demands for gold so that little gold would be sold by the United States.

The International Monetary Fund, unless it found some way to refuse gold, could become a dumping ground for gold—perhaps a useful instrumentality to spread internationally the loss resulting from the depreciation of gold. This could be a bit hard on the International Monetary Fund, until the situation was remedied through provision of additional resources or revision of Fund functions regarding credit creation.

As to the likelihood and timing of the above course of events, refusal by the United States to buy gold would undoubtedly cause central bankers to reconsider their own policies and the wisdom of accumulating large gold reserves. They might decide that no change in policy was called for, at least for the time being. On the other hand, some of them might follow the lead of the United States and not wait for the above events to develop and run their course. This country's action could thus lead to a similar rejection of gold by other countries. It would, in any event, tend to weaken the monetary role of gold.

Refusal by the United States to buy gold could bring about a situation close to the demonetization of gold for much of the world. A flight from gold internationally could develop and snowball, hastening if not causing the complete dethronement of gold. (The pattern of exchange rates would not necessarily be altered by the demonetization of gold, especially in the case of rates that are realistic.) If a chaotic market for gold ensued, the price of gold could doubtless be stabilized by the United States through its buying policy, as conditions might warrant. The possibility, however, of further reductions in the price of gold would create uncertainty for central banks wishing to continue to accept gold.

On the other hand, refusal by the United States to buy gold might be interpreted in some quarters as a sign of weakness. It is possible that the dollar, rather than gold, would depreciate. Doubts as to whether the rejection of gold by the United States would stick, and speculation that gold would survive and stage a monetary comeback, would tend to deter foreign central banks and to limit gold's expected depreciation. Demands for hoarding, especially in disturbed and backward parts of the world, would not disappear. Gold might have the proverbial nine lives and retain all or most of its value.

Depreciation of its large gold reserves would reduce the international liquidity of the United States, with possible effects upon confidence in the dollar—a further counter to the expected depreciation of gold in terms of dollars. Such a loss of liquidity would be less if the United States were to convert part of its gold into other forms of reserve before taking any action that would depreciate gold. Depreciation of gold would, similarly, cause a decline in world liquidity. The development of additional credit arrangements to fill the liquidity void for the United States and the world generally would be essential.

Refusal by the United States to accept gold, and the resulting need for new credit arrangements, could accelerate the establishment of a more effective and broadly based international monetary system. Replacement of gold in the international monetary system would require multinational administrative machinery to assure competent and reliable policy management over the creation of international means of payment. This machinery now exists to a large extent in the International Monetary Fund and elsewhere, and could be further developed to meet new requirements. Proposals for a composite reserve unit, CRU, envisage additional machinery of this type.

Effect on International Monetary System

A major aspect of the question of limitation on purchases of gold by the United States obviously has to do with the role of gold in the present international monetary system. Gold is currently serving a valuable function as a common denominator among currencies, along with that of providing a large amount of international liquidity. It is universally accepted without question in payments. While these functions could be replaced by an IMF unit and the further development of credit devices, the world may not be ready for such advanced and inherently rational procedures. Disagreement and inadequate action could result, with the monetary system the loser. Furthermore, opponents of the suggested move can point out that the range of possible depreciation of gold is less than that of credit money, which can theoretically depreciate to zero.

Against gold are the facts that the purchasing power of gold is unstable, that the cost of increasing the supply of gold is in a sense a wasteful expenditure, and particularly that the relatively fixed amount and slow growth of the supply of gold is the source of problems for the international monetary system. The commitment to maintain parity with gold, coupled with its limited and relatively inflexible supply, can have deflationary consequences and cause a slowdown of economic growth. Parity commitments require economic adjustments that are often painful, and in many cases otherwise unnecessary. This is the main case against gold. Proposals to raise the price of gold flow out of this situation of limited supply and poor adaptability to growing needs for liquidity.

Under present monetary practices, wherein pressures to maintain gold parity fall particularly upon this country, it is free sales rather than purchases of gold that constitute a special problem for the United States. Hence my proposal to withdraw unlimited convertibility of the dollar into gold. Control over sales of gold would not require a departure from gold parity, as noted. On the other hand, refusal by the United States to purchase gold could destroy the monetary role of gold. While such demonetization would remove certain difficulties, it would have far-reaching consequences.

The probable consequences would be disruptive of international financial conditions; the economic repercussions would doubtless be extensive; the psychological reaction would be considerable, as would the political. The United States would be subjected to severe criticism at home and abroad, especially in countries with large holdings of gold and in gold-producing countries. These disturbances, not necessarily unmanageable, would be of unknown intensity, magnitude, and duration.

The proposed move would be a divisive factor in the Western financial cooperation that has evolved in recent years. Even though cooperation in planning international monetary reform and in other matters leaves much to be desired, central banks have learned that a considerable amount of cooperation is essential—another case where they must all hang together or they will hang separately. The fact that the proposal would not contribute to further cooperation, however, does not necessarily mean that the United States should fail to take such action if and when conditions indicate its desirability.

These consequences reveal the need for thorough study and preparation if the United States were to refuse to buy gold, or to limit its convertibility into dollars. Matters requiring analysis include the difficulties inherent in the present role of gold and possible alternative solutions, long-run objectives including transitional measures, and such things as guidelines regarding prices to be paid and amounts of gold, if any, to be purchased. The United States might wish, for example, to purchase at present prices existing gold holdings of the developing nations, so as to avoid causing them loss. Decisions would need to be reached as to whether existing gold holdings of other friendly nations should receive some form of special consideration, and if so what kind of treatment. In view of the importance of sterling, gold holdings of the United Kingdom might warrant special treatment. One of the major questions to be studied is the role of gold (perhaps eventually none) in an adequately revised international monetary system and an expanded International Monetary Fund. There is also the question of what action the Fund should be prepared to take in the immediate sense, apart from a possible fundamental change in its structure and functions. These questions all need thorough exploration.

If the view is accepted that gold is on the way out as a monetary metal, the United States may discover it has a bear by the tail. It can hold onto a large stock of a metal with a prospective loss of value, and also face a reduction in reserves. If it should withdraw free convertibility of gold into dollars at $35 an ounce, it probably would precipitate such decline.

This paper is concerned primarily with the reverse problem, namely, the inadvisability on the part of the United States of maintaining unlimited convertibility of dollars into gold. Control over sales of gold could be undertaken immediately and without the disturbances that would accompany limitations on the purchase of gold. Such limitations on the purchase of gold could be considered for subsequent action, depending particularly upon developments in international monetary reform, and the possible need for independent action by the United States. To appraise and determine how to deal with the gold problem and its long-range aspects is part of the broad question of international monetary reform. The world in this connection should remember that gold is not an end in itself.

LEGAL PROVISIONS REGARDING GOLD PURCHASES AND SALES

There do not appear to be any legal requirements of the U. S. Government or commitments as a member of the International Monetary Fund which would prevent the President from putting into force the proposal made in this paper that the United States sell gold only at its own discretion.

United States Legal Provisions

The Executive has authority under the Gold Reserve Act of 1934 to discontinue the free purchase and sale of gold, a privilege now accorded only to foreign governments and under regulations determined by the Treasury. The President's authority to change the gold content of the dollar terminated June 30, 1943, but his discretionary authority over the purchase and sale of gold did not terminate.

The President, therefore, can sell gold entirely on a discretionary basis, as proposed herein, without additional legislation. Similarly, the President has authority to refuse to buy gold, or to buy gold only in amounts and from sellers determined by this Government. Since under present laws the United States cannot buy or sell gold at a price other than $35 an ounce, apart from minor charges, proposals that involve departure from the present official price of gold, such as a gradual reduction of the price, or a gradual increase in price, would require new authority from Congress.

Obligations as a Member of IMF

The Articles of Agreement of the International Monetary Fund do not require members to buy or sell gold freely, although under certain conditions the Fund may require a member to buy gold from the Fund itself. Sales of gold by the United States only at its own discretion, or refusal by the United States to buy gold, would not contravene the Fund's Articles.

Members are required to declare to the Fund the par value of their currencies in terms either of gold or the U. S. dollar of the present gold content (Article IV, Section 1). Members must maintain their exchange rates within one per cent of this par (Article IV, Section 3) and do so without exchange restrictions on current transactions, unless such restrictions are specifically authorized by the Fund (Article VIII, Section 2). A change in the par value, that is in the price of gold, must be only "to correct a fundamental disequilibrium" (Article IV, Section 5 a), and a change of more than ten per cent requires Fund approval. Proposals involving small changes in the official price of gold, therefore, do not require Fund concurrence, unless the accumulation of such changes reaches ten per cent of the initial par value.

The Articles provide that the obligation to maintain exchange rates within the prescribed limits is satisfied if the member's monetary authorities "freely buy and sell gold within the limits prescribed by the Fund" (Article IV, Section 4 b). The United States has notified the Fund that it is meeting this obligation by buying and selling gold freely. This method of meeting the obligation is, however, optional with the United States. The United States has the right to maintain exchange rates within the limits through exchange operations, as do other countries, and is not required to buy or sell gold freely in order to fulfill this obligation.

The Fund has the right to buy a member's currency with gold if the Fund desires to replenish its holdings of such currency (Article VII, Section 2 ii). The United States, therefore, would be required to accept gold from the Fund if the Fund felt it needed more dollars and chose to use gold in acquiring the dollars. The Fund must itself accept gold from its members (Article V, Section 2 and Section 7), and conceivably could require the United States to buy some of this gold. The United States, however, has an important voice in Fund actions.

Another provision in the Articles of Agreement requires a member to redeem balances of its currency held by another member when asked to by the other member (Article VIII, Section 4). The country redeeming its currency can do so either by paying the other member in gold or in the currency of such other member. This means that if the United States desired to convert its holdings of a foreign currency into dollars, the foreign central bank would have the option of paying either in gold or dollars. The United States, of course, is not required to convert such currency into dollars, and could sell the currency for some other currency, unless the foreign country restricted such transfer.

Mr. Barrett. Mr. Fino.

Mr. Fino. Thank you, Mr. Chairman.

Dr. Piquet, with regard to your statement that no legislation would be required to leave uncertain the buying price of gold at $35 an ounce, would you please have the Library of Congress prepare an analysis of the need or lack of need for legislation in order to accomplish——

Mr. Piquet. That is the guarantee?

Mr. Fino. Yes.

Mr. Piquet. Yes, sir.

Mr. Fino. Just one other observation. On January 18, a Mr. Austin Barker, an economist and also a partner in the brokerage firm of Hornblower & Weeks, in an article, expressed opposition to removal of the gold cover.

Mr. Piquet. To whom did you refer?

Mr. Fino. C.—for Charles, I suppose—Austin Barker, an economist and a partner in Hornblower & Weeks, in his article, on page 3, he says, speaking about this business of balance of payments, and I am quoting Mr. Barker:

> In itself it will do nothing to help the payments deficit and may even cause harm through a further loss in confidence, because its removal is considered a sign of weakness, nor is the removal needed to assure the world that we will maintain the price of gold at $35 an ounce, because we can do that under the present gold cover system.

Mr. Piquet. Of course, I disagree with the statement for the reasons I have already given. In the last sentence he says that we will maintain the price of gold at $35 an ounce. What I have been talking about is maintaining the value of the dollar in terms of gold. It is just the opposite from maintaining the price of gold. Even the President made the same mistake in his speech on the state of the Union on January 17. It was undoubtedly a slip of the tongue.

Far from being a sign of weakness I think it would be a sign of weakness if we fail to remove the 25-percent gold cover against Federal Reserve notes. We have the gold buried at Fort Knox, guarded by troops, and not touchable by anybody.

The Daughters of the American Revolution, when Mr. Truman was President of the United States, introduced a resolution to appoint a committee to go down there and take a look at the gold. They didn't seem to trust the administration and wanted to make sure it was there. Gold has come to be a mystical thing. It is an inert metal. If it isn't going to be used for international redemption of the dollar, why are we holding it? It certainly does not limit the total supply of money and credit in this country. The connection between gold and credit money was abolished long ago. The bulk of all transactions in this country are carried on neither in gold nor in paper money, but in bank credit in the form of checks. There is a gold "mystique." The gold "in back of" the dollar is supposed to do something, but we are not quite sure what.

Mr. Fino. You indicated from your testimony here this morning, that you wern't too concerned with the imbalance of payments. You expressed this fear, or concern, about the imbalance of balance payments deficit.

Mr. Piquet. I didn't go quite that far.

Mr. Fino. That is the impression I got.

Mr. PIQUET. What I said was, the ailment should not be confused with its symptoms. The symptoms are evidenced in the balance-of-payments deficit figures. The principal ailment is fear of an impending loss of confidence in the dollar.

I must disagree with you, Dr. Danielian, much as I do not like to do so, but as far as I know, the Commerce Department has not changed its basic method of computing the liquidity balance-of-payments deficit. If you take the Bernstein formula, of computing the deficit on the "official settlements" basis we actually had a positive balance of $200 million in 1966. There is a lot to be said in criticism of the figures, but I don't think that the Commerce Department has changed its figures in any way that would indicate that the balance-of-payments deficit was still in the neighborhood of $3 billion in 1965 and 1966.

Mr. DANIELIAN. I didn't say that the figures were changed. The accounts to which these transactions have been charged have been changed.

For instance, if you converted a 364-day paper into a 366-day period, 1 day more than a year, instead of an outflow it becomes an inflow, and then there were prepayment of debts and one-term transactions and so on, and the result is the figures look good at the end of the year, but in terms of basic movement of resources we have been running a balance-of-payments deficit of approximately $3 to $4 billion, consistently, since 1958, and I have predicted it year after year, without any great deal of mathematical calculation, simply because the private sector earnings have a short fall of that much in comparison with Government expenditures, and that short fall has been between $3 and $4 billion, year after year.

Mr. FINO. Dr. Piquet, your testimony here hinges on confidence on the dollar. You make a big point, a strong point——

Mr. PIQUET. That is the problem, seems to me.

Mr. FINO. Now, don't you think that there would be less confidence in the dollar if we didn't have any gold in this country?

Mr. PIQUET. No, I don't.

Mr. FINO. You don't think so?

Mr. PIQUET. I think that dollars are accepted by other countries for the same reason that you and I accept them—because we have confidence that we can spend them for goods and services.

Mr. FINO. You have confidence in your Government. You have confidence in the United States, the integrity of the United States.

Mr. PIQUET. I am not in the slightest conscious there is any gold in Fort Knox whenever I spend, or acquire, a dollar. I accept a dollar in payment for services, or as part of my salary from Government, because I can spend it. The important potential eroding here is a decline in its purchasing power—inflation.

Mr. FINO. Let me ask you this: would the foreigner or foreign country have the same confidence, if they knew we had no gold in this country?

Mr. PIQUET. Most of the foreigners who hold dollars cannot convert their dollars into gold any more than you and I can. Only central banks and foreign governments can convert dollars into gold on demand, and the dollars so held presently amount to about $14 billion.

Mr. FINO. Doesn't that give that country whose central bank is holding the gold, and the people in that country greater confidence in their monetary system?

Mr. Piquet. I think confidence is something that cannot be measured by statistics. You have confidence in the behavior of a government; confidence in the integrity of a currency, because the government behaves in such a way, with respect to taxation, budget deficits, et cetera, that it inspires confidence that it is not going to impair the purchasing power of its money.

Economic history following World War I was marked by successive devaluations of currencies. We should keep in mind that the only major country in modern times that has not been forced to devalue its currency has been the United States. We devalued in 1933, but we weren't forced to so. We are also the only country that has maintained convertibility of its currency into gold with respect to central banks and foreign governments.

France has devalued a number of times since the war. So has the United Kingdom and Germany.

Mr. Barrett. The time of the gentleman has expired. Mr. Reuss.

Mr. Reuss. I am very happy to hear the endorsement of both of you gentlemen to the bill before us to remove the gold cover, and also your additional statements.

Dr. Piquet, let me address myself to the point you raise, that those who find it, or think they find it, profitable to speculate against the dollar by creating gold flurries from time to time, ought to be warned that in the end they may be playing a losing game.

Mr. Piquet. That is what I intend to accomplish by abandonment of the guarantee to purchase gold at $35 per ounce.

Mr. Reuss. Now, let me make a statement here, and I know there is a quorum of the committee present.

I assert that the following is true, and if I state something which any member of this committee thinks is not true, I would yield to him so he can set the record straight.

I think the following is true: I don't believe there is a member of the House Committee on Banking and Currency who is prepared now or in the future to vote to increase the price of gold above its present $35 an ounce; and I further believe that there are a considerable number of members of the House Banking and Currency Committee who would view with equanimity a decrease in the price of gold at some future time, when it made international sense to sit still for such a decrease. I now invite any of my colleagues who disagree with this statement of mine to indicate the disagreement.

Mr. Johnson. I didn't understand the second premise about equanimity.

Mr. Reuss. Let me make it clear that while I believe from my conversations that it is the sense of everyone here that the Congress of the United States will not increase the official price of gold, I also believe that there are many Members who would not take it amiss if at some future time the official price of gold be decreased, who would not view that with alarm.

Now, I don't believe that there is any Member here who disagrees with the proposition I have just put. And if that is so, as it seems to be so, Dr. Piquet, haven't we, in a sense at least, created the kind of international environment which you think may signal the speculators that they may not have everything their own way from here to eternity.

Mr. PIQUET. I think so. You may remember that Prof. Fritz Machlup, of Princeton, a few years ago, proposed that the United States announce in advance that it will lower the price of gold in successive stages. The important thing is to keep the speculators guessing as to whether they can get dollars back for their gold holdings.

The assurance, if it is recognized as an assurance, that the United States is not going to raise the price of gold, goes part way in this direction. I would like to go the full way.

Mr. MOORHEAD. Will the gentleman yield?

Mr. REUSS. I will yield to Mr. Moorhead.

Mr. MOORHEAD. Just to clarify, I think maybe you changed the second proposition in the second time around. Certainly, I would go along with you on the dropping of the guarantee. I don't know that I am prepared to agree with you, if you meant an official lowering of the price of the gold.

Mr. REUSS. No. I meant to keep the proposition very general, so as to not pin anyone down.

Mr. MOORHEAD. Then I want to associate myself with your remarks.

Mr. LLOYD. Would the gentleman yield?

Mr. REUSS. In a second. The gentleman from Pennsylvania, Mr. Moorhead, has given credibility to the statement I have made. He has come out and said that as far as he is concerned in the future he would not be perturbed at some change on the down side of the price of gold.

I yield to gentleman from Utah.

Mr. LLOYD. I would like to express my general agreement. Dr. Piquet has said, in the present situation the speculators do not consider themselves to be speculators; but under the proposition suggested by Mr. Reuss they would indeed have to recognize that they might become speculators. With that proposition, I am in agreement.

Mr. REUSS. Let me try another question. I may have to come back for the answer. I will ask this of Dr. Danielian. You have said, Dr. Danielian, and on this Dr. Piquet is in agreement with you, that by and large the big balance-of-payments deficit that we incurred in 1967 was due not to the private account of trade, tourism, investment, remittances, but was due to the governmental foreign spending account, which is very largely military. This is a fact; is it not?

Mr. DANIELIAN. Mr. Reuss, the Defense Department issued a study on January 4, and on page 5, there is a table on military expenditures. I would like the record to produce this, if it is not in the record already.

Mr. REUSS. I ask now that the January 4, 1968, Defense Department summary be included in the record at this point.

Can you make it available, Doctor?

Mr. DANIELIAN. Yes, sir.

Mr. BARRETT. That will be done, without objection, and so ordered.

(The document referred to follows:)

[News release, Office of Assistant Secretary of Defense for Public Affairs, Jan. 4, 1968]

STATEMENT SUMMARIZING ACTIONS BY THE DEPARTMENT OF DEFENSE SERVING TO REDUCE THE NET FOREIGN EXCHANGE COSTS OF DEFENSE ACTIVITIES DURING THE PERIOD FY 1961–FY 1967

INTRODUCTION

The Department of Defense has long recognized that, due to the size of U.S. defense expenditures entering the international balance of payments (IBP), it has a major responsibility to reduce the foreign exchange costs associated with defense activities to the minimum consistent with the requirements of national security. In recent years, this continuing concern has been expressed in a wide range of Department of Defense programs serving to hold down and, where feasible, to reduce defense IBP costs and to increase receipts. There programs have been re-emphasized and expanded during the past two years as the intensification of hostilities in Southeast Asia (SEA) sharply raised foreign exchange costs. As part of this renewed effort, the Secretary of Defense in April 1967 re-emphasized the need to continue concentrated attention on the Department of Defense balance of payments program, and outlined more than 20 separate actions or studies relating to various facets of the program.

The primary function of the Department of Defense is to provide for the security of the United States. Therefore, balance of payments considerations cannot be overriding, or indeed, examined independent of requirements stemming from our national security objectives, including fulfillment of our commitments to help provide for the security of other nations. The Department of Defense balance of payments program has been developed and is being carried out under two general guidelines: first, essential combat capability must be maintained and second, expenditure reductions must be achieved without creating undue hardship for U.S. Military and civilian personnel and their familes.

The following table summarizes balance of payments data relating to U.S. defense actvities:

U.S. DEFENSE EXPENDITURES AND RECEIPTS ENTERING THE INTERNATIONAL BALANCE OF PAYMENTS, FISCAL YEARS 1961-67 [1] [2]

[In billions of dollars]

	1961	1962	1963	1964	1965	1966	1967
Expenditures:							
U.S. forces and their support	$2.5	$2.5	$2.5	$2.6	$2.5	$3.1	$3.9
Military assistance	.3	.2	.3	.2	.2	.2	.1
Other (AEC, etc.)	.3	.3	.3	.1	.1	.1	(3)
Total	3.1	3.0	3.1	2.9	2.8	3.4	4.1
Receipts	−.3	−.9	−1.4	−1.2	−1.3	−1.2	−1.8
Net adverse balance	2.8	2.1	1.7	1.7	1.5	2.2	2.3
Increase in SEA related expenses over fiscal year 1961	......	(3)	.1	.1	.2	.7	1.5

[1] The data reflected in this table are on a gross basis. They do not reflect so-called feedback effects; e.g., as U.S. military expenditures increase in a foreign country, that country will in turn be in a position through these increased earnings to increase its imports from the United States directly or through third countries Expenditure data also include expenditures in foreign currencies purchased from U.S. Treasury. In fiscal year 1967, these expenditures were approximately $200,000,000, of which $26,000,000 were in excess or near-excess currencies.
[2] Details may not add due to rounding.
[3] Less than $50,000,000.

Between FY 1961 and FY 1965, the net adverse balance on the defense account was reduced from about $2.8 billion to less than $1.5 billion. This reduction was achieved through (1) a substantial rise in receipts from sales of U.S. military goods and services to foreign countries, (2) a reduction in overseas uranium purchases of more than $200 million and (3) a successful effort to hold down Department of Defense expenditures in the face of (a) rapidly increasing foreign wages and prices, (b) increases in pay and allowances for U.S. military personnel (16% between FY 1961 and FY 1965) and (c) considering SEA related increases, a net increase in U.S. military personnel deployed in foreign countries.

Between 1961 and 1966 overall wages in France rose by 41%, in Germany by 52% and in Japan by 61%; during the same period wages increased in the U.S. by only 20%. Similarly, the cost of living rose in France by 19%, in Germany by 16% and in Japan by 34% from 1961 to 1966—but in the U.S. by only 9%. Average annual wages—including social security benefits under local law and other related costs—paid foreign nationals on Department of Defense rolls also have increased markedly during the last six years. For example, from FY 1961 through FY 1966 average foreign national wage costs to the Department of Defense increased in France, Germany and Japan by approximately 50%. While relative increases in prices and wages can have an eventual favorable impact on the U.S. competitive position in foreign markets and hence on the U.S. balance of payments position, for the Department of Defense they simply increase the cost of maintaining our defense posture overseas. (In Western Europe alone, it is conservatively estimated that such price and wage increases serve to increase Department of Defense foreign exchange expenditures by over $40 million annually.)

In FY 1966 and FY 1967, as a result almost entirely of the U.S. effort in SEA, Department of Defense expenditures rose markedly. Between end FY 1965 and end FY 1967, about 452,000 additional U.S. military personnel were deployed in SEA countries. During the same period total military strength in all foreign countries, including SEA, increased by about 434,000. Hence, in areas outside of SEA, there was a net reduction of approximately 18,000 military personnel.

Concurrent with the substantial increase in U.S. military strength in SEA, there was a substantial increase in logistical support requirements for military operations in South Vietnam. The extensive construction program included deep water ports, logistic depots and airfields. The supplies and equipment needed in Vietnam include more than one million different items. This reorientation and tremendous expansion of effort in SEA is shown in the following table which highlights shifts in military IBP expenditures by major geographic area:

U.S. DEFENSE IBP EXPENDITURES BY MAJOR AREA, FISCAL YEARS 1961–67

[In billions of dollars]

Fiscal year	Western Europe	Asian countries [1]	Canada	Other	Worldwide [2]
1961	$1.6	$0.6	$0.4	$0.5	$3.1
1962	1.6	.6	.3	.5	3.0
1963	1.6	.6	.3	.5	3.1
1964	1.5	.6	.3	.5	2.9
1965	1.4	.7	.2	.5	2.8
1966	1.5	1.1	.2	.6	3.4
1967	1.5	1.7	.2	.6	4.1

[1] Japan, Philippine Islands, Republic of China, Ryukyu Islands, South Vietnam, and Thailand. These data should not be equated with increases in SEA-related expenditures over 1961, shown in the table on p. 2, or with "costs of the war" since there have been increased expenditures in other geographic areas resulting either directly or indirectly from the Vietnam conflict. Other adjustments also are required to derive estimated SEA "war costs."

[2] Details may not add due to rounding. Although there was a marked net increase in Department of Defense IBP expenditures in fiscal year 1966 and fiscal year 1967, this net increase would have been significantly higher had it not been for the Department of Defense balance-of-payments policies already in effect at the time hostilities were intensified and the new measures which have been undertaken since that time.

REDUCTIONS IN EXPENDITURES BY U.S. MILITARY, CIVILIAN AND DEPENDENT PERSONNEL OVERSEAS

The Department of Defense balance of payments program relating to reductions in foreign exchange expenditures by U.S. personnel has three main focal points; first, a strenuous effort to review requirements for U.S. military and civilian personnel in foreign countries, with a view to reducing these requirements where feasible; second, continuing stress on voluntary actions by individuals to reduce personal spending on the local economy; and third, efforts to hold down IBP expenditures related to nonappropriated fund activities.

a. Military Strength Levels in Foreign Countries

Special procedures governing U.S. military strength in foreign countries have been developed during the past several years. These procedures, which supplement normal manpower requirements reviews, reflect the continuing Department of Defense effort to assure the assignment and continued deployment of military personnel in foreign countries at the minimum levels necessary to meet military requirements. Under these procedures, an overall end fiscal year ceiling on military strength in foreign countries is established for each military department. In certain cases there are additional subsidiary country and/or area ceilings.

Since 1963, although there has been an overall net increase in U.S. military strength in foreign countries, there also have been a substantial number of actions which served to reduce such requirements for military personnel without detriment to U.S. national security objectives and with beneficial balance of payments effects. Some of these actions are as follows: In *FY 1964*, three U.S. air defense units in Spain were phased out; SAC Reflex B–47 operations were consolidated in Europe (and later the B–47's were redeployed from Europe) and U.S. personnel requirements in U.S. military headquarters in foreign countries were reduced by 15% below end FY 1963 levels. (These actions served to reduce military strength requirements in foreign countries by about 6,500.) In *FY 1965*, the Army's Line of Communication (LOC) in France was reorganized and three U.S. interceptor squadrons and a C–124 transport squadron were withdrawn from Japan to the U.S. (On completion of these actions, military strength requirements in foreign countries had been reduced by more than 7,000 spaces.) In *FY 1966* and *FY 1967*, over 20 overseas activities were consolidated, reduced or discontinued with a savings of about 8,000 military spaces. In FY 1967, also, there was a gross reduction in U.S. military manpower requirements in Europe of about 18,000 U.S. military and civilian personnel resulting from the U.S. relocation from France. These reductions stemmed in part from special Department of Defense manpower revalidation procedures associated with the relocation.

Certain of the earlier actions outlined above, and others, served to reduce U.S. military strength in Western Europe by approximately 51,000 between March 1962 (the peak of the Berlin Buildup) and March 1965. Between March 1965 and March 1967, there was a further net reduction of approximately 16,000 U.S. military personnel in Western Europe.

b. Expenditures by Individuals

A continuing effort is made by the Department of Defense to encourage participation by its personnel stationed in foreign countries in voluntary programs designed to channel available disposable income back to the U.S. These programs were initiated by the Department of Defense early in 1961. As applied to individuals, these programs emphasize and encourage voluntary actions to reduce spending on the local economy, to increase use of payroll allotments and other voluntary savings programs and to increase spending in U.S. controlled facilities, including use of U.S. operated recreation areas.

In 1966 and 1967, existing programs relating to voluntary reductions in personal spending by Department of Defense personnel stationed in foreign countries were intensified and new programs were initiated. Disbursement procedures were modified to make it easier for servicemen to leave their pay "on the books." Regulations were amended to permit servicemen to increase the size of their allotments sent home. In addition, the Uniformed Services Savings Deposit Program was enacted. The law and accompanying Executive Order revitalized the old Soldiers, Sailors and Airmen's Deposit Program. Participation in the program is limited to military personnel on active duty in a foreign area. Amounts deposited under the program earn interest at the rate of 10% per annum, compounded quarterly and interest is paid on deposits up to a maximum of $10,000 while the depositor is on a duty assignment for more than 90 days outside the U.S. or its possessions or Puerto Rico. Any part of unallotted current pay and allowance (in multiples of $5), including a re-enlistment bonus paid in a foreign country, may be deposited.

Against the background of the actions outlined above, the Department of Defense undertook in August 1966 a concerted effort to encourage greater participation by all its members in foreign countries in the voluntary balance of payments program. The Directorate for Armed Forces Information and Education is producing and distributing materials supporting these personal savings programs, including Bulletins for Commanders, a special Fact Sheet for Servicemen, a special film and radio and television and press material. In November 1966, 277,000 copies of a special Fact Sheet entitled "Your Personal Savings Program" were issued. Later in the year about 300 copies of a 10 minute film entitled "Gold and You" were distributed for showing to Department of De-

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fense personnel. This film explains the U.S. balance of payments program, outlines ways and means of achieving reductions in IBP spending by U.S. personnel, and emphasizes the revitalized Uniformed Services Savings Deposit Program as an attractive avenue of saving. In this respect, as of September 30, 1967, there was $183.5 million in gross deposits in the program. (It is recognized that these deposits—as in the case of savings associated with similar programs—cannot be equated directly with equivalent net IBP savings since some portion of the new deposits are made in place of other forms of savings or expenditures which would not enter the international balance of payments.)

Currently, the Office of the Secretary of Defense and the military departments are taking additional steps to provide more comprehensive orientation on the U.S. IBP problem to Department of Defense personnel prior to their assignment overseas.

In South Vietnam, the efforts to encourage voluntary reductions in personal spending serve also as a significant part of the overall effort to reduce inflationary pressures in the local economy. Additional measures in South Vietnam include a special piaster budget for spending by U.S. agencies in that country, the use of military payment certificates and a prohibition on the use of regular American currency in the country as part of the effort to eliminate unauthorized currency transactions. In this respect, the rest and recuperation (R&R) program recently established in Hawaii for military personnel serving in South Vietnam also serves to hold down the foreign exchange cost resulting from R&R leaves outside U.S. dollar areas. On the basis of an average expenditure of about $265 per man on R&R in foreign countries, use of Hawaii as an R&R site is estimated to result in foreign exchange savings of about $20–$25 million in FY 1968.

c. Nonappropriated Fund Activities

It is the policy of the Department of Defense to promote the sale of U.S. items in overseas nonappropriated fund activities. Military exchanges and other nonappropriated fund activities in foreign countries have been directed to take whatever steps are possible, within the limits of sound business practice, to stock merchandise of U.S. origin to the greatest practicable extent. At the same time, it is recognized that there is a demand for foreign merchandise by U.S. personnel stationed in foreign countries and that a more favorable effect on the U.S. balance of payments will result if such goods are purchased through U.S.-operated nonappropriated fund resale activities than procured directly on the local economy or from other foreign outlets. Accordingly, nonappropriated fund resale activities in foreign countries are authorized to procure for resale foreign-made goods available in the local market, subject to certain restrictions. Among these restrictions is the requirement that the price of foreign items sold in overseas exchanges and other retail outlets must be at least as high a the selling price prevailing on the local economy. This pricing policy in effect permits a lower markup and more attractive prices on U.S. goods because of the additional profit from sales of foreign items, thus stimulating demand for U.S. products.

The Department of Defense also has expanded the use of catalogues to emphasize the availability of U.S. merchandise. In the fall of 1966, the Navy Ship Store Office distributed 25,000 U.S. commercial catalogues specially printed for the Navy to all overseas exchanges and to some 50 ships located outside the U.S. The Army and Air Force Exchange System also has established a "mail a gift" service for U.S.-made items which can be delivered in the U.S. In July 1967, the Military Departments were requested to review the sale of foreign merchandise directly or through concessionaires, by the various clubs, messes and sundry funds and curtail such sales by eliminating items, restoring to the military exchanges the responsibility for the sale of those items normally sold through that channel and by minimizing the presence of display type concessionaires.

In July 1967, new procedures were approved governing overseas exchange procurements based on a percentage of foreign merchandise procurement expenditures to total exchange sales, including Vietnam—27½% for July–December 1967 and 25% for January–June 1968—and a concurrent re-emphasis on U.S. merchandise sales. This action was designed to halt and reverse the increase in the proportion of foreign procurement expenditures to total sales experienced in the July–December 1966 period in SEA and concurrently, to increase emphasis on better stockage of U.S. merchandise and to assure the highest priority for purchase, promotion and sale of U.S. manufactured items. This program is being monitored closely in order to assure that there is no shift by Department of Defense personnel from purchasing in the exchanges to purchasing foreign items on the local economy. Early in August 1967, the Military Departments also were requested to conduct a thorough review of items stocked for resale in exchanges to ensure in-stock positions of U.S. manufactured goods in demand and to substitute comparable U.S. manufactured items for foreign goods wherever feasible.

This continuing stress on foreign exchange economies in the nonappropriated fund area rests on a base of actions taken during the FY 1961–FY 1966 period. In FY 1960, the overseas military exchanges spent about $150 million for the purchase of foreign merchandise and total exchange sales were slightly less than $500 million. In FY 1966, expenditures for foreign merchandise were slightly less than the FY 1960 level, but total exchange sales had risen to slightly more than $700 million, or a $200 million increase over FY 1960. The nonappropriated fund activities have provided, and provide today, perhaps the single most significant avenue through which U.S. military and civilian personnel and their dependents in foreign countries "return" dollars to the United States.

ACTIONS RELATING TO FOREIGN NATIONALS

The Department of Defense has made strenuous efforts to hold employment of foreign nationals to minimum essential levels. Major emphasis on reducing employment of foreign nationals was initiated in July 1963 with some actions to be effective by end FY 1964 and additional actions scheduled by end FY 1965. The results of the FY 1964–1965 program are reflected in the following table, which also reflects FY 1966–1967 SEA related increases:

FOREIGN NATIONAL STRENGTH AND DOD IBP EXPENDITURES, FISCAL YEARS 1961–67

Fiscal year	Foreign national strength (Mar. 31 data)	DOD IBP expenditures (in millions)
1961	243,100	$370
1962	242,800	400
1963	240,000	440
1964	223,300	425
1965	198,200	410
1966	203,800	440
1967	261,100	530

Between FY 1963 and FY 1965, there was an overall net reduction of close to 42,000 foreign nationals employed on Department of Defense rolls and a concurrent decrease in IBP expenditures for foreign nationals of about $30 million, in spite of some upward pressure in this area already being experienced as a result of the conflict in SEA. (During this period Department of Defense U.S. civilian strength in foreign countries remained relatively stable.) But the savings shown do not fully reflect the actions taken, in as much as foreign national wage costs were steadily rising during the period. If the FY 1963–1965 reductions had not been made, and if SEA foreign national employment increases had been added to the FY 1963 employment level, total foreign national expenditures in FY 1966 could have been well above $500 million, and in FY 1967 well above $600 million, instead of at the levels reported.

The increase in foreign national employment during the last two fiscal years is attributable almost entirely to SEA requirements. From March 1965 to March 1967, foreign national employment in Vietnam alone increased by about 47,000, while for the same period the number of foreign nationals in Western Europe declined by an additional 4,000. (Between March 1961 and March 1967, there was a net reduction of approximately 28,000 foreign nationals in Western Europe.)

EXPENDITURES FOR MATERIALS, SUPPLIES AND SERVICES AND MAJOR EQUIPMENT

Department of Defense policies place primary emphasis on use of U.S. materials and supplies in support of U.S. defense activities. Efforts to restrain IBP expenditures for materials, supplies and equipment can be related initially to a Presidential directive in November 1960 calling for reductions in Department of Defense procurement abroad during CY 1961.

Beginning in January 1961, Department of Defense purchases (excluding Military Assistance Program (MAP), nonappropriated fund procurements and POL) normally were "returned" to the U.S. when costs of U.S. supplies and services (including transportation and handling) for use outside the U.S. did not exceed the cost of foreign supplies and services by more than 25%. In mid-1962 the standard 25% differential was increased to 50%, and on a case-by-case basis could exceed 50%. These policies, which are continually re-emphasized, remain in effect today. Hence, in cases where the U.S. versus foreign procurement source is to be determined on price differential grounds, a 50% premium in favor of U.S. end products or services is acceptable automatically and cases over $10,000 where the price differential is over 50% continue to be forwarded to the Deputy Secretary or the Secretary of Defense for procurement source determination. From CY 1961 through FY 1967, about $340 million in procurements had been diverted from foreign products to U.S. products or services under this program, at an additional budgetary cost of about $75 million, or about 22%.

Similarly, for Department of Defense procurements of goods and services for use in the U.S., case-by-case review procedures using the 50% differential as a "bench mark" were initiated in July 1962. The 50% differential was subsequently formalized as a part of Department of Defense procurement regulations with a clear statement that this policy would be kept in force only as long as is required by the U.S. balance of payments situation. From FY 1963 through FY 1967, based only on cases where foreign source bids were received, approximately $13 million in procurements which normally would have been foreign were returned to U.S. sources at an additional budgetary cost of approximately $4 million, or about 31%.

With respect to purchases of POL, in FY 1967 the Department of Defense returned to the U.S. somewhat over $100 million of the approximately $570 million which normally would have been earmarked for overseas procurement; thus, about 20% of Department of Defense overseas procurement requirements in FY 1967 were purchased in the U.S. Additional returns have been determined to be infeasible, principally on economic grounds, e.g., the additional budgetary cost involved would greatly exceed any benefits in foreign exchange savings.

Emphasis on reducing Department of Defense expenditures overseas for materials, supplies and services is continuing. The Secretary of Defense in July 1967 approved a recommendation to establish as a FY 1968 objective a reduction in IBP expenditures for subsistence in foreign countries below FY 1967 expenditures, which were about $100 million, under specific guidelines. Similarly, in mid-July 1967, the Deputy Secretary of Defense confirmed the use of more stringent criteria governing the selection of foreign research and development projects. The Director, Defense Research and Engineering also has directed that a semiannual review of all foreign projects be made to ensure full compliance with these criteria.

REDUCTIONS IN EXPENDITURES FOR CONSTRUCTION AND OPERATION OF OVERSEAS FACILITIES

Department of Defense efforts to reduce expenditures relating to the construction and operation of facilities in foreign countries have two principal focal points. First, the Department of Defense has attempted to operate required facilities at minimum costs under ground rules which in part require that maintenance and repair of real property be conducted at levels sufficient only to ensure continuity of operations and to preclude uneconomical costs due to excessive deterioration. As part of this effort, there are continuous reviews to seek out areas where base closures or consolidation of activities can be achieved without detriment to national security objectives and with savings in budgetary and IBP costs. Second, the Department of Defense has eliminated or deferred all construction not essential to military needs and attempted to reduce the foreign exchange costs of essential construction even where additional budgetary costs are required.

Proposed construction programs in foreign countries are subject to special reviews as to essentiality, and those which are approved are designed, where permitted by the applicable country-to-country agreements, so as to reduce foreign exchange costs to a minimum. Under specially developed construction procedures, the Department of Defense is emphasizing the use of: (1) U.S. procured materials, (2) U.S. Government furnished materials and equipment, (3) U.S. flag carriers, (4) prefabricated buildings manufactured in the U.S. and (5) competent troop labor. It is recognized that these construction procedures may result in increased budgetary costs; however, extra budgetary costs generally are considered acceptable provided the added cost over normal construction methods does not exceed 50% of the amount of reduction achieved in IBP costs.

These special procedures also may be acceptable as approved on a case-by-case basis even though premium costs may exceed 50%.

In view of the magnitude of the construction program in SEA, particularly in Vietnam, an extraordinary effort has been made to reduce the IBP impact of the program. The results of this effort can be stated very simply. Of the over $1.4 billion in approved and funded construction for South Vietnam, almost $1 billion had been expended through June 30, 1967. But, only about $250 million, or approximately 25% of these expenditures were foreign exchange costs. This achievement also must be considered in the light of the extreme urgency under which much of the construction work has been accomplished.

The emphasis to restrict overseas construction projects to those necessary to meet national security objectives continues also in other geographic areas. As a result of a study called for in April 1967, the Secretary of Defense subsequently approved an action to hold IBP expenditures for military construction, including NATO Infrastructure, but excluding expenditures for construction in Vietnam, to $270 million in FY 1968.

MILITARY ASSISTANCE PROGRAM

Military assistance IBP expenditures generally are reflected in three separate areas: offshore procurement, NATO Infrastructure and all other MAP costs. An intensive effort is being made to hold down IBP costs in all these areas.

In December 1960, the Department of Defense issued instructions to the Unified Commands to review the MAP in their respective area and to recommend adjustments that would lead to reductions in dollar expenditures abroad either through deletion or deferral of requirements or through transfer to the U.S. of sources of supply. Initially, recommendations for changes were limited to adjustments which would not increase budgetary costs to the Department of Defense by more than 10%. This differential subsequently was raised to 25% and beginning in December 1963, the 50% differential relating to military functions appropriations procurements was applied also to MAP offshore procurement. In addition, policy guidance was revised in mid-1963 to require that offshore procurements under MAP cost sharing agreements be limited essentially to the fulfillment of prior commitments. Under the policies outlined above, IBP expenditures for MAP offshore procurement were reduced from about $160 million in FY 1963 to less than $50 million in FY 1967, and all other MAP expenditures entering the IBP were reduced by about one-third during this period.

Military Assistance Program funds also were used during the FY 1961–1967 period to provide the U.S. contribution to NATO multilateral efforts, the most significant of which is NATO Infrastructure, i.e., the joint U.S.–Allied funding of airfields, communication facilities, firing ranges and other facilities. During 1966, the U.S. negotiated a reduction in its percentage share contributed to NATO Infrastructure from 30.85% to 25.77%

Stringent control procedures to restrain MAP IBP costs, stemming in part from the provisions in the Foreign Assistance Act of 1961, as amended remain in effect today. For example, in addition to the percentage guidelines outlined above with respect to offshore procurement, the Assistant Secretary of Defense (International Security Affairs) must certify before foreign procurement can be undertaken that failure to procure outside the U.S. would seriously impede the attainment of MAP objectives.

MILITARY SALES PROGRAM

During the FY 1961–FY 1967 period, the U.S. military sales program has resulted in important balance of payments benefits to the U.S. In FY 1961, Department of Defense cash receipts, which stem in large part from military sales, were slightly over $300 million. By FY 1963, Department of Defense cash receipts had risen to well above $1 billion and during the FY 1963–1967 period have averaged close to $1.3 billion, with unusually large receipts of close to $1.6 billion in FY 1967.

The principal objective of the foreign military sales program, however, is basically the same as that of the U.S. grant aid program, i.e., to promote the defensive strength of our allies in a way consistent with overall U.S. foreign policy objectives. Encompassed within this overall objective are several specific goals:

1. To further the practice of cooperative logistics and standardization with our allies by integrating our supply system to the maximum extent feasible and by helping to limit proliferation of different types of equipment.

2. To reduce the costs, to both our allies and ourselves, of equipping our collective forces, by avoiding unnecessary and costly duplicative development programs and by realizing the economies possible from larger production runs.

3. To offset, at least partially, the unfavorable payments impact of our developments abroad in the interest of collective defense.

Under the policies and goals outlined above, between FY 1962 and FY 1967, the total program has resulted in sales of about $9.8 billion. In addition, outstanding sales commitments as of June 30, 1967 amounted to approximately $2 billion. The list of equipment involved has been dominated by sophisticated weapons systems: e.g., F–111's, F–4's, POLARIS equipment, HAWK and PERSHING missile systems, etc. Of the $11.8 billion of sales and commitments, $8.5 billion are for cash and $3.3 billion are credit transactions. Of the latter amount, about $2.1 billion are being financed by the Export-Import Bank without any Department of Defense guaranty and about $1.2 billion through a combination of Department of Defense credit sales and guaranty loans.

About 75% of the sales and commitments to date have gone to Europe and Canada, 12% went to the Far East, primarily Australia, Japan and New Zealand, with about 13% distributed among a substantial number of other countries throughout the world.

All important proposals for military sales are reviewed by the Secretary of Defense, with appropriate interagency coordination, and Presidential decision frequently is required. Decisions to sell equipment are based on a positive determination that it is in the best overall U.S. national interest to make the sale.

In addition, there have been some instances where U.S. sales have been associated with arrangements under which the purchasing country gains increased access to U.S. military procurement requirements on a competitive basis. From an overall standpoint, such arrangements at times are desirable, even though they serve in part to increase U.S. foreign exchange expenditures.

BARTER AND EXCESS CURRENCY PROGRAMS

The Department of Defense also is attempting to achieve maximum feasible use of U.S.-owned excess currencies and barter arrangements as a means of conserving Department of Defense dollar expenditures entering the IBP. In terms of priorities, Department of Defense uses excess currencies before barter for overseas procurements were a choice exists.

Specific policies and procedures have been developed which provide for the use of U.S.-owned foreign currencies rather than dollars for payment of overseas Department of Defense requirements. Where feasible, such items as (1) overseas allowances, (2) travel, transportation, per diem and related expenses of Defense personnel, dependents, employees of contractors and (3) contract procurements, are paid for in excess currencies. It should be noted, however, that the bulk of excess currencies held by the U.S. are currencies of countries where the number of U.S. forces and the magnitude of Department of Defense expenditures are relatively small (in FY 1967 less than 1.5% of all military personnel assigned overseas were stationed in excess or near-excess currency countries, and less than two-tenths of one percent were in excess currency countries.) In addition, there are relatively limited possibilities of using excess currencies to meet requirements in other countries, based in part on the nature of existing country-to-country agreements governing use of the currencies.

With respect to barter, where it has first been determined that excess currencies cannot be used and a determination also has been made under Department of Defense balance of payments procurement guidelines that the requirement must be met from an overseas source, an effort is made to use barter procurement, under procedures developed with the Department of Agriculture.

In its initial year, in FY 1964, the Department of Defense barter program amounted to less than $25 million. In FY 1967, the barter program amounted to slightly over $200 million (including about $15 million AEC barter), or about an eightfold increase over the FY 1964 level.

MISCELLANEOUS ACTIONS

During the past several years, the Department of Defense has given continuing attention to improving IBP reporting and management control procedures in an effort to supplement and enhance the various specific balance of payments policies. Some examples are as follows:

1. In FY 1964, Department of Defense implemented a revised system for recording and reporting Department of Defense expenditures and receipts entering the IBP. During FY 1967 these reporting procedures were further refined.

2. The Secretary of Defense has assigned balance of payments expenditure and receipt targets to various components of the Department of Defense. These targets which reflect approved actions, provide useful bench marks from which to measure Department of Defense balance of payments efforts.

3. As part of the actions and studies undertaken in April 1967, a Department of Defense-wide review of IBP procurement actions and related accounting is underway. These reviews serve to emphasize the need for continuing attention by activities to current IBP procurement policies and to help assure that IBP accounting reports accurately identify and report properly the impact of Department of Defense expenditures entering the IBP.

4. Specific procedures have been included in annual budget reviews which call for the identification of IBP impacts resulting from alternative budget decisions. International balance of payments implications also are required to be submitted for review in connection with basic budget estimates for construction, procurement and research, development, test and evaluation appropriations.

THE OUTLOOK FOR 1968

The Department of Defense balance of payments program will receive continuing attention during CY 1968 in keeping with the President's Message on Balance of Payments of January 1, 1968. This emphasis will rest in part on the significent number of policies and practices already in effect which serve to hold down, and, where feasible, reduce Department of Defense expenditures entering the IBP. In addition, the IBP Action and Project List, issued in April 1967, sets out for examination additional proposals where there was some possibility of additional IBP savings and/or the need for renewed attention. Decisions on some of the proposals, as noted above, already have been made. Other items on the project list still are under study and favorable decisions in 1968 on certain of these longer-term items may provide additional IBP benefits in the future. In addition, Department of Defense is examining other proposals with a view to reducing further the IBP costs of personal spending by U.S. forces and their dependents stationed in foreign countries, particularly in Western Europe.

In Western Europe also, it is anticipated that these actions will be supplemented by the previously announced planned redeployment of approximately 35,000 U.S. military personnel from the Federal Republic of Germany during CY 1968, with some associated reductions in foreign national employment. This action, based on current plans, will serve to reduce Department of Defense IBP costs by about $75 million at an annual rate, although substantial IBP savings are not anticipated until the first half of CY 1969. In SEA, the current outlook is for a smaller increase in expenditures as compared to the increases experienced in 1966 and 1967.

Overall, with respect to Department of Defense IBP expenditures, based on present programs and strength levels, significant new savings will be more difficult to achieve. As a result of past efforts, the "easy" reductions have long since been made. For example, under present circumstances the Department of Defense already appears to have reached the borderline, in the procurement area in terms of IBP savings/budgetary cost tradeoffs.

The Department of Defense also will continue to take all steps feasible within existing policies which would serve to increase receipts. Nevertheless, it is currently anticipated that there will be a reduction in Department of Defense cash receipts in CY 1968 below FY 1967 levels. In this respect, however, Department of Defense data exclude special purchases of securities by other countries and these purchases are expected to be substantial in FY 1968 and CY 1968. For example, as previously announced, the Bundesbank (FRG) has agreed to purchase in FY 1968 $500 million in U.S. medium term securities to ease the net IBP impact of stationing U.S. forces in Germany. There may be other actions of this nature which also represent a departure from the more traditionally military offset approach. Although these actions would be of benefit to the U.S. balance of payments during this period, they would not be reflected in Department of Defense receipts data. The Department of Defense is participating with Treasury and other U.S. Government agencies in these efforts.

U.S. DEFENSE EXPENDITURES AND RECEIPTS ENTERING THE INTERNATIONAL BALANCE OF PAYMENTS,[1] FISCAL YEARS 1961–67

[In millions of dollars]

	Fiscal year						
	1961	1962	1963	1964	1965	1966	1967
Expenditures:							
U.S. forces and their support:							
Expenditures by U.S. military, civilians and dependents[2]	$789	$775	$815	$879	$956	$1,121	$1,256
Foreign nationals (direct and contract hire)	366	396	438	425	408	438	525
Procurement:							
Major equipment	62	67	76	92	78	87	146
Construction	157	122	101	94	105	256	396
Materials and supplies (includes POL)[3]	562	597	547	474	415	527	642
Operation and maintenance (other)[4]	------	------	------	418	400	491	695
Other payments[4]	516	517	536	184	174	213	270
Subtotal	2,452	2,474	2,513	2,566	2,536	3,133	3,930
Military assistance program:							
Offshore procurement	155	122	161	118	75	53	29
NATO infrastructure	105	36	90	61	34	50	53
Other	52	64	67	58	59	54	44
Subtotal	312	222	318	237	168	157	126
Net change in dollar purchased foreign currency holdings	−2	+13	−6	−8	+1	+12	+25
Total expenditures	2,762	2,709	2,825	2,795	2,705	3,302	4,081
Receipts:							
Cash receipts[5]	319	899	1,394	1,204	1,253	1,060	1,566
Barter	------	------	------	23	69	139	204
Total receipts	319	899	1,394	1,227	1,322	1,199	1,770
Subtotal	2,443	1,810	1,431	1,568	1,383	2,103	2,311
Other expenditures (AEC and other agencies included in NATO definition of defense expenditures)	343	273	250	136	95	50	28
Net adverse balance (NATO definition)	2,786	2,083	1,681	1,704	1,478	2,153	2,339

[1] Data differ somewhat from data on the defense account shown in the Department of Commerce publication, Survey of Current Business. Commerce data exclude, on payments side, small amounts representing retired pay, claims and grants, and net changes in DOD holdings of foreign currencies purchased with dollars. On receipts side, Commerce data exclude military sales through commercial channels and barter. These data are included in Commerce accounts under other entries.

[2] Includes expenditures for goods and services by nonappropriated fund activities.

[3] Beginning with fiscal year 1964, data for materials and supplies include only expenditures for O. & M. supplies and stock fund purchases.

[4] Beginning with fiscal year 1964, "Operation and maintenance (other)" includes all O. & M. payments not included elsewhere and "Other payments" includes expenditures for retired pay, claims, research and development, industrial fund activities, etc.

[5] Cash receipts data include primarily: (1) Sales of military items through the U.S. Department of Defense; (2) reimbursements to the United States for logistical support of United Nations forces and other nations' defense forces; and (3) sales of services and excess personal property. They do not include estimates of receipts for military equipment procured through private U.S. sources, except where these are covered by government-to-government agreements, and data are available, i.e., FRG, Iran, Italy, and Saudi Arabia.

Mr. DANIELIAN. Worldwide expenditures of the Department of Defense went up from $2.8 billion in 1965 to $3.4 billion in 1966; to $4.1 billion in 1967; and so there has been an increase of $1.3 billion between fiscal 1965 and fiscal 1967. This is as of June 30. I think in the second half of the year, it probably went even further up.

Mr. REUSS. My time is about to expire. If, after everyone has had an opportunity, I can seek recognition again, I would ask you whether in your judgment, and given our military strategy, which is not the job of the Banking and Currency Committee to discuss, we have done everything that we could have done in order to reduce the balance-of-payments impact of our military expenditures abroad?

I will defer that question because my time is up. Thank you, Mr. Chairman.

Mr. BARRETT. Mr. Halpern.

Mr. HALPERN. Dr. Piquet, would you not evaluate the President's proposals differently, depending upon whether they are regarded as short-term or long-term measures?

Mr. PIQUET. The short-term versus long-term approach can become a trap. The newly imposed controls on foreign investment are intended, to be short term. And, it is probable that they will be repealed after the balance-of-payments deficit figure improves substantially.

With respect to restrictions on tourism, I think that whatever restrictions are imposed will be removed at the earliest possible moment. A more serious danger lies elsewhere. There are at present tremendous pressures for the imposition of import quotas, border taxes, and for remission of taxes on goods exported, all in the name of cures for the balance-of-payments deficits.

Imposition of a system of import quotas would be at direct variance with the trade policy followed and advocated by the United States for the past 34 years. It would be inconsistent with the tariff reductions made in the recent Kennedy round and in violation of the obligations assumed under the General Agreement on Tariffs and Trade. The violation would be particularly significant inasmuch as the United States has been the leader in the liberal trade movement over the past three decades, and was the leader in establishing the GATT itself.

Certain controls can be removed quickly, while others cannot. Import quotas are in this latter category. So, I think the danger is a very great one.

Mr. HALPERN. How would you evaluate the necessity of a domestic tax increase in terms of its importance in strengthening our international position?

Mr. PIQUET. The proposed tax increase?

Mr. HALPERN. Yes. How would you evaluate the necessity of a domestic tax increase in the terms of its importance in strengthening our international position?

Mr. PIQUET. The present proposal for a surtax has become so highly political that I, as one of your professional advisers, do not feel I should comment on the political side of it. But I would generalize that tighter control of the Federal budget, either by way of tax action and/or by way of curtailment of expenditures is a must.

Mr. HALPERN. In other words, you feel something must be done?

Mr. PIQUET. Yes. We must move in the direction of living within our means.

I do not believe that the Federal deficit—or the Federal debt—is a bad thing, in and of themselves. But, monetization of the debt is dangerous for, instead of taking money out of the pockets of taxpayers and/or bond purchasers, the bonds are sold to the Federal Reserve and then used as a basis for money and credit expansion.

Mr. HALPERN. Now, one further question: Do you really think in practical terms that there is much likelihood that merely by announcing that we may not buy gold at the same price at which we will sell it, the price of gold would push downward below $35 an ounce, when it has for so long been pushing up in the other direction?

Mr. PIQUET. This is a question that economists themselves do not agree upon. Some believe the price of gold would rise because there would be a scramble for it, while others think it would do the precise opposite. This is something that cannot be forecast.

My own opinion is that the guarantee price of $35 per ounce of gold on the part of the United States is such an important reason for the price of gold remaining at that level that if the United States announced that it was no longer going to guarantee in the future to purchase at that price all gold presented to it, it would be tantamount, in the long run, to demonetizing gold and that the value of gold, relative to the dollar, would decline. This is an opinion; I cannot prove it.

Mr. HALPERN. Thank you.

Mr. BARRETT. Mr. Moorhead.

Mr. MOORHEAD. As I understand your proposition, Dr. Piquet, it is that we should continue to prop up the dollar with gold but we should no longer prop up gold with the dollar?

Mr. PIQUET. Precisely.

Mr. MOORHEAD. Now, Mr. Danielian, as I understand it, on what I call legal, as opposed to economic, at least, you do not go along with Dr. Piquet's proposition, because you believe that it is blocked by our participation in the IMF. I would like to ask you, sir; as an economist, if the lawyers should tell us that we could legally adopt Dr. Piquet's suggestion—in other words, forget the IMF for the moment—just as an economist, would you then approve of Dr. Piquet's suggestion?

Mr. DANIELIAN. Yes; provided we find some means of either controlling our deficits or having these other countries buy our obligations so we can continue doing some of the things around the world that may be necessary for our security. To do that, and then not be able to finance our activities abroad, may push us back as I said, into the fortress America concept.

If we cannot keep our deployment in the Pacific or in the near East, in different parts of the world, we may gradually have to retrench, as the British have had to retrench. So I agree wholly with Dr. Piquet. As Mr. Martin said, we mustn't allow this barbaric metal to rule our lives; but, on the other hand, we have to find means of financing the things we want to do abroad.

So, with that reservation, I would go along with him.

Since a good deal of the discussion has revolved upon this point, I would like to read two provisions of the IMF articles that may be relevant.

In article IV, section 1, it says "the par value of the currency of each member shall be expressed in terms of gold as a common denominator, or in terms of the U.S. dollar of the weight and fineness in effect on July 1, 1944"—which is $35 an ounce.

Article VIII, section 4, on convertibility of foreign held balances: "Each member shall buy"—it doesn't say may buy—"balances of its currency held by another member, if the latter, in requesting the purchase represents that the balances to be bought have been recently acquired as a result of current transactions; or that their conversion is for making payments for current transactions. The buying members have the option to pay either in the currency of the member making the request, or in gold."

When you have excess dollars in the hands of countries, that they present for payment through IMF, or directly, you have to pay the par value indicated by article IV.

Mr. MOORHEAD. I think we are getting into a very technical discussion here. It would be impossible to argue the construction of the IMF agreement in this open hearing, but I think it is extremely significant that we have a legal memorandum submitted to us saying whether or not this suggestion is legal, because I think both after Mr. Reuss' statement and the silence of the committee, the committee is certainly interested in this thing. But if we are blocked by an international agreement, we might as well dismiss the idea.

Mr. BARRETT. Would the gentleman yield?

Mr. MOORHEAD. Yes.

Mr. BARRETT. Mrs. Sullivan asked to insert the very same thing in the record at the time Mr. Piquet spoke on the subject.

Mr. MOORHEAD. Dr. Piquet, could you submit a memorandum?

Mr. PIQUET. The pamphlet I referred to by Dr. John Parke Young goes into this at great length, and it is going to be in the record.

Mr. MOORHEAD. Does it reach the——

Mr. PIQUET. That we are not bound to buy the gold. That is an interpretation.

Mr. MOORHEAD. Then, Dr. Danielian, would you read that article and submit a memorandum showing where you think it is in error, because there seems to be a dispute over the construction of this agreement, and it seems to me we could resolve the question pretty quickly.

(The information requested follows:)

INTERNATIONAL ECONOMIC POLICY ASSOCIATION,
Washington, D.C., February 1, 1968.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency, U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: When I appeared before the House Committee on Banking and Currency on Tuesday, January 30, 1968, I called attention to the fact that the Articles of Agreement of the International Monetary Fund require the United States to redeem its currency from member governments for gold in certain circumstances. Attention was directed to a monograph by John Parke Young with the indication that it refuted my contention.

The monograph in question is *United States Gold Policy: The Case for Change*, No. 56 in the Princeton University Essays on International Finance, published in October of 1966. I have carefully reviewed this monograph. Its purpose is to demonstrate that the United States need not continue its policy of freely buying and selling gold at $35 an ounce. It suggests the United States could stop doing so and meet its obligations to the International Monetary Fund in the same fashion as do all other members, that is, by undertaking to maintain the parity of its currency with that of all other members within a margin of one point by redeeming dollars in the other country's currency. Under conditions of balance of payments deficits, the United States presumably would not have sufficient quantities of other countries' currencies. Therefore, it must pay in gold. This is what has been happening.

Mr. Young does not contend that this is not obligatory. At page 13 of the monograph, he concurs that the United States may be required to redeem dollars from other members either for their own currency or gold under Article VIII, Section 4 of the IMF Articles of Agreement. He also states, at page 30, that the United States may be required to buy gold from the Fund under Article VII, Section 2ii, of the same Articles.

Mr. Young's monograph confirms, rather than refutes, my contention.

Sincerely yours,

N. R. DANIELIAN,
President.

Mr. MOORHEAD. Did I understand you to say that you opposed the restrictions on travel and investment which the President announced on January 1, or only that you opposed them if this was to be a continuing thing?

Mr. PIQUET. It was stated by the people who are on the inside, that the heat that was anticipated would be so great when the figures of the fourth quarter were announced that "The President had to do something." That is one way in which it was put to me. Others, on the other side of the fence, however, put it differently, saying that "Somebody pushed the panic button." In view of all that has been said here this morning, it seems to me that the restriction of new direct private foreign investment and of travel by Americans abroad are, to use a football analogy, "off side."

Mr. MOORHEAD. Thank you, Mr. Chairman. My time has expired.

Mr. BARRETT. Mr. Clawson.

Mr. CLAWSON. Thank you very much, Mr. Chairman.

Mr. Piquet, in your presentation, or at least in the discussion since I have been here, and I am sorry I was not present for your presentation, you have talked about the mystical atmosphere in which gold is considered.

Mr. PIQUET. The atmosphere?

Mr. CLAWSON. The atmosphere surrounding gold, as mystical.

Mr. PIQUET. Yes, a sort of "mystique."

Mr. CLAWSON. I have difficulty, personally, separating this confidence you say is necessary from gold. We do not have your expertise and sophistication in this field. The majority of us, and I think this may be true of the foreign countries—and our constituents have problems in separating confidence and gold, when talking about confidence in the dollar.

Would you subscribe to that point of view?

Mr. PIQUET. If you ask certain economic advisers to American banks that question they will say that gold provides the basis for confidence in the dollar. If you talk to other advisers in other banks they will tell you precisely the opposite, that confidence in the dollar rests not upon gold, but upon confidence in its purchasing power and stability.

I don't think there is an objective answer to your question. It is a matter of belief. I have the feeling that the dollar is the basic currency in the world, not only the reserve currency, but also the vehicle currency, just as the pound sterling was during the 19th century. The vast majority of all international transactions are conducted in terms of dollars, not gold. Even in international settlements, dollars are used as well as gold.

Mr. CLAWSON. Let me ask you this question: supposing we do not take action on this legislation——

Mr. PIQUET. Don't take action on removal of the gold cover?

Mr. CLAWSON. That is right. Just let nature take its course. What would be the result?

Mr. PIQUET. It would mean that we would continue to sit on a pile of inert gold and refuse to allow it to support continuation of the present international monetary system. It must be understood that any system of international money—any system, including the gold standard, the old pound sterling standard, the dollar-exchange standard or some system of drawing rights—will break down if the major countries involved are not willing to obey the rules of the game. The gold standard can be wrecked if important countries hoard too much gold.

Short of a system of world government, short of a world economy, similar to the national economy of the United States, within which there is free movement of goods and services, and in which prices are allowed to adjust to each other, any device, or any system that we can dream up, whether it be based on gold, dodo bones, or paper can be wrecked if the people—if countries—don't abide by the rules of the game.

Thus far, there has been no major deviation from the rules of the game as far as the dollar-exchange standard is concerned.

Mr. CLAWSON. Is this because of the gold?

Mr. PIQUET. I would say, regardless of gold.

Mr. CLAWSON. Regardless of gold?

Mr. PIQUET. And I think, as Prof. Charles Kinderberger pointed out in a very interesting recent pamphlet in the Princeton international finance series, that the reason why the dollar has come to be the vehicle and reserve currency of the world, is comparable to the reason why English has come to be the world's dominant language because there are so many Americans carrying on transactions everywhere.

Mr. CLAWSON. What difference does it make whether or not we continue to redeem these dollars with gold, and why not just forget the gold?

Mr. PIQUET. I don't think we would gain anything by making an abrupt decision that we are going to throw gold overboard. Let's use it while we have it. If the present system is working, why not let it continue to work?

Mr. CLAWSON. Until it runs out, or falls down?

Mr. PIQUET. Yes, until a real danger point is reached. We have a lot of gold, $12 billion of it. If there were a determined attempt on the part of other countries to wreck the present system they have the power to do so. I doubt if they will do so because they stand to lose as much by such action, if not more, than we.

Mr. CLAWSON. In connection with this, isn't it a fact the priorities of the President's balance-of-payments program and its concentration on direct investment is essentially what most European central bankers hope we would do, because of their more or less discomfort over the cold wind of competition from the U.S. technology?

Mr. PIQUET. When it comes to appraising the feelings and motives of others we are on thin ice. I certainly would not take all of their statements at face value. Self-interest, pride, and sometimes unconscious patriotism play a part. I remember when I was in Canada some years ago and purchased something in a department store. This was at the time when the Canadian dollar was selling at a premium relative to the U.S. dollar. The clerk who accepted my money was gleeful over the fact that, for the first time in his memory, the Canadian dollar was worth more than the U.S. dollar.

There may be some such pride in what the Europeans are telling us to do now. We have been very free in our advice to them, particularly in the early days of the Marshall plan. Now that they are prosperous again, and the United States is encountering difficulties in its balance of payments, some of them get a psychological kick out of telling us what to do. I am not so sure but that if I were in their position I might not feel the same way, in view of the ubiquitousness of Americans in European industry and commerce.

My own personal observation in France and England has been that, in spite of what they say, they are anxious to have American capital invested in their countries. What troubles them most is that Americans so often go with the capital. They would prefer to have the capital without the Americans.

Mr. CLAWSON. I would like Mr. Danielian also to respond to that same question, if you will.

Mr. DANIELIAN. I have looked into this problem on many trips to Europe. In fact, beginning with 1960, during the tax debate of 1961 and 1962, it was quite obvious that Finance Ministers of European countries—this is a matter of record, Mr. Dillon put the information into the record—Finance Ministers of the Common Market countries insisted that the United States control direct investments in Europe.

In 1963 I went to Europe and visited with many central bankers—bankers, businessmen, Finance Ministry people, and Foreign Ministry people—and there was complete unanimity on these thoughts. U.S. balance-of-payments deficits are due to U.S. investments in Europe, and to correct that, the United States must control the U.S. investments.

At that time, the banking opinion was still undecided, whether or not they should put the squeeze on. They were considering in what way they could bring discipline into U.S. behavior. This past summer I was there again, inquiring into this problem, and this time it had gotten beyond the policy sphere into public opinion. The businessmen and publications, and so on, have all been arguing for curtailment of U.S. investments. They are now hopeful that we can work out some new partnership with them whereby they can join in the ownership of U.S. industries.

I do not believe that it is a mere coincidence that as a result of discussions in Basle, and on this, of course, Mr. de Gaulle has been in the forefront of this theory, in relation to U.S. investments, I don't think it is mere coincidence that the first and most severe measures were taken against U.S. direct investments as a result of this gold crisis. Does that answer your question?

Mr. CLAWSON. Well, at least, we have some variation of opinion. Thank you.

Mr. BARRETT. Mr. Hanna.

Mr. HANNA. Mr. Chairman, may I say for the record that I count myself quite fortunate to have been present this morning, to have heard the presentation of these two gentlemen. I think you have made one of the most valuable contributions that this committee has received.

I am particularly struck—and you correct me if I am wrong—by the fact that the message that you gentlemen have been bringing to us is that we ought to have a positive policy toward our position in terms of gold and the dollar, and the balance of payments, and we should not merely react, we should have our own positive policy and it should be based upon an intelligent understanding of what our situation really is.

Now, isn't that what you have been trying to tell us?

Mr. PIQUET. I would agree; yes.

Mr. DANIELIAN. I believe so; we even wrote a whole book on the subject, and I hope it will be read.

Mr. HANNA. I concur wholeheartedly, and I think that is the position of the committee.

It would seem to me that from what you two gentlemen have said, that in some respects the problem is a problem of discipline which occurs in any activity of mankind, of maintaining a proper balance between the ingredients that are in action. It seems to me our deficit right now is something like a problem of cash flow in a business activity. That it would seem to me that the President's program is only correct if it is reasoned on the basis of adjusting the investments abroad and the expenditures abroad so that we do have some sensible cash position or cash flow in terms of what our responsibilities are for short-term imbalance.

Is that not correct?

Mr. PIQUET. I think so.

Mr. DANIELIAN. I don't consider the balance-of-payments problem a short-term one. This has been one of the fundamental mistakes that has been made since 1960.

Mr. HANNA. Do you think that the United States could maintain a long-term position of either surplus or perfect balance?

Would you answer that question?

Mr. DANIELIAN. It depends on the amount of noncompensatory expenditures we have abroad. I don't think we can do it in the range of $10 million a year. On the other hand, I think we have means of earning more money abroad with harder bargaining on many fronts, like the agricultural front, for instance.

We practically gave up our agricultural interests in the Kennedy round of negotiations, and there are many other areas in which we can really work hard and earn more money. I don't think we can do it through exports. I don't think we can equalize the $4 billion deficit through exports alone.

Mr. HANNA. I don't think it would be healthy for us. I think that would be very unhealthy. But what I am trying to ask is, can the international trade actually support a position of the United States of perfect balance of surplus? Where will the liquidity come from, if we maintain that position over a period of 3 years? Would either one of you care to comment on that?

Mr. PIQUET. I would say that, up to now, the U.S. balance-of-payments deficits have been caused by the desire of the foreign recipients of dollars to keep them in the form of deposits, investments, and monetary reserves in preference to spending them on goods and services in the United States. It is possible, if not probable, that if the Vietnam war comes to an end soon, we shall be holding hearings on Capitol Hill on a "dollar shortage," as we were doing 20 years ago.

A major difficulty is that there is no direct connection between the amount of dollars being pumped into the world and the need for those dollars as reserves. Either a glut or a shortage of dollars is bad. In other words, it is not a true international system, and it is certainly not as desirable as some international system would be that would adjust the supply of vehicle and reserve currency to the need for it.

Mr. HANNA. Then you lead right into my final question, which is this: Regardless of what steps we take in this problem of balance of payments right now, it is my persuasion we ought to utilize those steps to get the European cooperation for a viable alternative to the dollar.

Mr. PIQUET. Yes; but we shouldn't be so anxious to do this that we give the impression that our own dollars—our I O U's—are not good. We should be anxious to cooperate with the Europeans, but since they are the creditors and we are the debtor, it is hardly up to us to insist on some other system. We probably have taken too much leadership along this line already. We say so much that we run the risk of ourselves undermining confidence in our own I O U's. But we should always be ready to cooperate.

I am in favor of a Triffin plan for a World Reserve Bank for, believe me, when we have that, we shall also be close to world peace.

Mr. DANIELIAN. I think we are confusing three different problems. One is the problem of liquidity, which is a means of settling differences in balance of payments between nations of a short-term nature.

Second, the need of the United States and Great Britain for tremendous amounts of external resources to carry on political and military operations.

Third, foreign-aid requirements of underdeveloped countries. And there is a tendency in this country to lump them all together under the generic term of "liquidity."

Liquidity, as some lady defined it, is the ability to pay your bills while you do not have the money.

Well, that may be all right for a little amount, but when it comes to billions and billions of dollars, we just aren't able to find the people who are going to finance it. So we have to find ways of transferring the amount of resources necessary to carry on the politically motivated expenditures; and you cannot depend upon the private economy to do it. This can be done in actually transferring the resources from here to there—and this is why we have come out recommending, buy American, in foreign aid, for instance, which was opposed in 1961, and now it has become very fashionable. And that is why we think that, for instance, the Europeans should pick up the tab on the maintenance of our troops for their security.

In other words, you either accomplish these things by physical transfer of resources from the United States to other countries, or you get other countries to accept a share in the payment of these expenses; and you cannot do it through dependence upon the private economy.

Mr. BARRETT. The time of the gentleman has expired. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman. I have been so interested in the general discussion that I haven't any specific questions at this time. However, I would like to inquire of the chairman, are we going to continue with these witnesses later on, or did you intend this morning would be the termination?

Mr. BARRETT. We will have witnesses tomorrow, but they will be different witnesses.

We will certainly miss these two gentlemen. They have been very edifying.

Mr. BROWN. I want to take my time to thank you for your appearance, and when Mr. Bingham completes his questions, I might have one or two.

Mr. BARRETT. If you desire, you may ask questions in writing, and I am sure the two gentlemen would be glad to answer them for you. Mr. Bingham.

Mr. BINGHAM. Thank you. I, too, have no questions at this time. But I would like to thank the witnesses for their testimony.

Mr. BARRETT. Thank you, Mr. Bingham. Mr. Reuss.

Mr. REUSS. Thank you, Mr. Chairman.

Because the House is now convening, if agreeable with you, Dr. Danielian, would you be kind enough to answer in writing a question which I propounded to you just a few minutes ago, which I will rephrase as follows:

Would you indicate any way in which the United States could have, or still can reduce its balance-of-payments losses on our foreign military posture in Europe and Asia, without interfering with the size of that military posture? In other words, obviously, anyone can figure out brilliant means of cutting our balance-of-payments deficit by coming home from Vietnam, bringing troops home from Europe, and so on. But my question is, given the quantum of our military posture, can we do more, or could we do more, to minimize the balance of payments?

Mr. DANIELIAN. I am flattered by the confidence you have shown in me in asking this question. But I am wondering whether the Secretary of Defense would not be a better source of information on this subject.

Mr. REUSS. Well, if you are satisfied that we are doing everything to minimize the balance-of-payments impact of our foreign military stance, so indicate; if you think there are things we could be doing that we aren't doing, indicate that.

Mr. DANIELIAN. I will try my best.

(The information requested follows:)

INTERNATIONAL ECONOMIC POLICY ASSOCIATION,
Washington, D.C. February 2, 1968.

Memorandum for: The Honorable Wright Patman, Chairman, Committee on Banking and Currency, U.S. House of Representatives, Washington, D.C.
Subject: How to reduce the balance of payments impact of military expenditures in Europe and Asia.
From: N. R. Danielian, President.

At the end of the hearings on the gold cover legislation on Tuesday, January 30, 1968, Congressman Henry Reuss requested our views as to ways and means of reducing the balance of payments impact of U.S. military expenditures in Asia and Europe without reducing the size of our commitment. We take this to mean without reducing the number of our troops. This sets up a pretty difficult target to reach.

The Defense Department has undertaken since 1961 many actions designed to reduce the balance of payments impact of our military expenditures abroad. In spite of this, however, they estimate the foreign exchange costs in Fiscal 1967 to total $4.1 billion, of which Western Europe accounted for $1.5 billion and Asian countries, $1.7 billion. In the case of Western Europe, in spite of all actions taken by DOD, there was hardly any material reduction in total foreign exchange costs between 1961 and 1967. In Asian countries, on the other hand, these expenses went up by over a billion dollars, most of the escalation having taken place between 1964 and 1967, from $600 million in 1964 to $1.7 billion in 1967. It is not unlikely that the foreign exchange costs of our operations in the Far East will be even larger in Fiscal 1968.

89-292—68——15

WESTERN EUROPE

Our military expenditures in Western Europe are mostly in the context of the NATO common defense commitments; about half—between $700 and $800 million—in Western Germany.

The Department of Defense has undertaken many activities in Western Europe to reduce these foreign exchange costs in amount. The principal ones have been: first, offset procurement of defense equipment by Germany, and, more recently when Germany declined to continue these offset purchases of military hardware, in the form of the purchase of $500 million in U.S. medium-term securities in Fiscal 1968. An attempt is now being made to continue these arrangements to offset or immunize these military expenditures as an immediate claim on gold. News reports from Bonn seem to indicate that the German Government is not disposed to buy long-term bonds from us.

The sale of Treasury securities to the German Government which may in the future still be converted into gold is not an adequate or wise means of meeting the costs of stationing U.S. troops in Western Europe. It is not an offset against these expenditures, but is simply mortgaging the future and it does not directly ease our balance of payments deficits and the claim on gold.

It seems to us that our Western European presence, within the context of the NATO Alliance, is a collective security arrangement, and, therefore, the cost must be shared in an arrangement which would eliminate the impact on the U.S. balance of payments. The United States contributes to this collective security not only its troops in Europe, but also the total military capability of the United States, as expressed in our total military budget. Generally, this country is allocating 10–12 percent of its gross national product for defense, as compared with 5–6 percent in most Western European countries. The assumption of the foreign exchange cost of our troop presence in Germany and other NATO countries, equitably divided, would add but a fraction to their military budget. The problems that have been raised are political, rather than the capacity to pay. The objections from European countries have been the tax burden, the limits on their military budget, and the public relations aspects of paying for the presence of U.S. troops in their midst. These objections may be overcome if the NATO Alliance could develop either of two alternative approaches: First, procurement of goods and services in the United States in the equivalents of our miiltary expenditures, making sure that such procurement will be in addition to their normal purchases in the United States; or a lend-lease concept of paying military costs within the NATO Alliance where each country would contribute the local national costs of troop presence.

We realize that there are situations such as Spain where we have a bilateral arrangement in exchange for bases that may make this kind of sharing of costs more difficult.

ASIA

The situation in Asia, particularly the larger part of the costs relating to Vietnam, differ from those in Europe, first, because they are not being made in the context of a formal mutual defense agreement, and, secondly, because the economic base of the countries involved could not afford to support the activities which we have undertaken. On the other hand, most of those countries are dollar-deficit countries and they are in need of growing amounts of imports from the United States. Hence, it should be possible to make specific arrangements with countries like Japan, the Philippines, Republic of China, Thailand, and South Korea to increase their procurement in the United States on a current basis with the accretion of dollar reserves due to military expenditures. This would require payment in block dollars in American banks acceptable for U.S. procurement upon specific administrative arrangements, assuring additionality of imports from the United States over a base period.

Although the question posed to us did not specifically encompass the defense-support grants to South Vietnam, which amounted to $584 million in 1966 and over $2.5 billion total for the period 1953–66, this is widely recognized as one of the more conspicuous forms of dollar drain. The use of these grants in the later years to fight inflation due to military expenditures by means of massive import programs is a strange way of managing what should be essentially a mobilized war economy. Many congressional investigations and reports have been critical of this program as wasteful and hurtful to our balance of payments. It would seem to us that a better system of allocation and utilization of resources applicable to a wartime economy can be devised than this free-for-all import assistance program. Not being on the scene, however, we hestitate to make specific recommendations.

Mr. BARRETT. Mr. Piquet and Mr. Danielian, I certainly want to thank you. You have been very fine witnesses here this morning, and I am thanking you on behalf of the committee.

I am sure they all appreciate the very fine dissertation you gave here this morning.

Mr. DANIELIAN. Would you allow the record to show the appearance of Mr. William Moran, my executive director and vice president of our organization, as a member of the panel—because he has been advising me on this testimony.

Mr. BARRETT. Yes, sir; that may be done, without objection, and so ordered.

Thank you, gentlemen, for being here, and the committee will stand in recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:05 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, January 31, 1968.)

REMOVAL OF GOLD COVER

WEDNESDAY, JANUARY 31, 1968

House of Representatives,
Committee on Banking and Currency,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman, chairman.

Present: Representatives Patman, Barrett, Moorhead, Hanna, Annunzio, Rees, Galifianakis, Widnall, Fino, Brock, Stanton, Mize, Blackburn, and Brown.

Mr. Barrett (presiding). Our first witness this morning will be Mr. W. B. Hicks, Jr., executive secretary of the Liberty Lobby.

Mr. Hicks, would you please come forward? You may read your statement and be questioned afterward, or if you desire to give a summary and then be questioned, you may do so. Any way you choose.

We do want you to feel at home here this morning, to feel as though you are a member of this big family. So whatever way you choose to make your presentation, we will abide by it.

STATEMENT OF W. B. HICKS, JR., EXECUTIVE SECRETARY, LIBERTY LOBBY; ACCOMPANIED BY MICHAEL JAFFEE, GENERAL COUNSEL

Mr. Hicks. Thank you, Mr. Chairman.

I am W. B. Hicks, Jr., executive secretary of Liberty Lobby. At my left is Mr. Michael Jaffee, our general counsel.

I am here to present the views of our board of policy, on behalf of the 170,000 subscribers to our monthly legislative report, "Liberty Letter."

Our board of policy consists of approximately 11,000 volunteers who live in every State and practically every city and town in America. They vote annually on the general positions to be taken by the Washington staff of Liberty Lobby. We attempt to carry out their wishes by analyzing significant legislative proposals to see how they affect the positions voted on by the board; and then by appearing before congressional committees to support or oppose the specific legislation.

To complement our activities in Washington, we carry out grassroots information campaigns both through our monthly newsletter and by other means, to arouse public support or opposition for legislation.

In the case of the proposed repeal of the gold cover requirement on Federal Reserve notes, our Washington staff has decided that in order to carry out the positions voted on by our board of policy, we must oppose the passage of the legislation in its present form.

Our opposition is predicated on the adverse effects that we think the legislation will have on the national security and the power of the United States in future crises, both military and economic.

Our basic position is this: We, as a nation, must act to prepare ourselves for whatever is to come. This is, or should be, the first duty of our Government.

Regardless of the form of future crises—whether they be food shortages caused by draught or disease, or sudden failure of the economy, or a military confrontation—our Nation will need gold to meet the crisis. Gold that we will not have, if we go on following our present course.

Can it be denied that we are presently under pressure to sell our gold to foreign claimants? No. And if the proposed legislation is passed in its present form, freeing our last remaining gold for shipment abroad without legislative restriction, can anyone point to a factor that will definitely prevent the loss of all our gold? We have searched in vain for it.

It is true that responsible spokesmen have assured us that they would never allow that to happen. But have they said at what point in the decline of our reserve they would act to stop further gold sales? Is it not true that, no matter how pressing the need to embargo the foreign shipment of gold at some point in the future, it would require an act of determination and political courage far beyond that which we should expect of political appointees and bureaucratic advisers to the administration?

Is it not more likely that, if this legislation is passed as presented, some future administration will allow our gold reserve to fall below the safety point, even inadvertently?

And, what is the safe level below which our reserves should not be allowed to fall? How much gold would be required to import food for the American people for a 2- or 3-year period, should our own production fail for any reason? Certainly, we should always maintain that amount of gold in a strategic gold reserve, no matter how pressing other demands for it may appear to be.

We are proposing that a study be made of our Nation's future need for gold as a strategic resource; that a determination be reached of the minimum number of ounces of gold that we should maintain as a strategic gold reserve, separate and apart from any monetary reserves; and that such a reserve be established by law, before releasing our domestic monetary reserves for foreign shipment.

We feel that it is necessary to set up the new strategic gold reserve before releasing our domestic reserve for a very vital and compelling reason: it is certain that, once our gold has been "freed" for foreign claims, to attempt to reclaim it for any reason would set off a run on our reserves. Congress would not be able to legislate a recovery of any amount of gold from our monetary reserves in time to accomplish the purpose of the legislation. The gold would all be gone before the President could sign the act into law.

Therefore, we urge this committee to delay the release of our domestic monetary reserve into the foreign claims reserve until the committee has called for testimony from economists and military experts on the subject of setting up a strategic gold reserve that will assure the Nation of the ability to survive future crises. Then, when this much of our gold supply has been earmarked and withheld by law from monetary uses, Liberty Lobby's attitude toward this proposed legislation would be altered.

But we cannot overemphasize the fact that the Congress will have but one opportunity to take this necessary action. Once the Congress relinquishes its last legal control over our remaining gold, future considerations of a strategic gold reserve will be academic, unless we are prepared to buy back the necessary amount of gold at a price twice that for which we sold it. Why must we burden ourselves needlessly in the future, when by foresight, we can avoid it?

Thank you.

Mr. BARRETT. Thank you. Two short questions. Which does your committee consider the stronger, the dollar or the gold?

Mr. HICKS. Well, I believe that probably a majority of our supporters would feel that gold is stronger in the sense in which it is commonly presented; I would have to say personally that I think the dollar supports itself, basically, on the productivity of the Nation.

Mr. BARRETT. May I just continue this a little further then. You say at the time it is presented. What element of time, now, are you characterizing that may be presented to be stronger?

Mr. HICKS. I am afraid I don't understand the question, sir.

Mr. BARRETT. Well, I asked, which do you think is the stronger, gold or the dollar, and you said gold, but you think it would be at the time that it is presented.

Mr. HICKS. Oh, I think I failed to make myself clear.

What I said was, I believe a majority of the supporters of Liberty Lobby would say the answer to that question is simply that gold is stronger than the dollar. I think this is an unarguable concept, looking at it from one point of view, but I, for one, do not believe that if the dollar were disconnected from gold that it would cease to serve as the major currency of the world.

Mr. BARRETT. And still maintain its strength?

Mr. HICKS. I think as long as America has a productive economy system, the dollar will be the major currency of the world.

Mr. BARRETT. Which country today produces the most gold?

Mr. HICKS. It is my understanding that South Africa does, sir.

Mr. BARRETT. Greater than Russia?

Mr. HICKS. Yes, sir. In fact, I recently read an article on the subject of Russian gold production, which indicated that practically the entire Soviet production from one year to the next goes into foreign commerce in purchase of goods from abroad for the Soviet Union.

I understand that South Africa does produce two-thirds of the world's production annually.

Mr. BARRETT. There were statements made here last week that the United States produces 52 percent of the world gold. Would you agree on that?

Mr. HICKS. I can't imagine on what that would be based. I understand, in fact, our costs of gold production run so near to the $35-an-ounce mark that many mines that have gold in them are closed down because of this limitation on the price of gold.

Mr. BARRETT. Thank you. Mr. Fino.

Mr. FINO. Mr. Hicks, I have just one question, which came to my mind when the chairman asked you the question: "Which, in your opinion, you considered stronger, gold or the dollar?" Apparently from your answer you seemed to have some mixed feelings.

May I ask you this question: Which would you rather have, gold or a dollar in your pocket?

Mr. HICKS. No question. As I said, the concept is unarguable that gold is something that cannot be printed or counterfeited. It is real and so, therefore, gold would always be preferable to paper money.

Mr. FINO. Don't you have some fear that if we remove the lid or the restriction on this gold reserve and make it available for transaction purposes and delivery in payment of dollars that we might dissipate this reserve of $10.7 billion?

Mr. HICKS. Yes, sir.

That, in fact, is the entire thrust of our position before the committee here today. We feel that it is a certain thing if we free this for international claims, it will eventually, at some point in the future, all be gone, leaving us with no gold reserve to use for strategic purposes.

Mr. FINO. The testimony before this committee on previous occasions, more particularly, yesterday, was that the basis of this whole financial structure is confident in the dollar.

Don't you believe that there would be more confidence in the dollar if we had some gold behind that dollar, than if we did not?

Mr. HICKS. Yes, sir. I am sure of that. There would be more confidence. However, I would not like to have that interpreted as saying that I believe there would be no confidence in the dollar if there were no gold behind it.

Mr. FINO. You say there would be much more confidence?

Mr. HICKS. There would be more if it were a gold dollar.

Mr. GALIFIANAKIS. I came in a little late. I was impressed by Mr. Hicks' statement that he would prefer to have gold. Are you advocating that people begin to accumulate gold in order that they might have a measure of wealth? Are you not aware that gold was first used as a measure of value centuries ago; that gold is bulky, very difficult to carry; that gold, unlike the dollar, does not accumulate any interest; I would like for you to expand on your statement about your preference to have gold rather than the dollar.

Mr. HICKS. Well, sir, I would have to say, first of all, this is not the point of our statement.

I was asked a question here about my personal feelings on the subject, and I think if we had—theoretically, if we had a gold dollar, everyone would be more confident in the gold dollar than they would be in a paper dollar.

As far as the use of gold as money, I mean, exclusively, I think this is an impractical idea. If we did trade in gold money, then gold would earn interest, because by loaning gold you could get gold back with interest. But this is a theoretical thing and I don't see the point. I fail to see it.

The question is not, should we go to a gold dollar, in my understanding.

Mr. GALIFIANAKIS. Well, Mr. Fino asked you, if you had a preference as to what you would choose, the metal gold or the dollar, and you stated, "gold." And it leaves me a little bit awed by that kind of response.

You know, Japan and West Germany, which have become large industrial nations, didn't try to acquire gold. Their acquisition was centered around the American dollar.

Mr. BROCK. Would the gentleman yield for a second?

I think he missed the original statement of Mr. Hicks in which he was asked by the chairman of the committee, which was stronger, gold or the dollar, and he said that he probably thought the membership would feel gold was stronger, but he personally felt that the dollar was; that it was the basic unit of world reserve; and I think perhaps you misinterpreted what he was saying.

Mr. GALIFIANAKIS. I predicated my remarks by saying, I heard the latter part of it and offered the opportunity for the explanation. He admits that using gold is impractical. He stresses that that gold is necessary to preserve the confidence in the dollar.

Isn't that the very reason for removing the gold cover, to preserve that confidence we are talking about?

Mr. HICKS. I didn't say gold was necessary to preserve the confidence in the dollar. In fact, I said exactly the opposite, that confidence in the dollar would not drop to zero if there were no gold to back it up. Because the dollar essentially, today, is not backed up by gold. It is backed up by the productivity of the American economy, the credit of the United States.

However, to say that I would prefer gold to paper money is not—I don't have to apologize for saying that—I think this is a human feeling that the majority of the people throughout history of mankind have always preferred gold coins to paper currency, when it comes to preserving a store of value, basically, because the Government cannot deprive them of their value by inflating the currency.

Mr. BROWN. Would the gentleman yield?

Mr. GALIFIANAKIS. Yes.

Mr. BROWN. I would like to ask my colleague at this time about the cases of Germany and Japan to which he has referred. When they rely upon the dollar, are they relying upon the domestic dollar which has no backing; that is, the Federal Reserve note only, or are they relying on the international dollar which is backed by gold?

Mr. GALIFIANAKIS. I think they, of course, relied initially on the international dollar. They wouldn't overlook the domestic dollar and the productivity which backs that also.

Mr. BARRETT. The time of the gentleman has expired. Mr. Brock.

Mr. BROCK. I think you raised a very significant point in your testimony, and I appreciate it. I also appreciate the fact that you say that if we had a strategic gold reserve which was adequate for our military and strategic needs, that you would support this legislation. I think that is a fairly significant step you take and I am impressed with your point, and I think it is well taken. I think it should be given consideration, and I appreciate your testimony.

Thank you.

Mr. BARRETT. Mr. Moorhead.

Mr. MOORHEAD. No questions, Mr. Chairman.

Mr. BARRETT. Mr. Stanton.

Mr. STANTON. No questions, Mr. Chairman.

Mr. BARRETT. Mr. Rees.

Mr. REES. No questions.

Mr. BARRETT. Mr. Mize.

Mr. MIZE. No questions.

Mr. BARRETT. Mr. Brown.

Mr. BROWN. I would like to thank the gentleman for appearing and for presenting his statement. I have no questions.

Mr. BARRETT. Thank you.

Our next witness will be Dr. Judd Polk, economist.

Mr. Polk, would you come forward?

Mr. Polk is from the U.S. Council of the International Chamber of Commerce.

It is nice to have you, Mr. Polk. You can sit more centrally, unless you have associates with you.

Mr. Polk, it is my understanding you do not have any copies of your statement.

STATEMENT OF JUDD POLK, INTERNATIONAL ECONOMIST

Mr. POLK. That is correct, Mr. Chairman.

Mr. BARRETT. And you desire to read your statement and then answer questions?

Mr. POLK. Yes, sir. It won't be a strict reading of the statement.

I should say at the beginning that the views I am presenting are essentially my personal views as an international economist.

The organization for whom I am the economist, the U.S. Council of the International Chamber of Commerce, is still studying this program and they anticipate making a statement. How identical it will be with the views I express here, I am not sure yet. But certainly on the item of the release of the gold cover, I think there is no disparity in our views whatsoever.

Mr. BARRETT. We want you to feel very comfortable here and feel you are among friends. We may want to ask you one or two questions. Whatever way you may desire to proceed, you may do so now.

Mr. POLK. Thank you, sir.

Mr. FINO. Did I understand the witness to say that he works for the U.S. Chamber of Commerce, or is employed by them?

Mr. POLK. No; the U.S. Council of the International Chamber of Commerce. This is a separate organization, Mr. Fino.

Mr. FINO. Not connected with the U.S. Chamber of Commerce?

Mr. POLK. No. There is some historic connection but as the country's international interests became greater, the U.S. Council broke off from the U.S. Chamber of Commerce. Not out of any disparity of views, but for convenience of operation.

Mr. FINO. A further question. Are the views expressed here this morning a reflection of the thinking and feelings of your organization, or are they your own?

Mr. POLK. They are my own views.

Mr. BARRETT. You may proceed.

Mr. POLK. I am in favor of the release of the gold cover to cover our international responsibilities; to cease using it to cover our domestic currency.

Mr. BARRETT. Would you mind talking into the mike?

Mr. POLK. Yes, sir.

Domestically, the United States has not relied on any linkage with gold, as members of the committee know, since 1934.

It plays no significant part in the determination of our credit or monetary policy.

Gold is not a factor in money supply or credit conditions, and I believe it is the almost unanimous agreement of economists that it should not play such a part. The conditions that affect the supply of gold are not related to the conditions which should determine the supply of credit and money in the United States.

In fact, to insulate currency and credit conditions from sporadic gold movements, we have made it illegal for our citizens to hoard gold. This is a somewhat unusual step. I believe that in the case of the United Kingdom it is also illegal there for citizens to hold or speculate in gold. I believe this is largely true in the Netherlands. In other countries of the world, I believe it is not true.

We hope in the United States that other countries like ourselves will move in the direction of a more economic determination of the supply of money and credit, not based on gold. In other words, we hope that in the interests of a coherent world monetary and credit structure, other countries like ourselves will move from linkage with gold and might soon move to make it illegal for their citizens to hold gold.

As it is, however, other countries are very goldminded, and they traditionally act upon their anxieties about inflation and stability of currencies by getting into gold.

We have just been through a period following the devaluation of sterling, on November 18, when there was a considerable—often called massive—movement of foreign private interests out of currencies and into gold. It seems this was probably less speculation against the dollar than it was against paper currencies in general.

I think I should say candidly that this, in my view, helpful step of releasing the gold reserve for its use internationally, in the face of international anxieties about the paper-currency situation, does not go much of the way toward resolving any of the underlying problems of the international currency network, or even the anxieties that create some of our temporary difficulties.

In short, we need to do much more than release our gold reserve for its useful purpose in international settlements.

We should be intensively exploring in the Congress and elsewhere the steps that will have to be taken in our efforts to cope with the causes of this present emergency.

We are faced with inadequate dollar-holding and very poor dollar-spending habits in the rest of the world and we should be looking into the causes that lead countries to accumulate their dollars and convert them into gold rather than spend them or hold them. This is what is leading to the emergency condition in the gold market.

Personally, I am confident that the only reason we can assign a very minor role to gold in the United States in maintaining the stability of the dollar is that we have productive assets far more important than gold. We have these productive bases, both here and abroad. The tremendous earning potential of our foreign investment is somewhat new to us and often gets forgotten.

We have now something over $115 billion in investment abroad. I have estimated the output of these production bases abroad must be in the order of a magnitude of something between $150 and $200 billion.

This is an order of magnitude that compares very favorably with the GNP of all countries of the world with the exception of Russia and the United States itself.

The earnings from these productive efforts abroad are now in the order of magnitude of $15 to $20 billion.

Since, internationally, we have no strict statistics on these, when I speak of "order of magnitude," it is merely making a bow to the fact that we can't count the production. Nonetheless, reasonable reflection leads to the establishment of these enormous figures and it is in this productive state abroad that the United States real assurance for the dollar lies.

Similarly, it seems to me, it behooves us not to take steps that in any way would render more difficult and less profitable the operations of our foreign investment establishment; and particularly in these days when the international responsibilites of the United States are clearly increasing and have done so regularly in the military and political fields.

They are especially costly. These are not productive expenditures in the normal economic sense.

In other words, they represent to us a deficit that has to be covered.

One looks, as an economist, in vain for a reasonable source of covering these expenditures unless it has come from the private producing community and the large-scale production efforts abroad.

In this connection, the direction of our international economic policy is, I believe, disturbing. The ever-increasing restrictions on investment and credit not only interrupt the natural economic evolution of these vital assets, but even threaten their proper maintenance.

The program is very perplexing to businessmen. It isn't easy to speak definitively yet on the effects of the present measures, and, as I mentioned, the U.S. Council, for which I work, is, like other organizations, studying the problem intensively now, and hopes soon to set forth its views.

In my judgment, we need to explore urgently in the months ahead how to reconstitute the traditional rule of international money and credit to acommodate, not frustrate, our economic growth and the rest of the world's.

Thank you, Mr. Chairman.

Chairman PATMAN (presiding). Thank you, sir.

Now, I have discussed this with Mr. Barrett, who has been acting chairman during my absence—which I appreciate very much—and we would like to have the other two witnesses come around and present their statements, 10 minutes each, and then we will interrogate all three of you at once.

Mr. POLK. Yes, sir.

Chairman PATMAN. Next we have Mr. Charles A. Weil. Representative Kupferman, of New York, requested that Mr. Weil be permitted to testify. Is Mr. Weil here?

Mr. WEIL. Yes, sir.

Chairman PATMAN. Have a seat at the microphone. Mr. Stewart is not here.

Mr. Weil, you proceed for 10 minutes and then you may put in the record your statement, or any other material that you want that is relevant, and then we will be privileged to ask both of you questions.

You may go ahead, Mr. Weil.

STATEMENT OF CHARLES A. WEIL

Mr. WEIL. Mr. Chairman, I am Charles A. Weil, age 70, of New York City, retired businessman, who has done business all over the world.

I have been a writer on military strategy and economics for over 30 years, a veteran of two World Wars, with a novel approach to this problem from the purely military, national security, patriotic angle.

The proposal to repeal the 25-percent gold coverage for Federal Reserve notes, is a menace to the effective conduct of foreign relations and national security. It constrains protesting unilateral financial disarmament from the national security aspect though heartily supporting opposition for need of disciplinary measures that make a balanced budget mandatory.

The people must be alerted. I have already sent each member of this committee a pamphlet, dealing with this and related geostrategic aspects of the Vietnam war, but appear here to mobilize opinion against what we are being let into, and against which I warned 5 years ago to the House Ways and Means Committee in a memorandum against fiscal policies that "win elections and lose wars," March 19, 1963, hearings page 2911, and the following, to which this committee is respectfully referred, as I foresaw then the very present dilemma the proposed repeal will only aggravate.

(The pamphlet referred to may be found on p. 309.)

Mr. WEIL. From President Johnson, himself—at San Antonio and Honolulu—our vital interest in a world balance of power has been conceded and enunciated. Indispensable to such a foreign policy are the means to implement same. We are committed to the same strategy followed successfully by England and for several hundred years described by the great English military historian and analyst, Liddell Hart:

> Our historic practice was based on seapower. This naval body had two arms; one financial which embraced sea-borne expeditions against the enemy's vulnerable extremities and military provision of allies.

Lloyd George said much the same in his memoirs quoted by Russian Marshal Sokolovosky, with a significance that cannot be overlooked.

Such defense capability necessitated a currency acceptable in foreign countries for imports to prosecute war and support overseas military forces and allies.

It compelled a policy of stable purchasing power for sterling that made Britain not only the naval bulwark of the maritime world but its banker and central reserve, financial as well as military.

Such policy required and created a strong credit standing for sterling to pay for indispensable imports and, if necessary, as medium in which to borrow abroad to carry on war, if and when her gold and foreign assets were exhausted. It gave confidence that when peace returned Britain could, and would, return to sound money, that in most countries depends on some relation to gold and a sound balance-of-payments position. That, gentlemen, is a condition, not a theory.

Sooner or later, if we continue to let gold slip out, as it certainly will, if this fatal measure is enacted we might find ourselves compelled to admit defeat and to pull out of Vietnam with the disastrous effect on our strategic position that President Eisenhower wrote Winston

Churchill in 1954 the passing of Indochina into the hands of Communists would have.

Such foreign financial coercion to withdraw before national security objectives have been achieved, can happen to us. France experienced it in 1922, when compelled, by stress of the franc, to withdraw from the Ruhr; and for fear of which financial duress again in 1936, France desisted, without English support, from marching into the Rhineland, which would have overthrown Hitler and probably prevented World War II. This was told me, personally, by Albert Sarraut, who was French Prime Minister at the time.

Pressure against the franc and sterling in 1956 compelled withdrawal from Suez in 1956, according to Anthony Eden and Anthony Nutting, then respectively British Prime Minister and Foreign Minister. The confrontation over Cuba started a run on the dollar.

We experienced it in the Civil War and afterward for many years when uncovered greenbacks shrank to 38 cents on the dollar and caused high interest rates and the crash of 1873 that ushered in the 6-year depression until resumption of specie payment in 1879.

French monetary expert, Jacques Rueff, De Gaulle's financial adviser, stated his disbelief in letting our gold outflow continue, as it certainly would if we remove the 25-percent gold cover from Federal Reserve notes, in a recent interview:

> I am not sure that your military people, for reasons of national security in case of emergency want to be left with so little gold.

A report attributed to the former Director of the Office of Domestic Gold and Silver Operations of the U.S. Treasury is that, when it looked as if Rommel was defeating our forces at Kasserine Pass—and I wasn't awfully far away from there in 1943—Gen. Mark Clark had to pay for military supplies in gold; that suppliers would not accept paper dollars and that the same happened in the Pacific following our disaster at Pearl Harbor.

It is said that the fall of Rome was due to its loss of gold, in the fifth century.

We financed and won World Wars I and II with the strategy described by Liddel Hart and Lloyd George. We have lost half our gold stock. In 1941, we had almost two-thirds of the world's gold stock and a national debt of only $61 billion short-term obligations to foreigners of only $3 to $4 billion, a favorable balance of payments and a money supply—currency and checking accounts—of only $50 billion covered by $24 billion in gold, a ratio almost 1:2 and no need of foreign exchange for support of troops abroad in defense of the maritime world.

We have lost half our gold stock, only $11.5 billion remain. We have a national debt approaching $350 billion and, instead of surplus, have a persistent international payments deficit for 17 years, currently worsening with an annual rate of $2 to $2.5 billion. As a result, the United States currently owes about $35 billion to foreigners, including 4.8-billion-dollar holdings of the IMF.

Our domestic budget deficit has risen to over $20 billion currently, a money supply of $182 billion against gold cover of $11.5 billion, a ratio of 1:15 and while we need external foreign exchange resources to pay for vast military forces outside the dollar area.

In 1941, the Federal Reserve discount rate was 1 percent. Today that rate is 4½ percent, with much higher for long-term financing that can only make war financing most difficult as a problem at home as well as abroad.

This measure would force interest rates to rise even higher than the penalty taxes and rates under present provisions of law and selective rediscount and credit as I personally experienced in Brazil, that when chronic currency depreciation took over, interest rates rose to 5 percent per month, 60 percent per annum, to compensate for the risk of such depreciation in purchasing power, foreseen not only by John Stuart Mill but even the godhead of "new economics," Lord Keynes.

Proponents of gold cover repeal speculate the value of the dollar, its purchasing power abroad, depends exclusively on the country's productivity without the security of its gold cover. Our only experience in 1933 negatives the pretense when the dollar fell steadily in value abroad until its relation to gold cover was reestablished at a new price for gold.

There is not a single instance in our history to support the repeal and many instances in foreign countries to destroy this newest of fine-spun theories of money debauchers.

However, assuming arguendo the gamble with dollar's value in peacetime may not be disastrous, as my friend here has argued, it is most likely to be calamitous in wartime when there is always a shortage of manpower, domestic raw materials, and foodstuffs, and shipping to produce and transport goods to pay for indispensable imports for war production and food, together with lack of shipping to transport American overseas expeditionary forces and materiel for allies and acceptable money to subsidize them.

Let us rather conserve our financial strength, that is, what remains of our gold stock for foreign emergencies, some of which are already threatened in Korea and the Middle East, as I foresaw 5 years ago. That means not repealing our present reserve requirements which place an effective de facto embargo on about all our remaining gold stock without the unfavorable shock of an embargo.

That would have been the English way. Let us not encompass this country's conquest, or its alternative, nuclear war, on fine-spun theories of the stupid savants of academe in league with Keynesian Marxists and union leaders who see no further than the next union election.

I don't suppose the Joint Chiefs of Staff approve of this removal measure unless for fear of the treatment, the French call it "limoges-in-g" accorded Admiral Anderson as CNO for holding views contrary to the political establishment.

Keynes himself wrote:

> Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency . . . Lenin was certainly right. The process engages all the hidden forces of economic law on the side of destruction and does it in a manner which not one in a million is able to diagnose.

I trust I am one of those.

In fine, Senator Fulbright in the New York Times, Saturday, January 27, conceded the dilemma, that the choice is between domestic requirements and power politics. But he overlooked the latter was not of our making but only a defensive reaction to avowed intents and acts by confessed enemies. However, he also conceded that history shows eventually the former gives priority to the latter.

The "realists" or "hawks" give priority to the former, the "sentimentalists" or "doves" the latter, which is reflected in the basic fiscal and monetary issues fundamental to the bill before this committee.

We overlook that Lord Keynes was primarily concerned with recurrent domestic cyclical depressions, not military challenges for world domination nor depressions resulting from such challenges as in 1929 to 1941. This bill represents the outcome of an economic and political philosophy generated to prevent domestic depressions but which has turned out, as I predicted, incompatible with defense of the realm.

Proponents of this bill overlook we have survived and can still survive many depressions but not military conquest, or its alternative, nuclear war. They would, out of humanitarian instincts, jeopardize 200 million sound and solid Americans and the rest of the free world for the votes of 5 million disadvantaged persons. That is your choice in bald terms, the choice between evils. We must choose the lesser, lest neither the 5 million nor the 200 million survive.

Perhaps this can be resolved by diplomacy with enemies, perhaps by accommodation with nations having parallel interests to help carry our mutual burden.

But if shortsighted political pressures overcome my feeble words as I expect, sooner or later, and, I fear much sooner than I like to believe, we will have to stop the gold outflow or perish from the earth.

So he performed a very useful service in focusing attention on the fundamental problem created by the Russo-Chinese avowal of intentions and acts to dominate the world that created the dilemma between incompatibles, between which we must choose, if we cannot apply Castelreagh's advice of adjustment between domestic and external interests.

This is my direct, gentlemen, and I am welcome to be cross-examined.

Chairman PATMAN. Mr. Barrett.

Mr. BARRETT. I have no questions. I do want to thank Mr. Weil and Mr. Polk for coming here and giving us their testimony.

Chairman PATMAN. Mr. Fino.

Mr. FINO. Mr. Weil, most of the testimony before this committee has indicated that gold is not so important, that, if anything, its value is merely psychological. I would like to know, why is it that all of these foreign countries are hellbent on grabbing our gold?

Mr. WEIL. Mr. Fino, I have been in many of those foreign countries and I know how they feel. It is visceral, and it is based upon a long experience and long history of finance in the world, since John Law's bubble burst in the 1700's.

Mr. FINO. Mr. Polk, do you see any difficulties on the mandatory repatriation of profits with regard to those U.S. direct investments that are jointly owned by the United States and European investors?

Mr. POLK. Yes, sir. This range of problems is certainly, now, very much under examination by specific companies to ascertain how it affects them. I believe it is the general reaction of companies now that there will be many instances, particularly for those companies who are most cooperative in the earlier period of the voluntary restraint program. This will create real difficulty for the maintenance of their minimal investment activities abroad now.

I think some of them figure, for example, that the immediate payback within a year that will be required, approaches 95 percent, and this is not a basis on which they can sustain operations. I am sure that the Commerce Department administrators are becoming aware of this problem. I don't know to what extent there will be sufficient flexibility in the administration to take care of some of this, but it is a very real problem.

Mr. FINO. Mr. Barrett asked the previous witness what, in his opinion, he considered stronger, the gold or the dollar, and the witness indicated, with some mixed feelings, that the dollar and the gold—and it was very difficult to elicit from him a firm, definite, exact, direct answer. And I followed that with the question, as you recall, which would he rather have, the gold or the dollar? There was no equivocation about that. He said the gold.

How do you feel about it. Which would you rather have?

Mr. POLK. Without any ifs, ands, or buts, the dollar.

Mr. FINO. Thank you.

Chairman PATMAN. Mr. Hanna.

Mr. HANNA. No questions.

Chairman PATMAN. Mr. Brock.

Mr. BROCK. Mr. Polk, first off, would you say again, what was our total investment overseas?

Mr. POLK. We estimate it is around $115 billion. When I say "estimate", we have a fairly firm basis through 1965, that this has been updated by inspection.

Mr. BROCK. What is the output, the production output, the sales of those investments overseas?

Mr. POLK. I estimate that at $165 billion, currently, with the proviso that there is a large possible margin of error in an estimate based on what we know about manufacturing concerns, which represent only about a third of total direct investment abroad, and about one-sixth of the grand total investment. Nonetheless, I think this is a fairly good figure.

Mr. BROCK. That would be the gross international product on an annual basis?

Mr. POLK. Yes. I wouldn't want to overdo the analogy. It is not operated like a country. This is cooperative production, scattered around the world. But in magnitude, it is in that order.

Mr. BROCK. What are the profits on those investments, on that production or sales, or provision of services?

Mr. POLK. By and large, 10 percent is a fair figure.

Mr. BROCK. You are talking about $16.5 billion. Of this, the annual return to this country is something in the neighborhood of $6 billion?

Mr. POLK. That is correct.

Mr. BROCK. So we are reinvesting $10 billion a year from our profits overseas?

Mr. POLK. Probably.

Mr. BROCK. In addition, we are also investing around $4 billion from this country a year, aren't we? What is the capital investment out?

Mr. POLK. Around 3½, now, in direct investment.

Mr. BROCK. So we have 10 over there, plus 3½—$13.5 billion per year now on those investments. That is $13.5 billion. If we get a 10-percent return, that would mean close to $1.5 billion net profit we would make next year on the investments we are going to make this year?

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Mr. POLK. Yes, sir; counting only the profit on new investment. Total earning on all our investment would be 10 times that amount. And profits repatriated are currently in the range of $6 billion a year.

Mr. BROCK. This is where I think the administration's proposed balance-of-payments program reaches a level of incompetence that has been exceeded by few. It is frightening to me to see us following the identical pattern that was followed in England the last few years.

I spent the weekend in England and talked to their economists, political and diplomatic leaders, and they have taken the attitude, just as we seem to take it in this administration program, that in order to address a problem that is created by the public sector we attack the private sector. The net return on our investments since World War II, as I recall the testimony of the previous witnesses, was $109 billion.

The net outgo as a result of governmental action was $125 billion. So the deficit is entirely the result of governmental policy and yet the President's program would curtail, or eliminate, investments, require the repatriation of profits now being earned, and reduce or eliminate any other loans overseas. It will be self-defeating.

I talked to some people in the English business community and the English political leadership, and I said, "Gentlemen, what will be your response to the balance-of-payments program in the United States?" They said, "Well, the immediate consequence is going to be on increasing our balance-of-payments deficit, which we just got through facing, that resulted in a devaluation. We will have to respond in kind to protect ourselves. And the same thing is going to happen to Japan, Germany, Italy, and France."

Any country in the world is going to have to respond in kind in order to protect their reserve position, because we are making an assault upon their reserves.

If we reduce our deficit, we reduce their surpluses.

Have you given any thought to the ramifications of this program in these terms? What is the potential for international trade recession similar to that which occurred in the 1920's, as a result of these policies?

Mr. POLK. I don't think this is subject to statistical forecast. We are dealing with a factor here that is at least as psychological as the anxieties that arise on the gold front.

It would seem to me it is entirely within the realm of expectation—let me start again. It depends a very great deal on what other measures are taken in the meantime. If this general program of U.S. restriction, plus the continued European pursuit of surpluses in their international accounts, proceeds with nothing more, we are bound, I think, to see a considerable deflationary movement. We have interest rates at a world level now that in the judgment of many economists—certainly, mine—is inimical to capital formation and production itself.

There are psychological overtones to this that put one in mind of the situation when the collapse of the Kredit Anstalt in the early thirties touched off a world depression.

Again, offhanded, I think that there is sufficient economic sophistication in the world to intercept deflationary movements of that depth. On the other hand, I do hear it said, quite openly, in Europe as well as this country, that perhaps we should live with a negative growth rate. This, to me, is incredible.

Mr. BROCK. I would agree with you on some improvement on our economic sophistication, but I think it is largely domestic sophistication and not related to international sophistication.

If I can conclude with this, the president of the First National City Bank, in the recent issue of U.S. News & World Report, made some interesting comments on the balance-of-payments program. He said something to this effect: That controls beget controls, rather than relieving the situation on the short term and long term. Very shortly the temporary controls become permanent, and in order to stop the outflow that thence occurs as a result of negative effect from previous years, you had to impose even more controls.

Would you agree with this premise?

Mr. POLK. Yes; I do.

Chairman PATMAN. Mr. Annunzio.

Mr. ANNUNZIO. No questions.

Chairman PATMAN. Mr. Stanton.

Mr. STANTON. Thank you, Mr. Chairman.

We appreciate your testimony this morning. Mr. Polk, in your attitude or approach toward the problem we are now faced with here in the committee, the general impression given by the administration and our Treasury officials on this subject is that we stand behind our commitment to exchange gold for dollars, down to the last bar, if necessary.

Would this attitude, down to the last bar—maybe a figure of speech—would this coincide with your own thoughts on this subject, or should there be a breakoff point at which we should, maybe, for national security reasons or defense or some other reason, take another look at this thing in a year's time?

Mr. POLK. Mr. Stanton, I must say, not having a great deal of thought to what that minimum might be, I think it would be very small indeed. I can imagine the Government stockpiling gold, as it would any strategic metal, and gold indeed has increasing strategic significance in electronics and high technological and industrial uses. As far as curtailing it for the purposes of maintaining some remaining contingently available psuedomonetary fund, I would not be in favor of this.

Mr. STANTON. Another question: To the extent that the President's January 1 mandatory controls, for the most part, only affect those corporations already in Europe and elsewhere, doesn't the President's balance-of-payments program most seriously affect that many U.S. corporations who intended to branch overseas sometime in the near future?

Mr. POLK. Yes, it does, unless they scale their intentions down to $100,000. I think this problem, again, is one that is under consideration and I would hope that there is flexibility to take this into account. You are quite correct.

Mr. STANTON. To the extent that U.S. capital outflows and direct investment are reduced, do you see any increased Eurodollar, Eurobond interest rates, and other economic dislocations?

Mr. POLK. Although we were watching Europe with increasing interest—by "we," I mean all of us in the international financial community—we don't know what the capacity of the European market itself may be for generating substitutes to dollar credits. In my own views, as you gather from my statement, dollar credit is absolutely imperative for the implementation of both U.S. growth, including U.S. growth abroad, and the growth of the rest of the world.

When we shut off the normal source of finance—the most advanced country in the world has, after all, been playing a role that is consistent with its achievements in production—when we cut this off, we look to see if one might expect European sources—I say European because Europe is most of the rest of the advanced industrial world—will be adequate to the needs?

Now, there has been some encouragement in the last couple of years as we have tried to borrow more in Europe under the voluntary program as it has existed. We may be getting up to a billion dollars a year in new credit. This has certainly stimulated the growth, an overdue growth, of the European capital market. I don't really expect that it is going to come up, however, to the level that American companies between their transfer of savings here, legitimate savings, and their earnings retained abroad, were able to generate in the past.

In other words, I think credit is going to fall off. Now, I think this is a long way around—but the Eurodollar market is just part of the entire context here—we will find the Eurodollar availabilities are also curtailed and this will bring credit stringency.

Mr. STANTON. I might have missed your answer to this question, if it was asked when I was called out. Did you comment on the President's January 1 statement as regards the subject of tourism? How do you feel in regard to that statement?

Mr. POLK. I don't in any sense consider myself an expert on tourism, and this is obviously an extremely touchy problem. So one feels, I think you understand, uncomfortable in commenting on it. Notwithstanding that, I think probably it is my duty as an economist and a citizen, to say that I rate very highly the right of Americans to travel. I think it is in the best interests of this country and I view with a great deal of concern any effort to curtail that right.

Now, if those efforts took the form of actual statutory prohibition or statutory provisions to inhibit travel by making it unduly costly, this, I think, raises a fundamental political problem: Is this within the context of the rights that Americans should have, and is it in the best interests to have the country curtail that travel? On the sheer economic question, would it save us money in the balance of payments, I think the answer is a sort of hesistant "Yes". I think it would, for a temporary period. I think it would be a much lesser amount than has usually been thrown around, but probably, "Yes."

The balance between the curtailment of right and the interests of the country in having our people abroad, has to be weighed against somewhat doubtful and temporary savings in balance-of-payment terms that might be achieved for a brief period.

Mr. STANTON. Strictly from an economist's point of view, do you see any direct relationship or indirect relationship between the outflow of gold in our country, which is a fact, and the relationship between that fact and the deficit of our Federal budget during the same period of time? The increase in size of the deficit of the budget, with the increase in the outflow of gold?

Mr. POLK. No; I don't think there is a direct relationship. I think there is a relationship. I think it has to be traced through far more intricate logic than is normally done in the debating of this issue. Somehow the Federal deficit has to be related to the spending habits of the country and the spending habits of the country to their import habits, and their import habits have to then be fitted into the context of the importing habits of foreign countries, and this has to be fitted into the psychological attitude of foreign countries toward gold, which is apart from this, and after you sort that all out, I think you say there is some relationship, a complex one, a most difficult one to spell out, and in my judgment, normally highly oversimplified.

Chairman PATMAN. Mr. Blackburn.

Mr. BLACKBURN. Mr. Polk, you stated that the dollar was preferable, in your mind, over gold. Yet at the same time, you wouldn't tend to minimize the psychological impact that gold does have in the world monetary market.

Now, the President's proposals, I think even your testimony, and most everybody agrees, that it does not pose a long-range solution to the problem, that we are just attacking symptoms and not the basic disease.

What do you think is the simplest and quickest thing we could do? Let me ask you, for example, one of the major drains is the maintenance of our troops in Europe, Britain, and these places. Suppose we were to pull back a large number of those troops and their dependents. Wouldn't that pose, and I am putting aside the possible political implications this might have internationally, but economically, wouldn't that be the simplest and most far-reaching and longlasting solution to our monetary problem?

Mr. POLK. This is a logical argument and I have certainly heard it made.

I must say, personally, I dislike the notion of trying to ascertain the priority of security obligations on the basis of financial considerations. This is especially so when the financial considerations in my judgment are subject to quite a different kind of treatment.

Now, whether we are excessively overextended abroad is a decision to be made by this country in its constitutional processes. This is somewhat divorced from the question of, are we financing those expenditures in a wise way. I would not like to latch onto a financial embarrassment as a reason for altering the deployment of our troops, for example.

Mr. BLACKBURN. Well now, we are all very much aware of Great Britain's retreat into Small Britain, we might call it, when her plans are ultimately carried out. Hasn't she been forced to take this rather ignominious step by reason of financial considerations?

Mr. POLK. I think you could put it that way. I would prefer putting it generally in terms of the shrinkage of their relative power.

Mr. BLACKBURN. Isn't that an illustration of basic fallacy, when you say that you don't like to give finances consideration when considering our international commitment? Can you separate the two that easily, when we have the very dramatic example of Great Britain before us today?

Mr. POLK. I think that is a very good point and it is a conceivable logical fallacy. What we have, I think, involved here is a question of judgment. Is the United States considering a revision of its international commitment because of an item that is called "deficit" in balance of payments that ranges somewhere between $1 and $4 billion a year in our recent experience, or is the United States reviewing those commitments in terms of whether we as a country are producing enough to maintain forces of that size abroad? In my judgment that latter question is not, in fact, forced on us. In Britain's case, I think it has been clearly forced.

Mr. BLACKBURN. Well, suppose we were, too, as another alternative, and inclined to agree that $1.5 billion a year deficit, with the gross national product running now close to $800 billion a year, perhaps we are letting the tail wag the dog a little bit. Suppose we were to remove or to stop our commitment to buy gold at $35 an ounce, and sell gold at $35 an ounce, and let the dollar reach its economic value on the world market; would that be an alternative to removing the gold cover?

Mr. POLK. Yes; it would.

Mr. BLACKBURN. Now, that would set off certain instability, would it not, in the international monetary market?

Mr. POLK. Unquestionably.

Mr. BLACKBURN. Well now, what we have to decide, and I don't think anybody really has an answer to this, is what would be the severity and how long lasting would be the repercussions? Do you predict utter chaos, or would you predict 3 or 4 months of unsettled world fighting?

Mr. POLK. We are now talking about the alternative of the United States altering its gold policy?

Mr. BLACKBURN. Right.

Mr. POLK. We are talking in a field where the stakes are rather high and where one cannot be certain of a judgment. Let me say I am not trying to evade this question. I personally believe that, should the United States change its gold policy, cease buying and selling of gold, it would become apparent that it is the monetary use of gold, the United States use of it, that keeps gold at $35 an ounce, and I think the world price would slip. But I am not certain of that and I am certain that there would be disturbances in the market.

This means that I would much prefer a solution that did not directly involve this risk and I think we have such solutions.

Mr. BLACKBURN. Let me ask you this quick question. The fact that gold is not being mined on a large scale, we know that there are gold deposits in this country but the cost of mining is not low enough to justify mining at $35 an ounce, now the fact that the industrial uses of gold are not high enough to give the real value of gold something greater than $35 an ounce, something great enough to justify its mining today, except, as I understand, in South Africa and Russia, where the cost of labor is a very small thing, doesn't that indicate to you that we are maintaining the price of gold, and the gold does not maintain the price of a dollar?

Mr. POLK. Yes; it does, among other reasons.

Mr. BLACKBURN. I see my time has expired.

Chairman PATMAN. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Following up, Mr. Polk, what Mr. Blackburn had to say, I think you would agree with the statement that has been made before the committee that today the dollar is propping up gold rather than vice versa?

Mr. POLK. Yes; I would say so.

Mr. BROWN. I am not quite sure that I understand your position in this next area. Is it our short supply of gold which is the main problem that this legislation would alleviate, or is your support of this legislation unrelated to gold supply but, rather, based upon your belief that gold backing should go?

Mr. POLK. Not the latter. My support is based on the belief that the most useful thing that gold can do in the world today is to stabilize conditions in markets that involve very strong feelings about gold. These markets can range all the way from the dealings of Arab chieftains to exiled political leaders, to Indian peasants, to French peasants, and to central banks, to some extent, who are in a way deferring to the other feelings.

I think we have a world in which these feelings are still operative—in short, where people want gold. The most useful thing that we can do with gold is to ease this international supply system by releasing U.S. gold. It is not hurting us and not doing us any good. It would give, I think, some stability and above, some time to the continuation of the discussions which have become quite broad now in the international monetary field to erect a better system of payments.

Mr. BROWN. Do you think that these anxieties, or this anxiety to which you referred earlier and have alluded to now, that gold kind of tempers, or alleviates, would be further alleviated if we then went to some means of providing a greater supply of gold, such as the subsidizing of the production of gold?

Mr. POLK. Yes, at least to a minor extent, I think the appetite would be appeased. But this isn't really the main reason for doing it. I think the main reason is, if we do it we don't have to do anything as drastic as a radical alteration of our gold policy—of our buying and selling policy, or changing the price of gold, which we are not going to change. We don't have to do this. We have time to discuss alternatives to this kind of policy.

Mr. BROWN. Well, let me just phrase another question to you, then. First of all, do you really think that most international economists believe as you do? Have you expressed to us this morning any opinions that are radical or unshared by others?

Mr. POLK. That is a hard question to ask me. I am certainly aware—I think all economists are—when we get together there is a broad range of opinion on a specific issue.

Mr. BROWN. Wouldn't most international economists probably say the same thing you said this morning in answer to Mr. Fino's question: "Would you rather have gold or the dollar," and you said, "The dollar, no ifs, ands, and buts"?

Mr. POLK. Yes, sir.

Mr. BROWN. Then, is it just the anxiety that you talk about that causes the necessity for maintaining the international backing of the dollar?

Mr. POLK. By "the international backing," you mean——

Mr. BROWN. Gold backing.

Mr. POLK. Well, yes. One of the ways in which we are advanced as an advanced economy is in our credit and banking practices.

Now, we have a perfect solution when a run on a bank starts in the United States, and there hasn't been one since we have had the solution. But if people really, all that much want cash instead of bank accounts, we would issue cash. But when an international run on the bank starts, so to speak, there is no place to go except to the United States, asking for gold, and here we cannot alter the supply of gold as we could domestically our cash reserves.

So, what we are asking in a way, what we are hoping, is that other countries will, in their attitudes toward international credit, come to have the same kind of attitude that the most advanced countries have, certainly including ours. There is no real basis for their doubts about the dollar.

Mr. BROWN. Well, Mr. Polk, you would agree, would you not, that the balance-of-payments problem and the legislation we are considering here today are intimately related?

Mr. POLK. Yes; I would.

Mr. BROWN. Then, are we not today in a comparable position to that of Great Britain of many years ago; that is, as the return from accumulated overseas investments commenced to compound itself, she found herself in the strange position of having almost a gross excessive favorable balance of payments and a deficit balance of trade?

Mr. POLK. I am not sure I know how best to answer that question. There are parallels between Britain and the United States, but I see them largely in terms of Britain having been over some of this path at an earlier date when they underpinned the maritime world of the 18th and 19th centuries. They were the top nation.

Now, the nature of the world has changed somewhat. No one would imagine by maintaining a navy alone that somehow the whole texture of a world would be firmed up. We have inherited a different kind of leadership that has to be shared, and a different kind of world. I guess it is those differences that——

Mr. BROWN. Well, Mr. Polk, if we happen to be following a similar course, and if our future holds for us that which the future of Great Britain held, you wouldn't be supporting this legislation now, would you?

Mr. POLK. I am not sure, Mr. Brown, I understand in what particular way you feel we are following a similar course.

Mr. BROWN. Others have testified before this committee and indicated that this is very possibly true, that as our overseas investments continue to accumulate, the return becomes much greater, and soon you find yourself with a much greater return than there is direct investment out, and so you have a surplus in your balance of payments. If there were a surplus in our balance of payments, I doubt very much that you would be urging this committee to report out this legislation.

Mr. POLK. That is certainly true. And I think we could do with a little period where we had that kind of situation.

Mr. BROWN. Again, I would ask whether or not you think we are following a comparable course of action in history. I think you said, "No."

Mr. POLK. Well, I think these things are hard to calculate out in broad historic terms. How much did Britain get out of their investment? You have to net out what she spent to keep the British-type of world going. I think this is hard for us, too. What we are doing, obviously under different international communications and technological terms, is to take the lead in international production and investment, and this is tremendously profitable on the face of it.

At the same time, we have taken the lead in certain costly activities, basic political and policing activities.

Mr. BROWN. I wouldn't expect you to be 100 percent accurate because Mr. Barr, the Under Secretary of the Treasury, was here awhile back and after giving us predictions and suggestions on what would happen if we don't pass this bill and what would happen if we do, he said, in answer to a question, "We have been 95 percent wrong in the past." Needless to say, that causes us to somewhat question the complete accuracy of his prediction today in this reference.

Mr. Weil, one question. I want to make sure I have the thrust of your argument. Oversimplified, is the thrust of your argument that preservation of our reserves of gold is essential to our national security, as a thing of value to exchange for other things of value, rather than as a backing for the dollar?

Mr. WEIL. That is correct, sir. I am interested, particularly in the international political power, political situation, and I tried to emphasize that; and I think you will find it even more emphasized in the memorandum which I presented. And if the committee would only permit me to read a few words from a memorandum presented to the House Ways and Means Committee 5 years ago, you will find that Cassandra is as usual, very unwelcome.

Mr. BROWN. My time has expired. I would be happy to have you do so, but you can't do it on my time because I have none.

Chairman PATMAN. Thank you.

This concludes the testimony of you two gentlemen. We now have another witness who has just appeared, Mr. Stewart.

Mr. BROCK. I would like to come back to one question to Mr. Polk, and he can answer it for the record.

We have talked about a lot of alternatives, and I would like you to submit your alternative to the balance-of-payments program. You say there are viable alternatives to what we are doing and the viable alternative to raising the price of gold. I would be very grateful if you would let me know what you suggest we do because we do have something of a problem.

Mr. POLK. I think that, by and large, we are headed in the right direction.

Chairman PATMAN. You can answer it for the record. When you get your transcript to correct you may supply the answer to his question in writing.

Mr. POLK. Very good.

(The information requested follows:)

POLICY CONSIDERATIONS FOR THE UNITED STATES IN INTERNATIONAL FINANCE

(By Judd Polk)

The general objective in international finance is to continue moving toward international arrangements which provide:

—*adequate credit* for international production, which means adequate freedom of capital movements so that the great capital markets—number one being New York—can serve efficiently as world centers;

—*adequate cash* ("liquidity") both for trade settlements and to cope with deteriorations in confidence;

—*adequate cooperation* in economic policies.

In short, the proper evolution of credit for a growing and increasingly internationalized world economy must be accommodated in an environment of reinforced confidence. This evolution of credit involves new procedures and attitudes, and consequently invites in this period of growth anxieties. Confidence, which is the essence of credit, has to be built, and in this building the strongest factor internationally, as we have found domestically, is a cumulative record of productive growth under reasonably stable conditions.

There is clearly no simple magic formula for building a credit structure worldwide. A "credit" is(above all, a documentation of trust, of confidence that the productive activities for which the credit is provided will be successfully concluded. Paradoxically, one of the major obstacles to the successful conclusion of such activities is the tendency of creditors to get nervous, to force liquidations of projects, and thus to arrest the production which alone could validate the credit. It must, moreover, be frankly acknowledged that the achievement of the above objectives of credit and production are unmeasurably more complex internationally than nationally. And for this there is a simple explanation: there is no international sovereign to oversee money and credit operations. There is no international "legal tender". There is no readily expandable international "cash" available to increase creditors' liquidity when their nervousness threatens a "bank run". In lieu of international cash, a bank run means essentially a run on the world's limited gold reserves, and more specifically on the gold in U.S. reserves.

So, while the problem of an adequate international financial system introduces a singular difficulty because of the unavailability of an international monetary authority with sovereign powers, the problem is nonetheless far more one of building than of invention. The achievement of an adequate, efficient system will be expedited by pursuing all the essential elements simultaneously.

FURTHER DEVELOPMENT OF FREE INTERNATIONAL CAPITAL AND MONEY MARKETS

As in the operation of major national economies, certainly the $800 billion U.S. economy, the all-important institutions internationally are financial markets, a term here meant to include both the money market (for demand and other short-term instruments) and the capital markets (for instruments of longer maturity than a year). While conditions in short-term and long-term markets involve differences, these are less relevant here than the broad characteristics they have and should have in common as places where a high degree of liquidity is assured to holders of debt instruments of any *maturity*. The liquidity which a good market affords is incidental, however, to its classic and still most vital function of facilitating the translation of idle savings into productive commitments. The regular further development of the major international financial markets should be the prime objective of policy. Otherwise, the cost to the world economy will run into ill-spared tens of billions of dollars a year in world production. What is at stake is the continued growth of international production, which has regularly achieved 10% a year over the past two decades, and of international trade which in providing expanding markets is vitally important to continued achievement in national or international production.

In short, the international financial problem much resembles that of any economy, certainly that of the United States: financial institutions and operating policies must assure the essential means for the ready translation of savings into production. This vital translation is the investment process.

PROVISION OF MORE ADEQUATE INTERNATIONAL CASH AVAILABILITIES

The confidence problem, which is deeply rooted in the long history of national monetary difficulties and even wildly destructive inflations, can ultimately be met only by demonstrated stable relations between achievements of borrowers and the expectations of lenders in regard to production for which financial accommodation has been provided. When creditors' anxieties—which stem from conditions and worries almost completely outside and in spite of the promising producers' "work in progress"—touch off a liquidity scramble, this all-important productive achievement by borrowers is simply undermined. Production halts while creditors evaluate inappropriately the cash value of their assets.

Whether conceived in terms of hot money movements, unstable short-term capital flight, or simply exchange speculation, the snowballing search for international cash in periods of anxiety has constituted a major problem of international finance throughout this century. The enormity of international commitments in trade and production today dramatize the crippling effects of the system's inability to provide liquidity seekers with a flexible cash asset commanding international acceptance. Such a flexible asset is a key element in all modern national monetary systems. The ability of a system to provide unlimited cash in a liquidity crisis is the main assurance modern industrial nations give against the disastrous impact of bank runs on production.

COOPERATION OF NATIONS IN BASIC ECONOMIC POLICIES

Intergovernmental approaches to the problems of the world economy are bound to be politically more complex than governmental approaches to national problems. At the same time, the disparities in economic policies are greater on the international scene that in regions of a single nation. The lack of an international government with power to induce cooperation by different nations emphasizes the unusual importance of constantly seeking improved ways and means for their voluntary cooperation in basic economic policies. In particular at this time, such cooperation must provide for higher consistency of national reserve aspirations: the direction of national policies in most of the world outside the United States to produce regular increases in reserves is not consistent with the simultaneous rejection of dollar reserves or any international alternative to the dollar. Similarly, national tax policies directed toward the assurance of reserve accumulation in all nations are inconsistent with international financial balance.

These three vital international financial objectives—credit adequate for production, cash adequate to assure confidence, and economic cooperation to fill some of the gaps in the international political structure—continue to spell out the proper direction of work ahead. It is an encouraging aspect of international financial policy that much progress toward all of these objectives have been fairly recorded since 1944, when the International Bank and Fund were founded—an identifiable new chapter in cooperation. On balance, this progress is readily distinguishable in spite of recurring setbacks, as in the recent vulnerability of sterling in the wake of liquidity pressures, and since sterling's devaluation, in the months of anxiety about the dollar and the adequacy of U.S. gold reserves.

U.S. policy in the immediate months ahead should return to pursuit of these basic objectives:

1. On the cash problem, which is uppermost in international attention, it is important to press for broadened IMF reserve functions at an early date—earlier than the present schedule envisaged for activating in 1969 or 1970 the first Sepcial Drawing Rights. It is equally important to continue the efforts to secure the cooperation of foreign central banks and governments in minimizing official gold conversions, in combatting the regular drain of official gold reserves to private hoarders, and in facilitating

the expenditure of accumulating dollars. Further extension ofthe bilateral swap-credit arrangements, already a considerable achievement, should be continuously sought, as well as special bilateral dollar-holding understandings of the sort already begun with various important countries. A more concentrated effort should be made to terminate the harmful and growing generation of free dollars to meet local costs of our current military operations.

2. On the credit problem, the prospect of progress has obviously been worsened by the ever-broadening program of capital controls adopted by this country. The provision of capital to the rest of the world is the normal position for the highly developed United States economy and is critically important to the viability of our present world investment structure—a structure which in turn makes vital contributions to foreign economies. Investment contributions by other industrialized countries are important to balance against the calls on U.S. sources. The recent signs of greater capital-generating capacity abroad are important to balanced world finance, and should be further encouraged.

3. On the problem of international policy cooperation, there is little more to say specifically. The important thing is to resist the evident tendency to discard cooperative approaches merely because not enough cooperation has been achieved to date to prevent the current discomforts of the U.S. gold drain. There is reason to believe that relatively marginal achievements in cooperation will be enough for the evolution of a workable payments system. The symptoms of imbalance—the U.S. gold drain, the U.S. balance-of-payments deficits, the persistent surpluses of Europe, the shortfall of capital financing—are all of most limited range in comparison with the production of the economies to which the symptoms pertain. We are talking of aggregate national GNPs of *$1600 billion* (half accounted for by the United States), and against this, financial symptoms in the $1 to $4 billion range.

Chairman PATMAN. Mr. Stewart has come in. Before calling Mr. Stewart, Mr. Fino and I have discussed, along with Mr. Barrett, that we would like to have the three witnesses tomorrow morning take 10 minutes each. Then we will interrogate all three of them, as we usually do. Then after that we will try to have an executive session on the bill, and see if we can dispose of it tomorrow, rather than having a Friday session.

Without objection, we will do that.

Mr. Stewart, you were not here when we called you. This places us at a little disadvantage because we usually hear the witnesses, each one, and we interrogate all three of them together. But I am sure you must have some good reason for not being here. How much time would you want to take, if we hear you now?

Mr. STEWART. Ten minutes.

Chairman PATMAN. That will be all right. We will hear you.

You can file your entire testimony, Mr. Stewart, although you need not recite it all. Identify yourself and proceed.

STATEMENT OF EUGENE L. STEWART, GENERAL COUNSEL, TRADE RELATIONS COUNCIL OF THE UNITED STATES

Mr. STEWART. My name is Eugene Stewart. I am general counsel of the Trade Relations Council of the United States, a trade association with broad industry representation, interested in the factual side of our foreign-trade picture.

Very briefly, this morning, I intend to present for the record and for such consideration as your committee may deem relevant to your balance-of-payments study, a computerized list of a very severe imbalance in our foreign trade that affects 122 manufacturing industries.

By way of explanation as to my appearance at this hour, Mr. Chairman, I had explained, but doubtless not in the most effective way, that as president of a nonprofit corporation which is creating low-income housing in the District of Columbia, we had great pleasure this morning at 9:30 to have our final settlement on the project with the FHA and FNMA and the builder and the bank. This project has taken so many years and months of preparation, and there were so many people involved in the settlement this morning, that it was simply impossible to arrange it at a different hour, and I was told it was not possible for the committee to hear me other than this morning, and that I could come at 11:30.

Chairman PATMAN. That is satisfactory.

Mr. STEWART. The Trade Relations Council has established a computerized data bank into which it has placed all relevant Government data concerning employment and output and foreign trade of U.S. manufacturing industries defined at what is known as the Four-Digit Level of the Standard Industrial Classification.

The Standard Industrial Classification is the system of statistical collection used in the Census of Manufacturers and the Annual Survey of Manufacturers.

Regretfully, the statistical system used by our Government in collecting industry data is entirely different than that used in tabulating imports, and still different from that used in tabulating exports. So that if you wish to know how a particular industry was doing in foreign trade, there is no place in Government statistics for you to look.

The Trade Relations Council, however, through a computer technique, has been able, with the assistance of the Commerce Department, to correlate import and export classifications with many, but not all, of the statistical classifications of American manufacturing industries.

Of the 425 industries defined by our Government, for which statistics are regularly collected, we have data in our data bank for 296.

Now, very briefly, the substance of the study this morning. We programed our computer to select those manufacturing industries for which data for the years 1958 to 1966 are in our data bank, which in the year 1966 had a balance-of-trade deficit. We then called for an analysis of those data which would show the trend from 1958 through 1966.

The document which I have presented to you presents the salient information on each of the 122 industries, but the cover page is all that need occupy our attention at this moment. It is the summary, and I call your attention to the two lines above the bottom of the page, "Total of Above Industries." We have a situation presented in which, in 1966, the column at the far right, the balance-of-trade deficit of these industries was $7,517 million, and that in the 6-year period, using 1958 to 1960 as a base period, from that base period through 1966 this balance-of-trade deficit had worsened from $2,969 million deficit in the base period, to $7,517 million deficit in 1966.

Now, if you look at the very bottom of the page, under the column "Imports," you will notice that these 122 industries received the impact of 63 percent of all imports of manufactured products into the United States, and in 1966, they accounted for only 14 percent of our exports.

If you will look at the line "Total of Above Industries," which was two lines from the bottom of the page, you will find that the imports of these 122 industries increased from $6,221 million in the base period, to $11,375 million in 1966, nearly 83-percent increase, or an average of about 14 percent a year.

Just adjacent to that column under "Exports," you will see that the exports grew from $3,252 million to $3,857 million for 19-percent growth, or the rate of a little over 3 percent a year.

The purpose of my remarks this morning is to say this: That when your committee and others are considering all facets of the balance-of-payment problem, at least there should be available to you information that shows for a selected group of industries our trade picture is so bad that the increase in the trade deficit of those industries is accounting for a larger gross impact on our balance of payments than the net deficit each year.

If, for example, in the trade of these 122 industries, import quotas were to be established just at the 1965 level, which involves a 14-percent rollback, it would achieve a savings of $1.5 billion in our balance-of-payments situation, which happens to be the amount that the administration is seeking to secure through restrictions on direct investments and restrictions on travel.

Now, I simply submit to you that in the course of considering what action ought to be taken, you at least ought to have available to you these data.

They are not available to you from any other source, other than the Trade Relations Council, and we respectfully submit them to the committee as a public service.

Thank you, Mr. Chairman.

(The material referred to follows:)

BASIC DATA OF U.S. MANUFACTURING INDUSTRIES WITH CHRONIC TRADE DEFICITS, 1958-60 (AVERAGE), COMPARED WITH 1966

RECAP SHEET—SUMMARY

[Employment data in thousands; all other data in millions of dollars]

Industry	Number of industries	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
		Average, 1958-60	1966	Average, 1958-60	1966	Average, 1958-60	1966	Average, 1958-60	1966	Average, 1958-60	1966
Food and kindred products	17	1,018.1	912.3	$34,139.1	$42,392.6	$1,310.1	$1,691.9	$249.3	$371.9	−$1,060.8	−$1,320.0
Tobacco products	1	28.0	19.4	371.4	378.8	4.6	2.5	.6	2.1	−4.0	−.4
Textile mill products	9	491.8	478.5	6,854.9	9,495.6	322.0	518.3	269.5	246.3	−52.5	−272.0
Apparel and related products	30	1,155.6	1,352.9	13,881.2	20,330.7	289.2	716.9	97.4	180.4	−200.8	−536.5
Lumber and wood products	7	475.7	453.4	6,616.7	8,500.2	589.5	816.3	122.8	194.3	−466.7	−622.0
Paper and allied products	2	148.5	150.9	4,021.0	5,530.3	1,112.8	1,539.9	205.1	359.7	−907.7	−1,180.2
Chemicals	1	12.1	12.7	465.5	581.8	11.4	41.0	20.2	26.7	+8.8	−14.3
Rubber products	1	21.4	28.7	248.5	410.2	53.1	67.7	.4	1.0	−52.7	−66.7
Leather and leather products	9	339.3	321.5	3,986.1	4,756.8	113.0	318.8	49.3	64.0	−63.7	−254.8
Stone, clay, and glass products	12	237.4	248.9	4,212.6	5,682.0	211.9	360.1	57.5	124.8	−154.4	−235.3
Primary metal products	8	604.3	650.6	18,173.7	26,021.3	876.0	1,962.1	604.0	671.4	−272.0	−1,290.7
Fabricated metal products	3	90.9	103.5	1,665.5	2,473.0	52.8	140.8	21.2	46.7	−31.6	−94.1
Machinery, nonelectric	2	48.2	62.9	763.5	1,558.0	27.2	181.8	68.1	116.5	+40.9	−65.3
Machinery, electrical	2	80.9	136.2	1,807.0	4,212.7	151.5	230.3	97.0	129.1	−54.5	−101.2
Motor vehicles	3	631.8	842.0	26,377.5	46,609.8	764.8	2,100.6	1,315.2	1,125.0	+550.4	−975.6
Instruments and related products	3	46.7	57.0	628.1	1,074.3	73.3	152.6	12.8	23.0	−60.5	−129.6
Miscellaneous manufacturing	12	187.6	209.7	2,710.0	4,001.1	249.5	533.6	61.9	174.6	−187.6	−359.0
Total of above industries	122	5,618.3	6,041.1	126,922.3	184,009.2	6,221.7	11,375.2	3,252.3	3,857.5	−2,969.4	−7,517.7
Percent change, average, 1958-60/1966	--------	+7.5		+45.0		+82.8		+18.6		−153.2	
All manufacturing industries	425	15,880.7	17,135.4	$340,265.1	$538,494.2	$9,836.1	$17,837.9	$14,578.7	$26,888.7	+$4,742.6	+$9,050.8
Percent change, average, 1958-60/1966	--------	+7.9		+58.3		+81.4		+84.4		+90.8	
Percent, 122 industries of the 425 in all manufacturing	--------	35.4	35.3	37.3	34.2	63.3	63.8	22.3	14.3	---------	---------

I. FOOD AND KINDRED PRODUCTS

[Employment data in thousands; all other data in millions of dollars]

Industry (SIC and name)	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966
2011, 2013—Meat slaughtering and processing plants	246.3	222.3	$13,896.8	$17,571.3	$452.5	$724.6	$195.7	$291.4	−$256.8	−$433.2
2022—Natural and process cheese	17.4	19.3	920.2	1,552.3	31.8	64.9	5.9	3.7	−25.9	−61.2
2024, 2026—Ice cream, frozen desserts, fluid milk	242.4	197.8	7,610.1	8,577.2	(1)	3.2	(1)	2.7	(1)	−.5
2031—Canned and cured seafoods	16.5	16.7	380.6	548.1	87.3	105.3	19.1	38.8	−68.2	−66.5
2051, 2052—Bread, biscuit, crackers, cookies, and related products	303.6	274.4	5,243.3	6,334.4	10.0	22.1	5.2	7.8	−4.8	−14.3
2061, 2062, 2063—Sugar and sugar refining	32.8	30.8	1,617.3	2,112.9	595.2	573.3	3.3	7.2	−591.9	−566.1
2071, 2072—Confectionery, chocolate, and cocoa products	73.6	74.8	1,719.9	2,152.5	53.9	60.0	8.0	11.8	−45.9	−48.2
2082—Malt liquors	70.8	60.5	2,085.8	2,699.9	13.7	28.5	1.9	1.1	−11.8	−27.4
2083—Malt	2.5	1.8	201.3	205.5	10.4	6.2	8.4	5.8	−2.0	−.4
2084—Wine and brandy	5.5	6.5	274.9	400.8	54.0	101.3	.6	1.3	−53.4	−100.0
2098—Macaroni and spaghetti	6.7	7.4	188.9	237.7	1.3	2.5	1.2	.3	−.1	−2.2
Subtotal, food and kindred products, 17 industries	1,018.1	912.3	34,139.1	42,392.6	1,310.1	1,691.9	249.3	371.9	−1,060.8	−1,320.0
Percent change, average 1958–60/1966	−10.4		+24.2		+29.1		+49.2		−24.4	

II. TOBACCO PRODUCTS

Industry (SIC and name)	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
2121—Cigars	28.0	19.4	$371.4	$378.8	$4.6	$2.5	$0.6	$2.1	−$4.0	$4.0—
Percent change, average 1958–60/1966	−30.7		+2		−45.7		+250		+90	

III. TEXTILE MILL PRODUCTS

Industry (SIC and name)	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
2211, 2261—Weaving mills and finishing plants, cotton	289.6	243.8	$3,719.5	$4,415.9	$71.9	$161.7	$155.2	$114.8	+$83.3	−$46.9
2221, 2262—Weaving mills and finishing plants, synthetics	97.8	127.4	1,552.0	2,791.3	78.6	111.4	88.9	105.2	+10.3	−6.2
2281—Yarn mills, except wool	66.4	72.6	926.6	1,478.5	5.1	50.8	14.3	8.0	+9.2	−42.8
2283—Wool yarn mills	17.3	15.1	321.8	407.3	13.0	28.1	.4	.8	−12.6	−27.3
2294, 2297—Processed textile waste and scouring and combing plants	11.4	10.5	195.3	237.9	108.6	109.9	8.2	12.2	−100.4	−97.7
2298—Cordage and twine	9.3	9.1	139.7	164.7	44.8	56.4	2.5	5.3	−42.3	−51.1
Subtotal, textile mill products, 9 industries	491.8	478.5	6,854.9	9,495.6	322.0	518.3	269.5	246.3	−52.5	−272.0
Percent change, average 1958–60/1966	−2.7		+38.5		+61		−8.6		−418.6	

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IV. APPAREL AND RELATED PRODUCTS

2311, 2253, 2259, 2322, 2341, 2384; 2321–2389 except 2342, 2351, 2352, and 2371—Apparel	1,018.6	1,208.4	$11,504.1	$16,816.4	$227.8	$592.3	$70.9	$129.2	−$156.9	−$463.1
2351, 2352—Millinery	38.2	22.3	376.5	263.6	11.0	15.7	3.1	3.8	−7.9	−11.9
2371—Fur goods	9.5	9.6	315.4	365.1	1.4	4.5	2.6	3.8	+1.2	−.7
2391, 2271, 2272, 2279, 2392—Carpets and household furnishings	89.3	112.6	1,685.2	2,885.6	58.0	104.4	20.8	43.6	−37.2	−60.8
Subtotal, apparel and related products, 30 industries	1,155.6	1,352.9	13,881.2	20,330.7	298.2	716.9	97.4	180.4	−200.8	−536.5
Percent change, average 1958–60/1966	+17.1		+46.5		+140.4		+85.2		−167.2	

V. LUMBER AND WOOD PRODUCTS

2421, 2426—Sawmills and planing mills; hardwood and flooring	273.3	225.1	$3,411.7	$3,805.1	$381.1	$438.2	$90.9	$132.7	−$290.2	−$305.5
2429—Special product sawmills	7.7	6.4	88.6	109.7	28.4	37.4	5.0	14.6	−23.4	−22.8
2431, 2433, 2439—Millwork plants, prefab wood products, and wood products, not elsewhere classified	130.8	144.9	2,077.3	2,885.5	59.8	102.3	20.0	31.0	−39.8	−71.3
2432—Veneer and plywood plants	63.9	77.0	1,039.1	1,699.9	120.2	238.4	6.9	16.0	−113.3	−222.4
Subtotal, lumber andwood products, 7 industries	475.7	453.4	6,616.7	8 500.2	589.5	816.3	122.8	194.3	−466.7	−622.0
Percent change, average 1958–60/1966	−4.7		+28.5		+38.5		+58.2		−33.3	

VI. PAPER AND ALLIED PRODUCTS

2611—Pulp mills	14.3	15.9	$460.2	$725.5	$346.8	$488.5	$119.9	$224.8	−$226.9	−$263.7
2621—Paper mills, except building	134.2	135.0	3,560.8	4,804.8	766.0	1,051.4	85.2	134.9	−680.8	−916.5
Subtotal, paper and allied products, 2 industries	148.5	150.9	4,021.0	5,530.3	1,112.8	1,539.9	205.1	359.7	−907.7	−1,180.2
Percent change, average 1958–60/1966	+1.6		+37.5		+38.4		+75.4		−30	

VII. INORGANIC PIGMENTS

816—Inorganic pigments	12.1	12.7	$465.5	$581.8	$11.4	$41.0	$20.2	$26.7	+$8.8	−$14.3
Percent change, average 1958–60/1966	+5		+25		+259.6		+32.2		−262.5	

VIII. RUBBER FOOTWEAR

3021—Rubber footwear	21.4	28.7	$248.5	$410.2	$53.1	$67.7	$0.4	$1.0	−$52.7	−$66.7
Percent change, average 1958–60/1966	−34.1		+65.1		+27.5		+150		−26.6	

See footnotes at end of table.

[Employment data in thousands; all other data in millions of dollars]

IX. LEATHER AND LEATHER PRODUCTS

Industry (SIC and name)	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966
3111—Leather tanning and finishing	36.2	32.7	$806.9	$940.5	$40.8	$78.3	$27.3	$41.3	−$13.5	−$37.0
3121, 3199—Industrial leather belting and packing and leather goods, n.e.c.	10.8	8.9	142.1	144.1	2.4	8.9	2.8	3.7	+.4	−5.2
3131—Footwear cut stock	19.4	14.5	280.5	282.8	.9	2.0	3.1	1.6	+2.2	−.4
3141, 3142—Footwear and house slippers, except rubber	228.8	219.7	2,300.3	2,812.1	48.8	141.0	11.3	9.0	−37.5	−132.0
3151—Leather gloves	6.5	7.4	58.7	89.6	8.9	29.5	.1	.6	−8.8	−28.9
3171—Handbags and purses	23.0	22.7	249.1	291.9	9.4	42.2	3.6	5.0	−5.8	−37.2
3172—Small leather goods	14.6	15.6	148.5	195.8	1.8	16.9	1.1	2.8	−.7	−14.1
Subtotal, leather and leather products, 9 industries	339.3	321.5	3,986.1	4,756.8	113.0	318.8	49.3	64.0	−63.7	−254.8
Percent change, average 1958–60/1966	−5.2		+19.3		+182.1		+29.8		−300	

X. STONE, CLAY, AND GLASS PRODUCTS

Industry (SIC and name)	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966
3211—Flat glass	23.9	24.9	$490.6	$638.1	$55.4	$69.2	$17.2	$36.0	−$38.2	−$33.0
3241—Cement, hydraulic	40.5	33.6	1,125.6	1,253.4	15.5	24.8	1.9	4.8	−13.6	−20.2
3253—Ceramic ware and floor tile	13.7	11.6	152.1	162.1	11.3	31.1	1.0	.9	−10.3	−30.2
3262—Vitreous china food utensils	7.1	6.6	50.3	60.0	23.8	39.8	.9	1.1	−22.9	−38.7
3263—Earthenware food utensils	8.9	6.3	55.5	47.6	12.5	25.4	1.2	1.1	−11.3	−24.3
3264, 3269—Porcelain electrical supplies and pottery products, n.e.c.	19.1	21.3	191.2	307.4	27.1	49.9	8.2	14.4	−18.9	−35.5
3271, 3272—Concrete block, brick, and other products	70.7	85.0	1,222.5	1,775.7	.7	1.8	1.0	1.3	+.3	−.5
3274—Lime	7.3	7.5	148.4	197.9	.6	5.3	1.0	2.9	+.4	−2.4
3281—Cut stone and stone products	19.8	17.2	211.1	224.2	8.3	18.2	1.7	1.4	−6.6	−16.8
3291—Abrasive products	26.4	34.9	565.3	1,015.6	56.7	94.6	23.4	60.9	−33.3	−33.7
Subtotal, stone, clay, and glass products, 12 industries	237.4	248.9	4,212.6	5,682.0	211.9	360.1	57.5	124.8	−154.4	−235.3
Percent change, average 1958–60/1966	+4.8		+34.9		+69.9		+117.0		−52.4	

XI. PRIMARY METAL PRODUCTS										
3312, 3313, 3316, 3317; 2814—Blast furnace, steel mill, and electrometallurgical products	574.8	613.6	$16,931.7	$23,823.8	$461.1	$1,144.1	$514.9	$490.4	+$53.8	−$653.7
3333—Primary zinc	8.7	8.6	232.5	379.9	36.0	86.3	7.3	1.4	−28.7	−84.9
3334—Primary aluminum	17.7	21.1	894.6	1,496.2	105.4	226.2	68.7	89.6	−36.7	−136.6
3339—Primary nonferrous metals	3.1	7.3	114.9	321.4	273.5	505.5	13.1	90.0	−260.4	−415.5
Subtotal, primary metal products, 8 industries	604.3	650.6	18,173.7	26,021.3	876.0	1,962.1	604.0	671.4	−272.0	−1,290.7
Percent change, average 1958–60/1966	+7.7		+43.2		+124.0		+11.2		−374.5	
XII. FABRICATED METAL PRODUCTS										
3421—Cutlery	11.7	13.7	$188.6	$373.6	$9.3	$27.5	$4.3	$12.6	−$5.0	−$14.8
3481, 3315—Steel wire drawing and fabricated wire products	79.2	89.8	1,476.9	2,099.4	43.5	113.4	16.9	34.1	−26.6	−79.3
Subtotal, fabricated metal products, 3 industries	90.9	103.5	1,665.5	2,473.0	52.8	140.8	21.2	46.7	−31.6	−94.1
Percent change, average 1958–60/1966	+13.9		+48.5		+166.7		+120.3		−197.8	
XIII. MACHINERY, NONELECTRIC										
3569—General industry machines, n.e.c.	28.7	41.0	$501.4	$1,024.1	$3.3	$120.1	$51.8	$83.3	+$48.5	−$36.8
3572—Typewriters	19.5	21.9	262.1	533.9	23.9	61.7	16.3	33.2	−7.6	−28.5
Subtotal, machinery, nonelectric, 2 industries	48.2	62.9	763.5	1,558.0	27.2	181.8	68.1	116.5	+40.9	−65.3
Percent change, average 1958–60/1966	+30.5		+104.1		+568.4		+71.1		−259.7	
XIV. MACHINERY, ELECTRICAL										
3636—Sewing machines	9.9	6.0	$124.2	$120.8	$40.8	$83.0	$30.7	$30.3	−$10.1	−$52.7
3651—Radio and TV receiving sets	71.0	130.2	1,682.8	4,091.9	110.7	147.3	66.3	98.8	−44.4	−48.5
Subtotal, machinery, electrical, 2 industries	80.9	136.2	1,807.0	4,212.7	151.5	230.3	97.0	129.1	−54.5	−101.2
Percent change, average 1958–60/1966	+68.4		+133.1		+52		+33.1		−85.7	

See footnotes at end of table.

[Employment data in thousands; all other data in millions of dollars]

XV. MOTOR VEHICLES

Industry (SIC and name)	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966
3713, 3717—Motor vehicles, trucks, bus bodies, and parts	623.7	830.5	$26,239.4	$46,348.7	$717.6	$1,866.2	$1,313.4	$1,122.2	+$595.8	−$744.0
3751—Motorcycles and parts	8.1	11.5	138.1	261.1	47.2	234.4	1.8	2.8	−45.4	−231.6
Subtotal, motor vehicles, 3 industries	631.8	842.0	26,377.5	46,609.8	764.8	2,100.6	1,315.2	1,125.0	+550.4	−975.6
Percent change, average 1958–60/1966	+33.3		+76.7		+174.7		−14.5		−277.3	

XVI. INSTRUMENTS AND RELATED PRODUCTS

Industry (SIC and name)	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966
3851—Ophthalmic goods	19.4	23.0	$211.5	$346.8	$6.0	$22.0	$7.7	$11.9	+$1.7	−$10.1
3871, 3872—Watches, clocks, and watch cases	27.3	34.0	416.6	727.5	67.3	130.6	5.1	11.1	−62.2	−119.5
Subtotal, instruments and related products, 3 industries	46.7	57.0	628.1	1,074.3	73.3	152.6	12.8	23.0	−60.5	−129.6
Percent change, average 1958–60/1966	+22.1		+71.0		+108.2		+79.7		−114.2	

XVII. MISCELLANEOUS MANUFACTURING

Industry (SIC and name)	Employment		Value of shipments		Imports, c.i.f.		Exports		Balance of trade	
	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966	Average, 1958–60	1966
3913—Lapidary work	1.8	1.6	$42.0	$74.6	$95.0	$184.9	$4.4	$70.9	−$90.6	−$114.0
3914—Silverware and plated ware	14.2	15.1	211.6	325.1	20.9	20.5	3.7	3.1	−17.2	−17.4
3931—Musical instruments and parts	18.3	25.1	269.4	437.3	18.4	60.5	8.4	21.3	−10.0	−39.2
3941—Games and toys	44.6	62.3	591.5	1,157.2	32.9	66.1	13.6	27.6	−19.3	−38.5
3942—Dolls	14.2	11.6	169.4	150.2	6.5	35.6	2.3	3.2	−4.2	−32.4
3949—Sporting and atheletic goods	38.3	39.7	651.3	826.5	24.0	67.7	19.3	29.1	−4.7	−38.6
3962—Artificial flowers	6.7	3.8	65.8	73.5	32.0	50.8	.7	.7	−31.3	−50.1
3963—Buttons	6.1	5.3	71.3	72.9	4.6	7.0	2.0	2.3	−2.6	−4.7
3964—Needles, pins, and fasteners	18.2	22.4	242.3	409.3	6.6	19.0	3.6	10.1	−3.0	−8.9
3981—Brooms and brushes	17.1	17.0	288.6	374.4	3.5	9.7	2.9	5.0	−.6	−4.7
3983—Matches	5.2	3.7	70.7	59.8	.9	1.7	.3	.4	−.6	−1.3
3995—Umbrellas, parasols, and canes	2.9	2.1	36.1	40.3	4.2	10.1	.7	.9	−3.5	−9.2
Subtotal, miscellaneous manufacturing, 12 industries	187.6	209.7	2,710.0	4,001.1	249.5	533.6	61.9	174.6	−187.6	−359.0
Percent change, average 1958–60/1966	+11.8		+47.6		+113.9		+182.1		−91.4	

[1] Not available.

Source: Trade Relations Council of the United States, Inc., Employment, Output, and Foreign Trade of U.S. Manufacturing Industries, 1958–66.

Mr. BARRETT (presiding). I sort of sense that you have a feeling here that might be related to high tariffs? Do I properly and adequately comprehend that feeling?

Mr. STEWART. No; you do not. The Trade Relations Council has no position advocating high tariffs, or any particular level of tariffs. We have dedicated our services through this computer facility in attempting to make available in meaningful terms authentic statistics which are not forthcoming from the governmental sector about our trade problems.

Mr. BARRETT. I think you have a very fine compilation of all these 122 industries here, something that I think is a great incentive to follow your method and system of bringing these facts to the Congress. I think you are doing a splendid job on this, and it is certainly very educational. While it is only 122, we ought to have all the industries.

Mr. STEWART. So that the committee would know what the full picture is, I have set forth on the summary page the total for all manufacturing industries, the 425, and you can see the picture presented for the total.

We fortunately have a surplus in our trade of all manufacturing industry, but in the total balance-of-payments picture, when we are running heavy deficits in such things as our foreign aid outlays and the like, when the administration itself is advocating that our export surplus be increased, one of the permissible methods at this juncture, under article 12 of GATT, would be to consider bringing the rate of increase of imports of the deficit industries under a measure of control, not to embargo, not to freeze out, but to achieve for the duration of the balance-of-payments problem a measure of control which within its sector can make a contribution as important as that which the Government is considering under the unprecedented steps of bars on direct investment and restrictions on travel.

Mr. BARRETT. One other very short question. I assume now that you are not going to talk on the removal of the gold cover?

Mr. STEWART. No. Because your committee had under consideration this very unprecedented step, it occurred to several of us that the committee might wish to have these data available in the total deliberation which it will give the balance-of-payments problem.

Mr. BARRETT. In order not to steal too much time of the members here, I am quite sure they will want to ask you some questions. Mr. Widnall.

Mr. WIDNALL. Thank you. I just came in and I missed your discussion, and I apologize for not being able to be here beforehand. I will waive my chance right now in favor of Mr. Fino.

Mr. BARRETT. Would you yield for this one statement? In order to give the other members an opportunity to be heard before we are called to the floor, could we adhere strictly to the 5-minute rule, so we can get over to the last member?

Mr. FINO. Getting to the issue at hand; that is, the removal of the gold cover, you indicated that your purpose here is to get into the field of the balance-of-payments deficit.

Will you say that the balance-of-payments deficit has had a definite impact on the drain of gold?

Mr. STEWART. Indeed, sir, it has.

Mr. FINO. Now, we have held hearings on this legislation and we have had a tremendous amount of testimony adduced at these hearings. Most of the testimony before this committee has been to the effect that gold is not so important, but, if anything, its value is merely psychological. I have been asking the witnesses here this morning—I don't know whether you were here—why is it that foreign countries are hellbent on grabbing all of our gold, if it is only for psychological reasons? Would you care to comment on that?

Mr. STEWART. Governments, in part, base policies upon the beliefs of their people. And this certainly is a widespread belief in this country, and in other countries, that the currency is strengthened by a measure of backing by gold.

When in our foreign trade picture we see a surplus of dollars accumulated in the reserve of other governments, and, contrary to the notions of the last decade, those dollars are not used to purchase goods and services from the United States, but rather to demand our gold, a concern and an uneasiness sets in, at least among the business people with whom I am in contact, as to a weakening of the strength of our currency because of these uninterrupted events, and I would judge that other governments and other people must feel the same way about it, Mr. Fino.

Mr. FINO. Mr. Barrett asked the question of the previous witnesses regarding the strength of the gold and the strength of the dollar. He wanted to know from the witnesses which they consider stronger, the dollar or the gold, and the witnesses indicated that there were some mixed feelings about which was stronger. I would like to ask you, which would you rather have, the dollar in your pocket or the gold in your pocket?

Mr. STEWART. The Treasury Department, as you know, has prepared an excellent booklet which explains the balance-of-payments problem in a technical point of view, and that booklet itself points out, when governments accumulate a surplus of dollars they reach a point where they do not wish to accumulate any more dollars in their reserves and they then begin to demand gold.

Since the drain on our gold which leads you to the consideration of possible modification of the gold cover is in part influenced by the failure of foreign countries to spend their dollar reserves for goods and services from the United States, and since our balance-of-trade deficit affecting one out of every three manufacturing workers is related to that rate at which dollars outflow, it seems to me relevant for the United States as a policy matter to consider imposing regulations over the rate at which that deficit increases in the future, and at which still additional dollar surpluses pile up abroad.

For these reasons, we felt that we would be doing a service to the committee in making these data available.

Mr. FINO. Just one further question. Do you see any difficulties on the mandatory repatriation of profits with regard to the U.S. direct investments that are jointly owned by the United States and foreign or European investors?

Mr. STEWART. Any regulation of this sort removes from businessmen some of the options which they require in a prudent and wise management of a business enterprise. What you do with your reserves and your surplus is a function, not in the best sense of Government policy, but of what is best for that particular business. And the decision to be made is as varied as the number of businesses abroad.

No less important than these other components is the inflow of dividends and profits from abroad at times when the health of the enterprise abroad can stand it. Any regulation that interferes with the exercise of good business judgment in that area is bound to be detrimental to the long-range interests of the United States, and at least at the time when we are considering such drastic measures, we should also study in depth the other components of the balance-of-payments problem such as I have described this morning.

Mr. BARRETT. Mr. Brock.

Mr. BROCK. Thank you, Mr. Stewart.

This is excellent and I appreciate it very much. It is a fascinating study. It is going to take me a little while to get all I can out of it. But you don't have any nonmanufacturing industries, any services, technological groups, and so forth?

Mr. STEWART. These are all manufacturing industries. We have no others in our data bank.

Mr. BROCK. Do you have any figures on the return on the investment of manufacturing industries from overseas investments?

Mr. STEWART. Regrettably, we do not as yet have such data in our data bank.

Mr. BROCK. I have never seen it selected out. All we get here are the gross figures. That is why this is so particularly relevant. And it becomes more so as pressure increases for some sort of import tariff restriction. But you do have things which we can select out that are relatively significant. For example, your deficit on sugar, $566 million there is not a whole lot we can do about that. We are going to have to import sugar.

Mr. STEWART. Yes, sir. One policy alternative that can always be considered is, however, at what rate do we wish to increase or worsen that particular deficit. There are alternatives with domestic policy in any industry that can be considered.

It is not a question of eliminating deficits that exist, but exercising a measure of control over how much larger they get in the future, and at what rate.

Mr. BROCK. And the quality that is involved.

Mr. STEWART. Yes, sir.

Mr. BROCK. In a particular kind of flow.

Mr. STEWART. Yes, sir.

Mr. BROCK. Thank you very much.

Mr. BARRETT. Mr. Mize.

Mr. MIZE. Mr. Stewart, I join my friend, Bill Brock, in complimenting you on a very scholarly study. I am sure it is all here, but would you give us some examples of imported products on which you want this approximate 14-percent rollback?

Mr. STEWART. Yes, Mr. Congressman. My suggestion is that all of the products of these 122 industries, which represents about one-third of the American market for manufactured goods, be placed under quantitative limitations on imports, based initially on the 1965 annual rate of increase, tied to the rate of increase in our exports, which is 3 percent a year.

Mr. MIZE. Would we have any kind of conflict with the outcome of the Kennedy round discusions in the type of legislation or restrictions you are imposing?

Mr. STEWART. No, Mr. Congressman, for two reasons: first, article 12 of GATT, under whose auspices the Kennedy round was conducted, specifically permits a member country to use quantitative limitations for balance-of-payments reasons.

Second, the reference point, the year in relation to which the Kennedy round was negotiated was 1964. I am suggesting consideration of quotas for 1965, which was 14 percent above 1964, with a growth factor of 3 percent a year, and only applied to a products spectrum which is equivalent to one-third of our market. Surely, such a limited response to the need which will produce the saving in the magnitude I have mentioned is much to be preferred over an across-the-board remedy such as a border tax as has been suggested by the administration.

Mr. MIZE. Would you anticipate any reciprocal action by governments against which this approximate 14-percent rollback would apply?

Mr. STEWART. No, sir; for two reasons: First, the action would be taken pursuant to article 12 of GATT, which specifically permits and allows us to do so; and secondly, there were many years in which the United States, without retaliation, and with, indeed, great complaisance, in a spirit of cooperation, watched the countries of Europe and other areas of the world do precisely this, to use for a limited period of time import quotas to get hold of a bad balance-of-payments situation. I am not advocating these as permanent measures, only for the duration of the intensity of our emergency.

Mr. MIZE. Thank you.

Mr. BARRETT. Mr. Blackburn.

Mr. BLACKBURN. I don't want to sound redundant, but I do, too, want to congratulate your group for providing this service, and I have asked this question of some administration officials, and I would like to pose the same question to you to get your reaction.

A study presented by the Treasury Department shows that the labor factor in export goods has remained fairly constant over the years. The question I have: is this labor factor constant because we are only exporting those goods in which we can maintain the labor factor at a constant rate, although we have given increases in salary, still our productivity per man is increasing at a sufficient rate to offset his wage increase, or are there areas in which we would otherwise be supporting a great deal, except for the fact the labor factor has increased in the country greater than in other countries?

Mr. STEWART. I think, if you look at the summary sheet, I can suggest an answer to you. Look, for example, under the two lines from the bottom after "Above Industries" under the export column. The 122 industries we are talking about are predominantly labor intensive, and you will find exports increased only 19 percent in the 6-year period. Right below it you will find the average for all manufacturing, and you will find that on the whole, exports increased by 84 percent.

Other studies performed by the Council show that this export increase is largely attributable to the capital intensive technologically based industries and from a labor point of view, the labor content of a million dollars worth of exports from such industries is very much smaller than the labor content of a million dollars of imports from labor intensive production. So we have the phenomenon that we may have a healthy overall balance-of-trade situation in dollars, but not quite as healthy a situation from the point of view of jobs created and displaced.

Mr. BLACKBURN. So you are saying the net result, even though we are shipping more out in dollars, is to decrease the number of American laborers engaged in manufacturing goods being exported?

Mr. STEWART. That is correct.

Mr. BLACKBURN. I would appreciate it very much if you could provide me with whatever studies your Council might have made in this respect. I am very much interested in it.

Mr. STEWART. I shall do so.

Mr. BARRETT. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman. I also would like to thank you for providing us with the data that you have. I want to make sure that I understand your statement regarding the GATT situation, the GATT agreement.

Am I correct in my understanding of your statement that under article IV, or whatever it is——

Mr. STEWART. Article 12.

Mr. BROWN. That each government having a deficit balance of payments has a right to set quotas on all imports, or is it only in deficit balance-of-trade industries?

Mr. STEWART. A very good question.

The answer to it is, first of all, it is the intent of article 12, that a nation be in a more or less chronic balance-of-payments situation.

Mr. BROWN. What do you mean by "chronic"?

Mr. STEWART. A long, continued one, and I think we will qualify under that.

Mr. BROWN. Like "several" means more than two?

Mr. STEWART. Over a period of years. Secondly, a government may either impose quotas across the board or it may do it selectively.

Article 12 does not foreclose either choice.

Thirdly, it is not required in article 12 that the quotas be imposed on those products which themselves are undergoing a balance-of-trade deficit.

A government may choose to marshal its total resources by imposing quotas across the board to get an overall absolute reduction in imports; or it may do it selectively, and because of the great importance of the U.S. market to foreign interests that export here, and because of the great sensitivity of our position as a leader in the liberalization of the world trade, it seems to me to make sense to consider a limited response which would, however, husband our resources to a degree that would help restore confidence in the dollar, the objective we are all after.

Mr. BROWN. And, therefore, if I may add, it is your conclusion that we should go back to the 1965 level with respect to the 122 industries that have a deficit balance of trade?

Mr. STEWART. Correct. That is my conclusion.

Mr. BROWN. Now, then, I think you said earlier, in answer to Mr. Fino's question, or Mr. Brock's question, that you consider—at least, I got the impression—that you consider the legislation that we are dealing with here today as drastic action?

Mr. STEWART. Yes, I do, sir.

Mr. BROWN. Do you realize that the representatives of the administration, Mr. Robertson from the Federal Reserve Board, and Mr. Barr from the Treasury Department, both rather "pooh-poohed" the tremendous significance of this legislation. They said today the gold cover doesn't control the flow of currency. We still have $1.3 billion free gold. We have never gotten to the point where Treasury had to consider, or Federal Reserve had to consider, the problem of currency exceeding the reserves which we presently have, so that therefore gold backing today doesn't control the flow of currency whatsoever.

Mr. STEWART. I think in my own remarks I attached a symbolic significance to it, which can only be important to the confidence held in the Government and its currency by the people in this country and in other nations.

We cannot entirely ignore things of symbolic importance. It doesn't mean that we necessarily make them a major premise, but to ignore them, I think, can lead to disaster, just as quickly as to give them exclusive controlling force.

Mr. BROWN. Mr. Stewart, as a representative of business, do you think that today's decisions with respect to capital expansion, relocation, all of these different things, that these are based as much on a hard-nosed analysis of the facts about taxes, and so forth, as they are on a kind of a feeling about things?

Mr. STEWART. Well, I would say this——

Mr. BROWN. I think in your testimony you said earlier that this feeling seems to prevail.

Mr. STEWART. The Government policies in this area are mutually exclusive and absolutely contradictory. On the one hand, we are devoting great energy to attempting to create jobs by industry, to appeal to industry, to create jobs for the disadvantaged of our population. The disadvantaged, primarily, are those who do not at the moment possess a high level of skill. Job opportunities for them by definition must come in labor-intensive industries, but it is our foreign economic policy to eliminate the labor-intensive industries by subjecting them to unrestricted imports so as to transfer resources into the sophisticated or technologically oriented industries.

This is a clear-cut contradiction of our policy for the employment of the disadvantaged. Secondly, we have massive programs to assist our own underdeveloped areas, such as the Appalachian program.

You will find that the industries represented in this tabulation, such as textiles, apparel, steel, flat glass and the like, are located in a significant degree in Appalachia, and in similarly less-developed areas.

The manufacturing jobs that they provide call for essentially unskilled and semiskilled labor or a low threshold of educational attainment, yet we are systematically weakening those industries and eliminating their employment potential from those areas by our foreign economic policy. This is a square, clear-cut contradiction in our national policy. If you ask me if there is a consistency in our national policy, I must say to you as a serious student of the subject, that there is not.

Mr. BROWN. Well then, don't you concur that many of these decisions are more feeling than fact, because if you try to reach an answer from the standpoint of policies, you come to no conclusion because there are contradictions?

Mr. STEWART. They are piecemeal and pragmatic responses to a situation without relating them to total international policy, and a pragmatic solution to a segment of an overall problem deserves to be described as action based upon feel as much as anything else, certainly not based upon systematic analyses.

Mr. BROWN. If I may follow with one further question or comment—Isn't this anxiety that attaches itself to the question of removal of the gold cover as important as though it were a real concern?

Mr. STEWART. It certainly is.

Mr. BARRETT. I understood you to say about 122 of these industries supply about one-third of the American population in their needs?

Mr. STEWART. One-third of the manufacturing jobs, Mr. Chairman. You will notice at the bottom line, in 1966, it was 35.3 percent.

Mr. BARRETT. I noticed that. It is my understanding that there are about 500 corporations that supply the need to about 40 percent of the American population.

Would these industries be tied up in any of these 500 corporations?

Mr. STEWART. Well, Mr. Chairman, within the 122 industries there are doubtless manufacturing plants that are owned by one or more of the 500 corporations.

The value of this study is that it proceeds on an establishment basis; that is, individual plants are classified.

Mr. BARRETT. May I interpose and say, while I certainly want to commend you and the industry for making this very fine study and having it computed in the way that you have, would it not be just as convenient to take a larger span of the manufacturers of America to get a better perspective under the same method that you use?

I am asking you this because I want to lead to another question.

Mr. STEWART. We have not left out any industry, to our knowledge, in our data bank that had a trade deficit in 1966. Since we were focusing on a balance-of-payments problem to which trade deficits relate, we thought that the universe for study were those industries who are contributing to that payment deficit by a trade deficit.

Mr. BARRETT. Well, let me ask you, would the import quotas, as you suggest, possibly lead to higher prices for the American consumers?

Mr. STEWART. Well, in my judgment, it would not, for this reason: the imports in each one of these areas does not yet account for a major part of the American market. Indeed, as I recall, almost all of the industries' imports account for less than 20 percent of domestic consumption. The manufacturing capacity utilization rate in these areas is, according to the general picture presented by the Federal Reserve Board statistics, running somewhere around 85 or 90 percent.

We therefore have a situation in which these industries have capacity that is unused. Imports do not represent such a large part of the market that cutting back imports 14 percent would result in a shortage of supply, because that slack would be made up by increased utilization of existing capacity by the domestic producers, which would lower their costs; so I think no change in consumer prices would follow from the fact of the quotas alone.

If we were to roll the imports back a number of years, the answer might be different; but based on 1965, no.

Mr. BARRETT. You are interested in a very flexible quota system, are you not?

Mr. STEWART. I am interested in a quota system that provides an annual growth factor keyed to the growth in the American market and growth of our exports. I regard this as flexible.

Mr. BARRETT. Is it not also the administration policy to seek a reduction of nontariff barriers?

Mr. STEWART. I think there is a distinction here between——

Mr. BARRETT. And let me say this: I think you are using this to permit GATT, rather than encourage them.

Mr. STEWART. Well, Mr. Chairman, in regard to nontariff barriers, the effort that is being made there is in the context of such permanent barriers as frontier taxes imposed by every European country, which are not related to balance-of-payments reasons.

Secondly, the administration had an unexampled opportunity to do something about this during the years of negotiations with the Kennedy round and failed signally to achieve any significant progress.

What we are now proposing is not the systematic adoption of nontariff barriers, but the selective use of very reasonable and equitable quotas for the duration of this particular emergency, because if we do not strengthen the confidence in the dollar abroad, results in our country will far exceed any temporary inconveniences involved in consulting——

Mr. BARRETT. Are we doing something that would cause the other countries to react in reverse of what you are doing?

Mr. STEWART. If we base it on my recommendation, on a chronic balance-of-payments situation, and limit the quotas to these particular industries, or those industries that have a demonstrable and increasing trade deficit, we do not encourage other countries on a broad scale to retaliate because it would be a violation of their commitments under GATT to do that, since we invoke article 12; and, secondly, all of the countries have utilized similar measures in the past when they were in a similar situation. So it would be difficult for them now to say, we deny to you the right to do what we did when we were in the same situation. It is not a practical question.

Mr. BARRETT. No other questions, Mr. Stewart.

You have certainly been very helpful here, and I know the members appreciate your edification this morning. You are a good witness and we were glad to have you.

The committee will stand in recess until 10 a.m. tomorrow morning. At that time, we will have the following witnesses:

Leif Olsen, First National City Bank of New York;

Roy Reierson, Bankers Trust Co. of New York; and

Mr. Peacock of the Crocker Citizens National Bank of San Francisco.

(Whereupon, at 12:05 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, February 1, 1968.)

REMOVAL OF GOLD COVER

THURSDAY, FEBRUARY 1, 1968

House of Representatives,
Committee on Banking and Currency,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Wright Patman (chairman) presiding.

Present: Representatives Patman, Barrett, Reuss, Stephens, St Germain, Gonzalez, Hanna, Annunzio, Rees, Galifianakis, Widnall, Fino, Dwyer, Halpern, Brock, Johnson, Stanton, Mize, Lloyd, Blackburn, Brown, Williams, and Wylie.

Chairman Patman. The committee will please come to order.

We have Mr. Leif H. Olsen, Mr. Roy L. Reierson, and Mr. Leslie C. Peacock.

Mr. Olsen is senior vice president and economist for the First National City Bank of New York.

Mr. Reierson is senior vice president and chief economist for the Bankers Trust Co. of New York.

And Mr. Peacock is senior vice president and economist for the Crocker-Citizens National Bank of San Francisco, Calif.

We are glad to have you gentlemen, and we would like to ask that you confine your statements to 10 minutes each, and then give us an opportunity to ask you questions, if you please.

We are attempting to finish by 11:30, if we can, to see if it is possible to vote the bill out this morning in executive session.

Mr. Olsen, if you will start first, then Mr. Reierson and Mr. Peacock.

Anything you do not present this morning you can insert in the record.

STATEMENT OF LEIF H. OLSEN, SENIOR VICE PRESIDENT AND ECONOMIST, FIRST NATIONAL CITY BANK OF NEW YORK

Mr. Olsen. Mr. Chairman, I want to thank you and the committee for this opportunity to speak in support of the legislation to remove the 25-percent gold reserve requirement for Federal Reserve notes.

Other witnesses, of course, have presented testimony about the loss of gold since 1957 and the present status of the gold stock, so I won't cover that ground again. But I would like to call your attention to developments since the gold reserve requirement against Federal Reserve deposits was removed in 1965.

It is interesting to note that of the total decline in the gold stock which has taken place since 1965, 55 percent is accounted for by an increase of $7 billion of Federal Reserve notes in circulation, reflecting the expansive monetary policy of the last several years.

The remainder, except for small domestic sales to industry, was due to an outflow of gold to foreign governments.

Even if we had lost no gold in recent years, the question of reducing or removing the gold cover requirement would have arisen at some point. Now, we know of course that there are provisions in the Federal Reserve Act which permit the Board of Governors to suspend the gold reserve requirement. But there are penalties, penalties which will add from 1 to 1½ percent or more to the discount rate, depending upon how far the gold reserve declines. Obviously, however, there are limits to the extent to which such suspension can be carried on without interfering with the orderly conduct of monetary policy.

There is what might be called the "mechanical" aspect to the proposal to remove the gold reserve cover. A normal expansion in Federal Reserve notes is needed to satisfy a growing economy and a growing population. It seems to me that to force, in effect, a rigid cessation of any further expansion of such currency would serve no useful purpose and would be extremely disruptive to the economy. Both at home and abroad, it would harm confidence in our ability to conduct our economic affairs in a rational manner.

Others have testified before this committee that removal of the gold cover is needed to maintain the confidence of foreigners that America will continue support of the gold exchange standard. At the end of September, foreign official holdings of U.S. dollars; that is, holdings by central banks and governments, amounted to $15 billion. Private holdings amounted to $16 billion. There is no question that the dollar is strong as an international currency. It is eagerly sought after for use in commercial transactions. It cannot be denied, however, that some measure of its value is attributable to the fact that it is convertible into gold by the U.S. Treasury. This value tends to be substantially diminished when foreigners see only $1.1 billion available for conversion. This excludes an $800 million gold obligation to the International Monetary Fund.

I do, however, believe that at this time, when the Treasury and the Federal Reserve find it necessary to request legislation to remove the gold reserve requirement against Federal Reserve notes, the dialog should be broadened. We should be circumspect and consider all the ramifications of this move. It has been presented as largely a mechanical step, necessary to remove an obsolete impediment to orderly monetary policies. But Congress should not overlook that this very step is part of a major question; namely, the future role of gold and the dollar in international finance.

Over the years, since the end of World War II, we have increased our financial assets at a far more rapid rate than we have increased gold production. Moreover, on a net basis, none of the new gold production since 1949 has flowed into the Treasury stocks. The United States and Great Britain notably have been net losers of gold over this period of time.

Consequently, gold has developed a scarcity value, in terms of dollars as well as other currencies. Markets are very sensitive to scarcity values in any commodity. And when commodities are scarce they tend to rise in price. As a result, markets will, from time to time, test the ability of suppliers to hold the price. The most recent such test for the gold price took place during the month of December when the United States lost $900 million of gold, largely to private buyers in the London gold pool.

As you know, central banks of seven countries supply gold to the London gold pool to prevent the price of gold in private markets from rising above the U.S. price of $35 per ounce.

This committee has been told by administration witnesses that American citizens cannot own gold. Gold belongs in a nation's international reserve. But private ownership of gold is permitted in many parts of the world and through the London gold pool, the private market has direct access to the monetary gold stock of the United States and six other countries. France is a member but, as we know, no longer makes gold available.

I believe we will see successive efforts on the part of the private market to test the willingness and ability of the United States to maintain the present gold arrangements or the present dollar price of gold. If private acquisition of gold is joined by purchases of some central banks our present gold stock, after removal of the cover, would be drastically reduced or depleted, unless we stopped gold sales.

Of course, the logical strategy behind removal of the gold cover—from the standpoint of supporting the dollar overseas—is to say that our entire gold stock is now available for conversion by foreigners. As I understand it, as a further part of that strategy the Treasury hopes to correct our balance-of-payments deficit long before we run out of gold. To this end, the administration at the end of last year hastily revised its controls program and added some new aspects. These range from a moratorium on private dollar investment in continental Europe to potential restraints on tourist travel.

The new controls program seeks to fragment the balance of payments. This cannot be done. Cutting back on one area can have undesirable effects on another. New funds going into direct investment are being cut, even though they help to finance a sizable share of U.S. exports—as much as one-third of total nonagricultural exports in 1964, according to the latest available figure. Furthermore, investment cuts today will reduce investment income tomorrow. And we must not overlook the possible effects of our controls program on sterling, whose fortunes are closely linked to the dollar.

Considering the lateness of the hour, that is, our heavy gold losses and the magnitude of last year's deficit, the emergence of new controls is not surprising. They will, of course, be supported by American industry. But they must also be supported by fiscal and monetary policies and reductions in Government spending overseas. Controls alone simply do not work. Without that support, we will get no more than temporary relief in the months immediately ahead. As more oversea liquidity and earnings are brought home the benefits will diminish. If monetary and fiscal policies continue to be excessively expansive in pursuit of our domestic and oversea programs, then the effect of the controls on the deficit will be lost.

We have lived with controls for 4½ years, beginning with the imposition of the interest equalization tax, as a temporary measure, in July 1963. There were those who predicted at that time that controls would proliferate because one begets another. And we have seen it happen.

Our hasty, troubled, ad hoc approach to solving the balance-of-payments problem has probably done more to worsen it. The anticipation in private markets of increased controls has undoubtedly intensified the outflow of dollars above what might be regarded as normal.

For example, the public statements of Federal officials expressing uneasiness about the situation last December created excessive nervousness in the marketplace and led to large dollar outflows.

The Treasury has indicated before this committee that if after removal of the gold cover we again experience substantial gold drains, new and tougher measures will be undertaken. This, too, is not likely to engender confidence. This affects not only Americans, but foreigners who also have a major stake in the free movement of dollars.

The great danger we face is that the Treasury will be misled into thinking that after losing $2 or $3 billion more of gold, stronger and more sweeping controls are needed and that they will surely work. Then, if we lose another $2 or $3 billion of gold, more controls will follow. There must be a point at which even the Treasury officials will be convinced that controls alone do not work. I only hope that point comes soon enough to prevent the creation of a structure of controls, deeply rooted, standing opposite retaliatory controls of other countries.

If the Federal Government does not expect to be able to deal decisively with the problem of domestic inflation; if it does not expect to be able to further restrain spending and slow down monetary expansion; if it does not expect to be able to get a tax increase enacted; and if it does not expect to be able to cut back substantially on its huge oversea commitments, then we are not going to correct our balance-of-payments deficit. And if we don't correct the deficit we are going to lose more gold, if not the foreign central banks, then to the private market through the London gold pool. For with growing wealth, it becomes less and less burdensome for an individual or an institution to lock up $1 million, $5 million, or $10 million in gold.

I can't believe that the United States would purposely elect to be left without any gold. Consequently, we had better begin facing up to some hard decisions about the present gold arrangements. For what could we possibly gain by hanging on to our remaining gold stock if the price of doing so is comprehensive exchange control over the dollar and the consequent setback to world trade and investment? It would be better to raise the price of gold than to continue down the avenue of controls, if these are the only alternatives. If we continue down the control route because we are unwilling to adopt the right domestic policies, we will end up in the same place anyway—with an increase in the gold price or—much worse, I think—a moratorium on gold sales. But along the way we will do even greater harm to the world's international financial structure.

Chairman PATMAN. Thank you very much.

Now, we will hear from Mr. Reierson, senior vice president and chief economist of the Bankers Trust Co. of New York.

STATEMENT OF ROY L. REIERSON, SENIOR VICE PRESIDENT AND CHIEF ECONOMIST, BANKERS TRUST CO., NEW YORK

Mr. REIERSON. Mr. Chairman and members of the committee, proposals to eliminate the 25-percent reserve requirements against Federal Reserve note and deposit liabilities have been made repeatedly over the years. Back on November 18, 1959, back in your home State, Mr. Chairman, I suggested that consideration be given to their elimination. In that address, I observed:

> In meeting the broad complex of the balance-of-payments problem * * * it may be wise to alleviate these anxieties by reducing, or even eliminating, the present 25-percent gold reserve requirement against Federal Reserve note and deposit liabilities.

Subsequently, a number of distinguished members of the financial community took a similar position. The gold certificate reserve requirement on Federal Reserve deposits was removed in March 1965. The present proposal is to eliminate the reserve requirements against Federal Reserve notes and against U.S. notes and Treasury notes of 1890.

Elimination of the remaining reserve requirements would have no significant effect upon Federal Reserve credit policy, upon banking and credit conditions in the United States, or upon the domestic value of the dollar. In the comparatively near future, the reserve requirements will have to be eliminated—or reduced—to accommodate the growing currency needs of an expanding economy. The reserve requirement is an archaic holdover from the days before 1933 when the dollar was convertible into gold, domestically. No other major industrial nation has a similar requirement at present.

If done in a favorable international monetary environment, action to remove the remaining reserve requirements would have passed largely unnoticed. Taken under present adverse conditions, however, such a step could weaken, not strengthen, the standing of the dollar internationally.

The root cause of the problems of the dollar is the failure to reduce the American balance-of-payments deficit, especially since 1958, when deficits have increased in size. The U.S. balance of payments has been in deficit in every year since 1949, except for 1957, the year of the Suez crisis. These deficits have contributed to large gold losses, to big increases in short-term liabilities owing to foreigners, and to a serious deterioration in the international liquidity position of the United States—as shown in the attached tables.

Repeated efforts to deal with the payments problem have not succeeded, confidence in the dollar has dwindled, and the devaluation of sterling last November 18 was followed by a massive attack on the dollar, reflected in tremendous waves of gold buying abroad. As a result, the United States, in the few weeks following the devaluation of sterling, reported a gold loss of $925 million, at least.

Elimination of the gold certificate reserve requirements will do nothing to correct the basic problem—the large American payments deficit and the resulting outpouring of dollars at a rate which is far greater than foreigners want or need to hold. Elimination of the reserve requirements at this time is, in fact, likely to encourage delay in taking the effective action required to bring the American balance of payments into sustainable equilibrium, and would in all probability be interpreted abroad as an indication that we are content to continue down the road that has already cost us over $11 billion in gold during the past 10 years.

Consequently, if the American balance of payments continues in deficit, repeal of the reserve requirements would not prevent but might even encourage further drains on our gold stock and bring closer the danger of an international monetary crisis. This is because, in a troubled and uncertain world, our national interest surely argues against permitting our gold reserve to decline below a reasonably large minimum amount. Whether one thinks in terms of national defense, or in terms of the need for gold in the monetary system of the future, whatever its form, it is difficult to see the United States denuding itself of the only generally accepted reserve medium currently available to support the dollar in the foreign exchange markets.

A solution to the American payments problem is not to be found in the activation of the special drawing rights now under consideration by the International Monetary Fund. This device, not yet approved, will not be uesd to ease the payments problems of individual countries. Nor is a solution to be found in gimmicks, such as reducing the American buying price of gold, or in adopting a system of flexible exchange rates. In an inflationary world environment in which gold production is declining and in which the $35 price is being maintained only by taking gold out of monetary reserves, both central banks and others are eager to conserve and build up their gold holdings. Gold is still regarded as the only ultimate means of payment internationally and the preeminent hedge against persistent decline in the value of currencies—as current experience clearly demonstrates.

Nor can the industrial strength of the United States and the large American investments abroad save the dollar from severe pressures in the foreign exchange markets or prevent large gold losses, if the payments deficits persist. Despite the productivity of American industry, the commercial trade surplus dropped to a miniscule $600 million in 1966, the latest year for which data are available. American investments abroad are not readily salable and are in private ownership—two important considerations that prevent their being marshaled in defense of the dollar.

There is, therefore, no alternative available to the United States, if the dollar is to be restored to strength and if serious monetary disorder is to be prevented, other than to achieve prompt and meaningful improvement in its payments position. Repealing the gold certificate reserve requirements would be in order if the American balance of payments were clearly on the mend, with the quarterly deficits being sharply reduced and sustainable payments equilibrium in sight within the year. Unfortunately, this is not the prospect.

On the basis of information presently available, there is little basis for a realistic appraisal of the probable savings that will result from the latest balance-of-payments program. Despite these uncertainties, one may hazard the guess that the payments savings achieved by the new program will fall far short of the $3 billion to $3.25 billion target projected for 1968. The current year is, therefore, likely to show still another substantial payments deficit.

The longer term prospects for the present program are even more dubious. The American public is not likely to tolerate, for too long, highly restrictive restraints on travel; the risk of foreign retaliation will probably increase with the passage of time; even without more extensive involvement, rising wages and prices will add to the foreign exchange cost of the military operations. The longer the payments program continues, the more serious will be the adverse effects upon the ability of American business and financial enterprise to compete in foreign markets. Despite the fact that receipts from direct investment abroad have been exceeding outflows by $1.5 billion to $2 billion per year in recent years, the goal in the latest payments program is to achieve a $1 billion saving this year. The upward trend of receipts on direct investment, one of the few favorable trends in the American payments record of recent years, will assuredly suffer if restrictions on direct investment are continued for very long.

If the Congress desires to strengthen international confidence in the dollar, the more effective approach would be not to repeal the gold certificate reserve requirements and to insist that additional action be taken to achieve sustainable equilibrium in the balance of payments of the United States. Action is required along three fronts:

1. To reduce the payments cost of the foreign economic and military activities of the Government. The present program sets a savings target of only $500 million on the Government programs which have, year in and year out, been showing deficits of several billions of dollars. In contrast, the private sector, which has consistently shown large payments surpluses, has a target of saving, under the program, of $2.5 billion to $2.75 billion.

2. To achieve a substantial reduction in the Treasury deficit in fiscal 1969. The temper of the voters and the Congress being what it is, this would appear to require more effective curbs on spending than are reflected in the latest budget message. Failure to achieve a significant improvement in the fiscal position of the U.S. Government will clearly have a highly adverse effect upon the standing of the dollar in world financial markets.

3. To follow a credit policy that is appropriate to the inflationary conditions in the American economy, the highly adverse payments position and the plight of the dollar abroad.

These steps will have to be taken sooner or later if the dollar is to be saved. Neither an increase in the price of gold, nor the use of SDR's, nor other possible courses of action, will relieve the United States of the necessity of bringing its international accounts into balance. The discipline of the balance of payments ultimately is inescapable for a major industrial country. Even with the alleged benefits of unilateral devaluation—a course of action which is not available to the United States—the British are being forced to recognize, at long last, that their balance of payments must be brought into equilibrium, even if this involves unpalatable actions which they refused to take earlier.

By holding to the present gold certificate reserve requirements and by taking additional steps now, we can still restore confidence in the dollar and stave off an international monetary crisis.

(Attachments to Mr. Reierson's statement follow:)

Balance of payments—Liquidity basis

(In millions of dollars)

Year:	Surplus or deficit (—)	Year—Continued	Surplus or deficit (—)
1949	136	1959	—3,870
1950	—3,489	1960	—3,901
1951	—8	1961	—2,370
1952	—1,206	1962	—2,203
1953	—2,184	1963	—2,671
1954	—1,541	1964	—2,800
1955	—1,242	1965	—1,335
1956	—973	1966	—1,357
1957	578	1967	—4,000
1958	—3,365		

INTERNATIONAL RESERVE POSITION OF THE UNITED STATES

[Dollar amounts in millions]

	End of 1949	End of 1957	Latest	Latest versus— 1949	Latest versus— 1957
U.S. monetary gold stock (as reported)	24,427	22,781	[1] 11,984	—12,443	—10,797
U.S. monetary gold stock (excluding IMF gold counted in the U.S. stock)	24,427	22,581	[1] 10,951	—13,476	—11,630
Gold tranche position, IMF	1,461	1,975	[2] 381	—1,080	—1,594
Short-term liabilities owing to:					
Foreign official agencies	2,908	7,917	[3] 13,408	10,500	5,491
Other foreigners	4,710	7,241	[3] 16,512	11,802	9,271
Total	7,618	15,158	[3] 29,920	22,302	14,762
Ratio of U.S. monetary reserves (Jan. 24, 1968) to short-term liabilities owing to foreign official agencies (October 1967):					
(a) Gold, as reported	840.0	287.7	89.4	--------	--------
(b) Gold, ex IMF	840.0	285.2	81.7	--------	--------
(c) Gold (ex IMF) plus gold tranche	890.2	310.2	84.5	--------	--------
Ratio of monetary reserves (Jan. 24, 1968) to total short-term liabilities to foreigners (October 1967):					
(a) Gold, as reported	320.6	150.3	40.1	--------	--------
(b) Gold, ex IMF	320.6	149.0	36.6	--------	--------
(c) Gold (ex IMF) plus gold tranche	339.8	162.0	37.9	--------	--------
"Free" gold:					
Gold stock (as reported)	13,830	10,868	[1] 1,598	—12,232	—9,270
Gold stock (ex IMF gold)	13,830	10,668	[1] 565	—13,265	—10,103
Drawings (net) on IMF	--------	--------	[2] 831	831	831

[1] Jan. 24, 1968.
[2] November 1967.
[3] October 1967.

Chairman PATMAN. Thank you, sir. Now, we are glad to have Mr. Leslie C. Peacock, senior vice president and economist, Crocker-Citizens National Bank, San Francisco, Calif.

You may proceed.

STATEMENT OF LESLIE C. PEACOCK, SENIOR VICE PRESIDENT AND ECONOMIST, CROCKER-CITIZENS NATIONAL BANK, SAN FRANCISCO, CALIF.

Mr. PEACOCK. Thank you, Mr. Chairman.

Some of the arguments for removal of the 25-percent gold reserve requirement rest on the proposition that the formal link between gold and currency is an outmoded and potentially harmful feature of our domestic monetary system. These arguments I believe to be correct. In my judgment, the requirement has little or no relevance to the inherent soundness of our domestic currency, and clearly we should not allow it to take precedence over the public's requirements for normal growth in the supply of currency.

With strong prospects that the Nation's gold stock will be inadequate to meet requirements in the not too distant future—reflecting the combined impact of currency expansion and additional gold drains—there is presently not much hope of being able to develop an ultimate alternative to the elimination or relaxation of the requirement.

If the issues raised by H.R. 14743 were no broader than the question of the removal of an undesirable appendage which could stand in the way of desirable currency expansion, or if the Congress could pass this bill with a legislative history or other indication of intent that the bill is designed to do no more than that, it is not likely that the proposed legislation would arouse much anxiety or opposition. If this were the sole purpose of the bill, however, there might be some questions raised as to its premature consideration.

Clearly, the bill has a broader import—and that is that it would pave the way for this country to continue to purchase with gold exports what it has not been able to earn through adequate performance of its international accounts—that is, international confidence in the sustained convertibility of the dollar at the rate of $35 per ounce.

Arguments advanced in behalf of the bill indicate clearly that the proposal is meant in part to remove any suspicions that the full U.S. gold stock may not be available for the satisfaction of legitimate foreign claims. Much of the language used in support of the proposal, particularly with reference to how far this country is prepared to go in paying out gold, underscores this point.

In many respects, in fact, the bill implies a strategy of dealing with international financial problems; and support for the bill reasonably might be expected to imply support for the strategy which it suggests. It does not seem unreasonable to assume that congressional approval of the bill also could be considered as being tantamount to congressional approval for a plan of action which calls for, in the event of a failure to achieve progress toward reaching a sustainable position in the balance of payments over the next year or so, the continued paying out of gold and possibly, but not likely, the complete liquidation of the U.S. gold stock.

Such a strategy has much to recommend it, not the least of its merits being that the policy posture which it supports tends to minimize gold drains in the short run and assures the United States the maximum amount of time in which to struggle for answers which, after a decade of search, remain as elusive as ever.

The fact that a full and unconditional commitment of U.S. gold to the satisfaction of international claims—as long as gold remains—would add significantly to this country's time and maneuverability in responding to international financial problems is not open to question.

The question remains, however, whether this is the wisest course of action. The question cannot be answered categorically, but at least some observations can be offered. If the United States has the capacity and the willingness to bring about near-term and significant improvement in its balance of payments, if this progress can be sustained and built on, if it can be secured without exacting too high a price in terms of regimentation or inferior economic performance at home or a damaging withdrawal from international responsibilities, and if all this can be done while we are heavily committed in southeast Asia, then the strategic arguments which underlie this bill unquestionably are correct. If these possibilities could be held to be strong probabilities, there would be little risk in the removal of the gold cover requirement and little risk that our gold stock would be dissipated without the consideration of existing alternatives.

If, on the other hand, Congress accepts the gold payment strategy underlying this bill and finds subsequently that balance-of-payments programs are inadequate to meet our urgent needs, it also is almost certain to find that it has chosen the worst alternative now open to the United States.

In addition to the commitment to pay out gold until the stock is completely exhausted, these alternatives include now, as they always have—

(*a*) The willingness to resort at some point to a suspension of gold payments while there is still gold left for the purpose of exchange rate stabilization;

(*b*) The willingness to take the initial step toward a worldwide increase in the price of gold; and

(*c*) The willingness to undertake corrective measures which, however painful they might be in the short run, would succeed in restoring a sustainable position to the international accounts.

Of all these alternatives, the latter is, in my judgment, the most preferable at the moment. In the final analysis, any of these alternatives is preferable to the exhaustion of gold supplies by meeting demands which would ensue from attempts to preserve the existing price of gold in the face of continuing and substantial deficits in the balance of payments.

It is not easy to say what price the country must pay in order to achieve the balance-of-payments progress required. The price is to be reckoned in terms of accepting less buoyant domestic economic conditions than many consider essential, in terms of the elaboration and proliferation of selective economic controls which most of us deplore, in terms of accepting encroachments on certain freedoms—such as foreign travel—which many view darkly, in terms of paying higher taxes and/or accepting less in the way of services from the Federal Government, and in terms of settling for a small share of responsibility for what happens elsewhere in the world. Even if one could lay out precisely what will be required in terms of these sacrifices, there still would be room for debate as to whether the game is worth the candle.

In contrast with these ambiguities, some thoughts can be expressed with relative certainty. Among them is the judgment that existing programs for the defense of the dollar, insofar as they are known, do not appear adequate to the task. In the light of this personal judgment, and in view of my strong opposition to the export of gold indefinitely under circumstances which offer no prospect that the factors underlying the gold drain will be reversed, I cannot endorse the provisions of H.R. 14743.

A more reasonable course of action, in my judgment, would be in using as profitably as we can the time remaining for intensive measures aimed at restoring payments equilibrium. If these measures are not sufficient and the supply of free gold is exhausted without a sharp improvement in prospects for our balance of payments, I would be opposed to the continued export of gold.

This is not a comfortable view, nor is it one which is in harmony with my traditional preference that American bankers avoid statements and actions which complicate the task of officials in bolstering international confidence in the dollar. Perhaps the most that can be said is that the views are honest ones.

Chairman PATMAN. Thank you, sir.

Mr. Reierson, I would like to ask you first about the payment of gold to citizens of England. Can a citizen of that country get gold when he wants it through this gold pool?

Mr. REIERSON. No, sir.

Chairman PATMAN. How do they go about it? Under what conditions can a citizen of that country get gold?

Mr. REIERSON. Legally?

Chairman PATMAN. Yes, sir.

Mr. REIERSON. My impression is that citizens of the United Kingdom and citizens of the United States are legally prohibited from holding gold.

Chairman PATMAN. We enforce it here. Do they enforce it there?

Mr. REIERSON. To the best of my knowledge, I believe it is enforced, although I have no direct evidence. I have asked the British authorities——

Chairman PATMAN. Is there any country in the world that pays out gold on demand?

Mr. REIERSON. I believe there is one very minor country that does. I asked Mr. Schweitzer about this about a week ago. He mentioned one other country, the name of which I can't even remember. The answer is, there is no major country that follows our practice.

Chairman PATMAN. They would obviously have control over their money and credit and gold, that particular country you are talking about?

Mr. REIERSON. This is such a small country, it is without consequence.

Chairman PATMAN. Mr. Olsen, I would like to ask you now about our exports of goods and services, concerning our balance of payments. I have been impressed over the years that maybe we are on the plus side on the actual balance of trade on goods and services. Is that correct or not?

Mr. OLSEN. Yes, sir. We have had a rather comfortable surplus for some years.

Chairman PATMAN. So our problem has grown out of the fact that we have permitted the export of money and credit; is that right?

Mr. OLSEN. In part; yes.

Chairman PATMAN. Well, do you know of any country on earth, except our own, that does not control the export of its money and credit? We have not been controlling it, but I don't know of any other country in the world that doesn't have such controls; do you?

Mr. OLSEN. No. Most of the major countries have some form of control.

Chairman PATMAN. Dr. Peacock, do you agree with the answers that these gentlemen have given to these questions? I know you have your own viewpoint.

Mr. PEACOCK. Yes, sir; I do.

Chairman PATMAN. All right.

Mr. Widnall.

Mr. WIDNALL. Thank you, Mr. Chairman.

First, I would like to thank each of you for coming down here today and for the very frank statements which you have given. I think it is very helpful for the record and something that has been needed to fill in holes in what we have had presented to us so far.

You don't have to answer this question if you don't care to, but with the full cooperation of the chairman, the minority has been given this additional week of public hearings in order to explore the balance-of-payments program.

Would you care to venture a guess, why the international business community, those U.S. corporations with large overseas direct investments, has resisted in no uncertain terms the opportunity offered by us to come in and testify?

As I say, you don't have to answer that.

Mr. REIERSON. Mr. Chairman, I recognize the sensitive nature of this question. I can report that I did discuss this specific question with a high official of an international business corporation. I asked him whether he had been invited to appear at these hearings, knowing that invitations were being extended to members of the business community, and he said he had not. I then asked him if he were invited, would he appear, and he said no.

I then asked him why he would not appear, and his answer was, "Fear of retaliation." The present direct investment program cannot possibly operate unless numerous exemptions are granted. In this instance it was the fear that if somebody from this company appeared at these hearings and took a critical point of view, this might endanger or impair, or influence, or affect the decisions that the Departcent of Commerce might make in their applications for exemptions which they will be forced to make.

I am making no generalization. I am giving you an accurate report of one interview.

Mr. WIDNALL. Mr. Olsen.

Mr. OLSEN. I would certainly agree with what Mr. Reierson has said with respect to the nature of the program—that corporations in many instances will have to come in to seek exceptions when they encounter peculiarly difficult problems. But I have not had an experience such as Mr. Reierson described in talking with corporate heads.

I would offer, though, the suggestion that I believe the Ways and Means Committee is holding hearings on the control program, beginning here on the 5th of February. I would expect to see there the heads of corporations, and I would certainly hope so.

Mr. WIDNALL. The direct investment program finds its legality on banking law, and that is the reason it should have occurred here.

Mr. Peacock, do you have any comment?

Mr. PEACOCK. One of the things which has not been said is that most heads of large, international corporations find themselves not in sympathy with the restrictions. Nevertheless, they are of a rather mixed mind because while they may agree as to the necessity for actions which would limit the outflow of funds on long-term investment accounts, and they are reluctant to oppose these restrictions without also offering some alterations. There is a very great shortage of alternatives at the present time.

Mr. WIDNALL. Mr. Peacock, I would like to say this to all of you. I admire your courage in coming here today and speaking frankly about this. It seems to me that banks are under the same pressures that the business community seems to feel they are suffering under at the present time.

With our present worldwide military and foreign aid commitments, can the President's program be in any manner considered temporary?

Mr. OLSEN. I am not encouraged at all that it will be temporary, except that the course of events will force decisions that will change the program as it evolves.

It has been from the first instance, when the interest equalization tax was enacted, there were many who were regarded as cynical who said that measure, which was temporary, would be with us for a long time; and it appears now it is likely to be. So the history of legislation of this sort indicates that it stays with us for a long time. It takes more fundamental changes, which I touched on, and I think Mr. Reierson had touched on, also, to guarantee that these controls would be temporary.

Mr. WIDNALL. Mr. Reierson.

Mr. REIERSON. May I make a comment on your question. I have just taken a look at the testimony submitted in February 1965, preceding the elimination of the reserve requirement against Federal Reserve deposits in March. There is a very interesting similarity between the optimism then expressed and the determination to put our balance-of-payments situation in order, and similar statements that we are hearing in the present hearings.

I also read with interest Mr. Barr's comment on the reason for our failure to deliver on the promises made in 1965. In 1966, assuming that the President's higher estimate is correct, the payments deficit will be close to $4 billion. Vietnam, if my recollection of Secretary Barr's testimony is correct, accounts for $1½ billion.

The United Kingdom in 1967 accounted, according to his testimony, for $600 million. This still leaves $2 billion of the deficit unaccounted for or unexplained.

My point is this: The reason we have failed to come to grips with this problem is not due to lack of effort. The voluntary programs covering direct investment and lending by banks and other financial institutions have been in effect for some time. The interest equalization tax has also been in effect.

We have been trying, apparently, to reduce the cost of the foreign aid and military programs and we have been promoting exports and foreign travel in the United States.

The big mistake, I think, is that we have failed to support the balance-of-payments efforts by appropriate general economic policy. The fiscal policy of the United States in the past 2 years has been nothing short of horrendous.

With the outbreak of Vietnam, we began to increase nondefense expenditures—on a cash budget basis—at an unprecedented rate, instead of curbing them. We have so far failed to enact a tax increase. We have been following a credit policy, which, except for a few months in 1966, has certainly been quite inconsistent with the inflationary trends at home, and the serious state of the dollar abroad.

The real thrust of my statement is that there are some things we can do in a special balance-of-payments program, particularly, I think, in the Government sector.

I have no hope that this effort will be temporary. Our efforts in this area will not succeed, however, unless we are willing to support this effort by the use of appropriate general economic policy, in the fiscal and credit area.

Mr. WIDNALL. Mr. Olsen.

Mr. OLSEN. I only want to reinforce briefly what Mr. Reierson said, by recalling a study which was done in 1963, by the Brookings Institution. That study in many ways makes much more interesting reading today than it did in 1963.

My recollection is that they projected a surplus in our trade account of $5.3 billion by the year 1968. They projected that because they expected that the United States would have less inflation than the rest of the world, and that our rate of productivity would grow more rapidly than the rest of the world. It was not based on the success of controls. And even though they did not foresee the advent of the growth of the Vietnamese war, the growth in our trade surplus on which their forecast now depended has not come to pass.

For the last 3 years we have actually had a higher rate of inflation and we have done less well than other countries in Europe and other countries in the world who are our trading partners.

I say this because we so frequently tend to be overly optimistic. This study was done by thoughtful men who, nevertheless, frequently draw a picture of the future which is ideal and not, unfortunately, often realistic.

Chairman PATMAN. Mr. Barrett.

Mr. BARRETT. Mr. Chairman, I would like to ask Mr. Peacock: On page 3, you seem to give a sort of continuity of "ifs." "If, on the other hand, Congress accepts the gold payment strategy underlying this bill and finds subsequently that balance-of-payments programs are inadequate to meet our urgent needs," and then you go off and you give (a), (b), and (c).

I would like to ask you, Mr. Olsen and Mr. Reierson: It is better to control the monetary flow by an increase in taxes, rather than putting controls on everything we do overseas, and to destroy the harmony we may have now through the monetary fund in all countries?

Mr. PEACOCK. There is no single area in the balance of payments which, being dealt with as a separate sector, is capable of giving us the degree of improvement that we need. That is why I take the position that it would be very easy to support a bill removing the gold reserve requirement if there were in existence, or in definite prospect, the kind of comprehensive measures which are needed.

If one examines the various approaches to restoring equilibrium to the balance of payments, I think we, first of all, must work harder on the reduction of the dollar drain from Federal expenditures overseas. This is an essential part of a constructive, adequate balance-of-payments program.

There is not enough room in that area alone to restore equilibrium in the balance of payments, however, so I would suggest we also must go further. We must work on basic underlying economic conditions in this country—such things as the rate of growth in aggregate demand, the degree of overheating that hampers price-cost stability in the United States. In this connection, I would note that a tax increase around the corner, or definitely in prospect for this year would make one feel somewhat more comfortable that we are in a better position to deal with the balance of payments.

The prospects in the short run for getting gains out of our trade surplus, and out of reductions in the oversea expenditures of the Federal Government, are not so strong, and probably cannot be so strong, as to suggest tomorrow or the next day that we can dispense with the kind of controls we have already introduced.

Mr. BARRETT. I am somewhat impressed with Mr. Reierson's statement, and I was wondering if you would tell us which you think is the stronger, the dollar or the gold?

Mr. REIERSON. As of today, I don't think there is any doubt but that gold is stronger than the dollar—for a variety of reasons.

Mr. BARRETT. I am sorry you say it is.

Mr. REIERSON. It is stronger than the dollar, and I don't think there is any reasonable prospect that the international monetary system will dispense with gold for many years to come.

First, gold is the underpinning of the whole IMF structure. Second, there are many central banks today which are holding more dollars than they would like to hold. They have not been able or willing to convert them into gold, first, because the United States has been using persuasive techniques to induce them to invest in 13-month obligations in order to reduce the deficit.

In addition, the United States has been using, for a number of years, various techniques designed to induce them to hold the dollar obligations rather than to convert into gold.

Secondly, one reason they go along with this is their fear that if the major countries were to convert substantial amounts of dollars into gold, which they would prefer to hold, this would cause great difficulty for the international monetary system.

And, third, the amount of the rush into gold at the time of the sterling devaluation is evidence of uncertainty about the future of the dollar. We don't know how much gold was paid out. My guess is that it was somewhere between a billion and a half and $2 billion, paid out in a matter of a few weeks. While some of it probably went to some central banks, the great bulk of it went elsewhere.

So, as of today, unfortunately, it is my opinion, and it is not one that makes me happy, that gold is definitely stronger than the dollar.

Mr. BARRETT. Mr. Olsen, my time is going to run, but I would like to get your concept of this and, if you will, give me your concept. I think you are inclined to think that the dollar is stronger than gold, and if you do, I would like to ask you, at which period in our economy is the dollar the stronger?

Mr. OLSEN. What time?

Mr. BARRETT. Yes.

Mr. OLSEN. Well, let me say that the expression "strength" is something I find difficult to define; gold has a value, because we give it a value. At the present time, it has considerable value, of course, and the purchases of gold which were made in December, in particular, were purchases which may have been mixed with fear. They were also purchases which, I think, stemmed from great hope, hope that possibly the United States would be forced into increasing, or perhaps doubling, the price of gold quickly.

So that gold has, as I stated in my statement, a certain scarcity value which, by virtue of its being a monetary unit, has developed relative to other currencies. What its strength would be as a commodity is something which we have yet to test at some point. The dollar is used in international transactions, in commercial transactions, in the markets. It earns an income as an investment. In this sense, the dollar has a great deal more usefulness than gold.

The strength of gold will only be borne out by future events in the world financial structure.

Mr. BARRETT. Just one final question. When will the dollar be stronger or weaker, what period? What time in our economy? I know when we have a booming economy—I am trying to get this into the record.

Mr. OLSEN. When will the dollar be stronger than gold?

Mr. BARRETT. When will it reach its weakest point?

Mr. OLSEN. I think it is, as Mr. Reierson says, weak at the present time in the sense that gold is being sought more eagerly than it has been previously—if that is a measure of its relative strength to gold. But I would hasten to add, however, that the strength or weakness of the dollar should be measured more importantly against other currencies rather than against gold.

Chairman PATMAN. Mr. Fino.

Mr. Fino, before you start, may I pose this question: We had understood we were to have an executive session at 11:30. But I have talked with Mr. Widnall and he thinks we could safely go to 11:40. I wonder if it would be all right with the members to say now we will have an executive session at 11:40, and pass on the bill?

(No response.)

Chairman PATMAN. Without objection, so ordered.

Mr. FINO. Thank you, Mr. Chairman.

I, too, want to compliment you gentlemen for your straightforward, honest evaluation of this legislation before this committee.

I have no questions except that I do want to say I am happy to hear that you gentlemen do not agree with the Treasury Department or the Federal Reserve Board that the elimination of the gold cover will not affect the international confidence in the American dollar. That is it.

Chairman PATMAN. Mr. Reuss.

Mr. REUSS. Thank you, Mr. Chairman.

I note that there are 40 minutes between now and 11:40. There are 10 people here. Does anybody who shall come after me mind if I take my 5 minutes? If anybody does, say so. Hearing nothing—thank you, Mr. Chairman.

Gentlemen, you have been leading us toward the truth, and I want you to continue that. Let me, before asking my question, see if the three of you gentlemen can't stipulate with me about a couple of truths that I think are self-evident.

Truth No. 1. We have got to get our balance of payments under control and in equilibrium. Do we all agree?

Mr. REIERSON. Yes, sir.

Mr. OLSEN. Yes, sir.

Mr. PEACOCK. Yes, sir.

Mr. REUSS. The January 1 President's program is likely not to succeed in doing that, and besides that, it has autarchic overtones which you gentlemen don't like. Is that a fair statement?

Mr. REIERSON. Yes, sir.

Mr. OLSEN. Yes, sir.

Mr. PEACOCK. Yes, sir.

Mr. REUSS. Let us stipulate also that we need to stop price inflation in this country by adopting sound fiscal and monetary policies, spending less, taxing more, and creating money in an amount which will not add unduly to demand, and we need to do that for domestic reasons and also for international reasons, because otherwise the price of our exports and the demand for our imports produces international problems.

Can we stipulate to that point?

Mr. REIERSON. Yes, sir.

Mr. OLSEN. Yes, sir.

Mr. PEACOCK. Yes, sir.

Mr. REUSS. Now, my point. It seems to me that the private account in our international balance of payments; that is, trade, tourism, and investments, pretty well balances out, or even yields a little surplus, and that the devil in the flesh is our public account.

Can we stipulate to that?

Mr. REIERSON. Yes, sir.

Mr. OLSEN. Yes, sir.

Mr. PEACOCK. Yes, sir.

Mr. REUSS. OK. It is also true, I believe, that while we can save a few dollars, or scores, or even hundreds of millions of dollars, by eliminating fluff and nonsense from our foreign embassies, cutting down on the number of employees, which we should certainly do, and while it is true that a few dollars may leak out of our aid programs, by and large, the biggest single item in our balance-of-payments deficit is the cost of our military posture in Asia and Europe?

Mr. REIERSON. Mr. Reuss, may I offer a qualification and a reservation which may be based as much on ignorance as on anything else?

I have some reservations about the accuracy of data that have been submitted as to the balance-of-payments cost of the economic program. But beyond this I think there is a question which to me has not yet been answered; namely, what is the adverse effect upon our commercial export market of the giveaway programs of the Federal Government? If we could get a defensible answer on this, I really believe, Mr. Reuss, that the payments cost of the economic programs would be greater than they are presently stated.

Mr. REUSS. Instead of being chicken feed, they may be chicken feed to the second or third power, but the main drain is with \$1.5 billion that we spend in and around Vietnam, and the \$1.5 or more that we spend in and around Germany and the rest of Europe. I think it is time we told the public the truth about this, and isn't what I am saying the truth?

Mr. OLSEN. I would agree. We have done this in our monthly economic letter in the past, analyzed the accounts of the Government and private sector to indicate that over the years the private sector has indeed been largely in balance. But I would add the qualification that it is difficult to fragmentize the balance of payments to the extent of indicating that Government outlays overseas don't in some way find their way into the spending stream and thereby result in some higher private exports from this country.

It is interesting to look at our balance-of-payments situation over the long term. In comparison to the early twenties, the deficits that we have incurred over the past 10 years or more are without precedent. It may well be that our foreign aid program and military posture overseas which we never had prior to World War II, accounts for the difference.

Mr. REUSS. Isn't this the fly in the ointment? In World War II, when we fought Hitler and the Japanese, I never heard of the words "balance of payments," and the reason I never heard of it, was there wasn't any problem. We were the only trading country in the world. Everyone else was devastated or behind enemy lines, so we accumulated a tremendous surplus.

Now, however, we are attempting military operations on a vast scale without, so far as I can see, any important allies who are willing to pick up the balance-of-payments costs of those operations. Therefore, is it not true, gentlemen, that we are attempting something unprecedented in history? Has there ever been a time when anything like this was tried before?

Mr. PEACOCK. I think it is quite right to say that the United States has been in the unique position of deciding independently the amount of money it needs to spend abroad, then looking to the private sector to generate the surplus required to finance it. I believe this has never been done successfully.

Mr. REUSS. Let us, then, as my time expires, ponder this thing, because, as I see it, we are simply attempting more ventures abroad in the governmental sector than God must have meant us to. The balance of payments seems to be working drastically against us.

Mr. REIERSON. May I make a one-sentence comment? Nothing I said earlier should be construed as differing with what you say, vis-a-vis, the military. I completely agree that the military cost is very big, that it is bigegr than it should be, and that it needs very careful, very serious, and very energetic attention.

Chairman PATMAN. Gentlemen, since some members, including Mr. Reuss, will obviously not get to ask all the questions that they desire to ask, will it be satisfactory if we submit questions to you in writing, and when you look over your transcript, answer them, please?

Mr. REIERSON. Yes, sir.

Mr. OLSEN. Yes, sir.

Mr. PEACOCK. Yes, sir.

Chairman PATMAN. That will help the members, because there are certain questions we feel strongly about and we would like to submit them in writing, please.

Mr. HALPERN. Mr. Chairman and gentlemen of our panel, I certainly want to thank our distinguished panel for their superb testimony. I believe they have contributed greatly to the history of this legislation and have effectively cleared the air on any doubts there may have been on this bill. So I wish to extend my heartiest compliments to them.

It took years to interest the American business to invest abroad, and now the administration attempts to discourage this investment. As I see it, this is a reverse of the trend that took years to develop, and we may not ever be able to reverse it again.

In terms of comparative advantage, vis-a-vis other nations, isn't the role of the U.S. direct investments overseas and free capital flow more vital to future balance-of-payments consideration than balance of trade? In other words, has the administration underestimated the vital importance of encouraging more, not less, direct investment, and I direct that to the three of you for any comment you may wish to make.

Mr. REIERSON. Mr. Halpern, I think that both are important. On the trade, we have suffered a very serious decline in our net commercial export surplus which in 1964 was $3.9 billion and which in 1966 got down to $600 million.

Over the years, prior to 1964, this commercial trade surplus was of the order of magnitude of 2 to 3 million, so the decline is important. On the direct investment, I certainly agree, because again, direct investment, if we take the outgo and balance it against the inflow, has been showing surpluses year after year after year; the surpluses recently have been running a billion and a half to $2 billion. I am greatly concerned, as I said in my statement, as to the impact of the direct investment program, and this is the big target in this program.

Let's face it. This target is $1 billion out of the total target of $3 billion, and this is a billion the administration is really trying to get.

I am very much concerned about the impact upon the flow of income from direct investments—one of the few items in the balance of payments that has been behaving favorably in recent years.

Mr. OLSEN. Well, I would agree with that assessment. The importance of our direct investments, I think both direct investments and our trade efforts, are of equal importance.

Actually, much of our export is linked to the growth of direct investment overseas. We, through our foreign policy efforts after World War II, particularly with the Marshall plan, worked hard to create an environment for the growth of international investment and trade overseas, and business communities followed this lead.

Now, we find that we are seeking to cut back sharply on the very goal which we spent billions of dollars after World War II to achieve. So in many ways, our foreign policy position overseas tends to be somewhat contradictory to our policy with respect to the private sector of the economy at the present time, and this conflict is not going to be resolved, I am afraid, in any constructive way, if it continues in the present course.

You can cut back sharply on investments and still see the balance-of-payments deficit grow, and grow substantially, in fact, because of the damage that you do to the income-producing ability of private investment.

Mr. REIERSON. And the decline in exports that might follow restriction on direct investment.

Mr. HALPERN. Mr. Peacock, would you care to comment?

Mr. PEACOCK. I don't think I would care to add anything.

Chairman PATMAN. Mr. Stephens.

Mr. STEPHENS. Thank you, Mr. Chairman.

The military posture of the United States has been discussed and Mr. Reierson made some comments on it. Are we going to have to make a choice of having military forces in other countries, or having them all at home, if we are going to achieve a balance of payments?

Mr. REIERSON. I think there are several sorts of choices involved. I think we should give some of our allies abroad, who can afford it, the choice to decide whether they will cover balance-of-payments costs of the troops or accept the consequences. If they are not willing to do this, then, this is a token that they do not really believe the defense support of the United States is that important.

Beyond that, I think if you will examine the record you will find that when the troops were sent to Germany, there was a distinct understanding that they would be returned shortly thereafter. Now, this is something that I think could be explored. I have been told this by a man who knows. Third, I think there is also the question of what military posture involves. Does it involve a rest camp in Europe for wives and children? Why should we treat troops in Europe so favorably when we consider what the boys in Vietnam are going through?

I know the answer of the military. But this is a decision that does not affect our military posture at all.

Finally, another area that needs very careful investigation is: How many military establishments are we maintaining around the world which are no longer of military significance, by virtue of the change in the art of war, and the perfection of new military devices?

How many military establishments are we maintaining because some chap on the area desk in the State Department feels that it would ease his problems, if we continue to pay money into these areas? These are very serious questions. I really think that a substantial reduction can be made in the military outlays abroad without impairing our military posture.

Mr. STEPHENS. Only slight mention was made of the foreign aid program. But we have spent a substantial amount of money in the period since World War II in the foreign aid program.

We have taken our money, is it not true, and it has been utilized to rehabilitate other countries? It was designed initially under the Marshall plan. We have built up these other countries, and now we are suffering some of the consequences of the economic advantages that we have given to these other countries with our money.

Mr. REIERSON. I think, in retrospect, it was a mistake for us not to make this a loan instead of a grant. In the light of what has developed since this, it would have been very appropriate and useful.

Mr. STEPHENS. I don't question the wisdom of that.

Mr. REIERSON. This is past history.

Mr. STEPHENS. That is the main reason that my position has been to favor the program of the Asian Development Bank that takes other countries' money, too, and is put out as loans. But the other thing that I would like to ask you, if you would, any of you, to develop some thought on this:

Is it possible for us to continue to be the international bankers for the world and also the guardian of peace for the world, and still not have a continual balance-of-payments deficit?

Mr. REIERSON. I think the answer is really put the other way: If we continue to have these big payments deficits, it will impair our ability to be the world banker, which is a function which I regard as very important, and one which was thrust upon us. We did not ask for it. But it is a responsibility which we cannot easily shed because there is no alternative available.

Mr. STEPHENS. You mean as far as the world banking situation, that we are the financial center of the world?

Mr. OLSEN. We have said much here about our military outlays, about inflation, about the pursuit of full employment. There has been a good deal of debate about the merits of these goals. While they all seem, and are in many ways, worth while, I think we go astray in not accurately projecting the consequences of seeking all of these goals at the same time. We don't face up to the fact that if we continue to seek all of these goals immediately and simultaneously, we will impair our ability to achieve any or all of them in the future.

Mr. STEPHENS. Well, my time has expired, but I would like to make one comment. I agree with you that the consequence of some supposedly worthwhile goals will cause dislocations. For example, we have had that in the southern section of the United States in the textile field. America has assisted foreign countries to build up textiles. The competition has made serious inroads on domestic markets and reduced domestic production. But if you will take the map and look at the areas in Appalachia that have received a concentration of attention for U.S. help as poverty areas, you will find they are the areas—every single one of them—where there used to be high employment in a cotton mill or textile mill.

Chairman PATMAN. Mr. Brock.

Mr. WILLIAMS. I would like to call attention to the fact that at 11 we decided to terminate questioning at 11:40. It is now 11:20, so that half of the time has been used, and four members have consumed all of this time. I don't see any point in trying to mark up this bill in an executive session, and I would like to suggest we continue until 12 o'clock.

Chairman PATMAN. We would have to come back tomorrow, but it is not likely we would have a quorum because some members don't like to come back on Friday.

Mr. WILLIAMS. If we are going to try to discuss a bill as important as this——

Mr. ANNUNZIO. I would like to move that the remaining time you have left be divided among those who haven't had a chance to ask questions.

Chairman PATMAN. Let's divide this among those who haven't had a chance to ask questions.

Let's divide it up, 2 minutes each, and any questions you don't get in may be submitted in writing. Will that be satisfactory?

Keep the time, Mr. Clerk, to give each one an opportunity.

Mr. WILLIAMS. Is the chairman going to try to mark this bill up and discuss it and reach a decision by 12 o'clock?

Chairman PATMAN. All right, Mr. Brock.

89-292—68——19

Mr. BROCK. Thank you, Mr. Chairman.

I hope we can accomplish something of significance.

Mr. Peacock, in light of your statement, what action could we take that would immediately—I mean, within the next 60 days—make an impact upon our policy situation?

Mr. PEACOCK. Actions which would result in the immediate improvement of balance-of-payments performance are out of the question. What is needed is not so much a large improvement within the next 60 days, but rather the initiation of far more effective action than we have any reason to believe is contemplated now.

Mr. BROCK. I do think there are certain things that could be done to be effective. I think the thing that bothers me, and I personally would disagree with you in this respect, is that we lost $900 million of gold last month. We have a billion and a half left in free reserves. I question whether we have the time to take the action to correct the basic imbalances without removing the gold cover, as you seem to suggest.

It seems to me we are simply buying time. I do happen to agree with you, if we don't take effective action, then we have done nothing other than postpone the pending bill.

Mr. REIERSON. I don't think action will show up in the figures in the next 60 days. But I do think that the action is important in itself. If we embark upon a positive course of action, that would be important.

Mr. BROCK. I would like to ask one question for the record. Would you each, in correcting your transcript, answer for me what you think the most effective single action is that this Government could take legislatively to correct our imbalance of payments in the short run, with the minimum adverse long-term effect?

Chairman PATMAN. You can answer that for the record.

(The information requested follows:)

REPLY OF MR. REIERSON

This is a very difficult question to answer, especially since some of the most effective actions would not require legislation. In the legislative area, perhaps first priority is in the fiscal area—to hold Government spending below the amounts projected in the Budget Message and to enact a surtax.

Chairman PATMAN. Mr. St Germain.

Mr. ST GERMAIN. No questions.

Chairman PATMAN. Mr. Johnson.

Mr. JOHNSON. I have no questions. I yield my time.

Chairman PATMAN. Mr. Stanton.

Mr. STANTON. Gentlemen, on behalf of this Congressman, you have been the most enlightening witnesses we have had on this particular subject. Now that you understand the time pressure that we are under, I would like to know, in your own personal opinion, considering that you have somewhat a divergence of opinion on this particular legislation, how each of you feel about the wisdom of perhaps forestalling a decision on the question of removing the gold cover until such time as the Ways and Means Committee determines exactly what will be this Government's balance-of-payments program? This is presuming that a program of a balance of payments that the President suggested on January 1 will be enacted within the next 60 days?

Chairman PATMAN. Any other questions you will submit in writing.

Mr. STANTON. I have just the one question. I just asked one question, and I want an answer.

Chairman PATMAN. You want an answer for the record?

Mr. STANTON. I want an answer now.

Chairman PATMAN. Well, of course, that would be in violation of our agreement.

Mr. STANTON. No; it will not be. I haven't used my 2 minutes.

Mr. REIERSON. I see no great emergency that requires immediate action today or tomorrow.

Mr. OLSEN. I would agree also that the logical thing would be to follow, after the hearings on the program, the balance of program.

Mr. PEACOCK. We are in accord.

Mr. STANTON. I agree, gentlemen, for the simple reason if we come up with a strong program and we impress upon the world the strength of the dollar, we would be under less pressure on this type of legislation, once the world knows we mean business and we do have a strong balance-of-payments program.

Chairman PATMAN. Since the gentlemen have answered the question; Mr. Gonzalez.

Mr. GONZALEZ. Gentlemen, apparently, from the reading of your testimony, essentially you believe in holding up things for the time being?

Mr. REIERSON. I do.

Mr. GONZALEZ. And, Mr. Reierson, as I came in you were mentioning something about the necessity of stopping the giveaway programs. Could you define those?

Mr. REIERSON. I do not believe I said we should stop them. I believe I said—the giveaway programs—and I was referring specifically to the agriculture program—were having adverse effects upon our commercial market, and that we do not know how much the adverse effect is, and that this adverse effect upon the commercial market adds to the balance-of-payments cost of these programs.

Mr. GONZALEZ. This is the foreign aid agriculture program?

Mr. REIERSON. Yes, sir.

Chairman PATMAN. Mr. Mize.

Mr. MIZE. Were any of you, or any of your colleagues with similar views, asked to join the Government's fiscal and monetary experts as they developed the President's January 1 proposal to help this balance-of-payments problem?

Mr. REIERSON. No, sir.

Mr. OLSEN. No, sir.

Mr. PEACOCK. No, sir.

Mr. MIZE. Is there any estimate as to how much of the gold losses of the fourth quarter of last year were paid out to speculators, thereby reducing the world gold monetary reserve?

Mr. OLSEN. The estimates are that somewhere between a billion and a half and $2 billion were withdrawn from the monetary gold stocks of the world.

Mr. MIZE. Thank you.

Chairman PATMAN. Mr. Hanna.

Mr. HANNA. No questions.

Chairman PATMAN. Mr. Lloyd.

Mr. LLOYD. No questions.

Chairman PATMAN. Mr. Annunzio.

Mr. ANNUNIZO. Thank you, Mr. Chairman. No questions.

Chairman PATMAN. Mr. Blackburn.

Mr. BLACKBURN. I have no questions.

Chairman PATMAN. Mr. Rees.

Mr. REES. Gentlemen, I would like to ask three questions for the record.

Most of the restrictions would be on American firms investing abroad in highly developed countries of Western Europe. Can't these companies go to the European capital market and borrow there, without inhibiting their ability to expand in Europe? Isn't their greatest long suit American technology and American know-how?

Second, the program of the administration is, No. 1, a surtax; No. 2, an attempt to cut down spending, both foreign and domestic; and No. 3, a program to restrict our balance-of-payments deficit through specific restrictions.

Do you think this is sufficient to handle the balance-of-payments problem, and third, do you think this, tied in with the bill before us, represents a feasible package?

Chairman PATMAN. You are asking that to be answered for the record?

Mr. REES. I don't believe there is time to answer any other way.

Chairman PATMAN. All right.

(The information requested follows:)

REPLY OF MR. REIERSON

I think these actions are all essential but I believe that Government spending must be held down more than the Administration proposes. In addition to the three lines of action you mentioned, a less expansionary monetary policy is also required.

Chairman PATMAN. Mr. Brown.

Mr. BROWN. Mr. Brock asked you to state the single most effective means of curing our balance-of-payments problem. I would like to have you state alternative means in their order of priority, as you view it.

Mr. OLSEN. That question, I assume, you want for the record?

Mr. BROWN. Yes, sir.

Mr. OLSEN. I only wanted to say this, which is obvious, to be sure. As you know, I took a position in support of removal of the gold cover, with reservations, which I outlined. I want to stress the importance of this legislation because a failure to remove the gold cover means one of two things: A freeze in domestic currency, or a change in the present gold arrangements with respect to the world.

(The information requested follows:)

REPLY OF MR. REIERSON

In approximate order of priority I would suggest: (1) a less expansionary monetary policy; (2) more restraint on spending than the Administration proposes, together with the imposition of a surtax; (3) vigorous and effective action to reduce the cost of the Government's foreign military and economic programs; (4) much greater support than has been given in the past to efforts at promotion of exports and travel by foreigners in the United States; and (5) efforts to induce other important industrial countries to modify their practices vis-a-vis the rebate of taxes on exports and the imposition of border taxes on imports or to permit the United States to adopt similar measures.

Chairman PATMAN. Mr. Galifianakis.

Mr. GALIFIANAKIS. Mr. Chairman, I have a couple of questions. There are a variety of explanations about going off the gold standard in 1934. I wish you would comment on the link between the reasons that were applied in 1934 for going off the gold standard and the reasons that are being applied now for the removal of the gold cover. That is one point, for the record.

The other is, I wish you would comment in the light of the fact that the Federal Reserve Board now has authority, and I take it, you understand they do have authority, to temporarily life the gold cover.

I wish you would comment as to the gravamen of the passage of this bill, in the light of the fact they do now have the authority to do that temporarily.

Chairman PATMAN. Yes; you gentlemen answer that for the record.

(The information requested follows:)

REPLY OF MR. REIERSON

The fact that in the United States and in all other major countries gold no longer functions as a medium of exchange is a reason why the gold certificate reserve requirements are no longer meaningful. The dollar is not freely convertible into gold, domestically, and the gold position of the United States, or changes in the gold stock, have had no discernible effect upon the rate of expansion of bank credit which the Federal Reserve permits. The function of gold, today, is to serve as an international monetary reserve and settlements medium.

As to your second question, Mr. Brown, the fact that the Federal Reserve has authority to suspend the gold certificate reserve requirement and the further fact that the United States still has a substantial amoun of "free" gold are reasons why I see no pressing urgency to take immediate action on the elimination of the gold certificate reserve requirements.

Chairman PATMAN. Mr. Williams.

Mr. WILLIAMS. I want to thank you gentlemen for coming here this morning. I found your testimony to be most helpful, and I was happy to learn you don't believe there is any great urgency to remove the gold cover. We have had representatives from the Treasury Department and Federal Reserve before us, and they seemed to believe that if we do take the gold cover off our currency, definite steps will be taken by the administration to correct our unfavorable balance of payments. The President's state of the Union message, in which he came out with a $186-billion budget, $10 billion over the last fiscal year, and with some new giveaway programs, would, even with a tax increase, result in an $8 billion deficit. Also, during this fiscal year we have seen a projected $6 to $8 billion deficit bloom into a $30 billion deficit. Now, with inflation pricing this country out of the international markets, and all of the other things that are happening in this country today, do you believe there is any indication of any determination at all on the part of the administration to take the necessary steps to restore internal fiscal discipline here at home, and create a favorable balance of payments?

Mr. REIERSON. You want it for the record?

Mr. WILLIAMS. I want it right now. I have 35 seconds left.

Mr. REIERSON. My answer is, I see no evidence that the present program presented is adequate to the task.

Mr. WILLIAMS. Do you care to comment on that, Mr. Olsen?

Mr. OLSEN. I would agree with that, as it is now contemplated.

Mr. WILLIAMS. Mr. Peacock.

Mr. PEACOCK. I would agree with that.

Chairman PATMAN. Mr. Wylie.

Mr. WYLIE. I have no questions.

Mr. REIERSON. Would you please arrange with the clerk to have the list of questions for the record put in order, because my notes are very erratic and incomplete.

Chairman PATMAN. We will have the reporter help us on that. We will be very glad to do that.

Mr. BROWN. May I ask one more thing for the record. You gentlemen do this for the record. How can one in the briefest, most succinct way, express the reasons for voting "No" on this legislation?

Chairman PATMAN. Thank you, gentlemen, very much.

You have been very helpful and we appreciate your testimony.

(Whereupon, at 11:40 a.m., the committee adjourned and moved into executive session.)

APPENDIX

(The following statements, letters, and information requested by members of the committee, were submitted for inclusion in the record:)

Statement by Representative Walter S. Baring, Congressman at Large From Nevada

Mr. Chairman, I thank you for the opportunity to make a statement on the legislation before this committee, H.R. 6428 and related bills, proposing the removal of the 25-percent gold support that now underlies the paper currency of the Federal Reserve Bank of the United States.

I am unalterably opposed to this proposed legislation.

As one who has been interested in gold mining and the gold problem throughout the years, I am most distressed at the proposal pending before your committee today. I have urged, as have many of my colleagues, over the years and during several administrations, that proper remedial action be taken to halt the continued mounting of the balance of payments deficit.

The removal of the gold cover would open the way to unlimited expansion of Federal Reserve notes . . . to the weakest money known to man, fiat money and, in my judgment, a collapse in the value of our currency.

Why are we being asked to remove the gold cover? Is it because this is the only way to prevent a complete collapse of our fiscal basis of our country?

Treasury Secretary Fowler stated before this committee that, and I quote, "the world knows as a fact that the strength of the dollar depends upon the strength of the U.S. economy rather than upon a legal 25 per cent reserve requirement against Federal Reserve notes, and it is clearly appropriate for this fact now to be recognized in legislation."

The world also knows as a fact that, the value of our dollar has been steadily depreciating, hence they—our foreign creditors—would rather have our gold than our value shrinking dollars.

As the late Lucius Beebe so accurately put it: "Most people know that basically, and when all is said and done, gold is the only abiding, permanent, perennial and universal standard of value in human affairs. Whether it is legal or its ownership is forbidden, gold is the one and only property whose essential worth has never been questioned and which will always be the unimpeachable commodity.

"A dishonorable federal government may repudiate its money as our's has done. An irresponsible banker may indulge in fantasy in terms of its confiscation, but everyone who has had a $10 gold piece on his watch chain knows he has a property which has never yet been devalued in the history of human folly and government chicanery."

Mr. Chairman, to dissipate our remaining gold would constitute one of the worst monetary blunders in history. For the life of me, I can't see the headlong rush to destroy ourselves financially.

The economists constituting the President's Council of Economic Adbvisers are dedicated Keynesians. They are of the opinion that gold is a "barbarous relic." They are also of the opinion that the shortage of monetary gold is a major economic problem. They fear that the shortage of monetary gold would restrict international trade and world economic output.

Yet, realistic authorities of European countries have shown no desire to abandon the monetary use of gold nor to agree to any schemes that would foster worldwide inflation.

Mr. Chairman, this problem of gold is a complicated one. So much so, top economists are at odds with one another. Even our esteemed Treasury Department seems confused when it comes to gold. For example, on May 17th, Fred

Smith, General Counsel of the Treasury, in a letter to the Honorable Wayne Aspinall, chairman of the House Interior and Insular Affairs Committee, on the subject of gold subsidy bills stated:

"Gold is not comparable to other commodities or metals. It is primarily important as a monetary standard of value. The dollar is linked to gold, and it is the firm policy of the Government to maintain the present dollar price of gold at $35 an ounce. This policy is the foundation for the international monetary system."

This is contradicted by Secretary Fowler in his statement before this committee hearing:

"Today, the strength of the dollar is not a function of this legal tie to gold—a tie which is only applicable to one portion of our total money supply, Federal Reserve notes. The value of the dollar—whether it be in the form of a bank balance, a coin, or 'folding money'—is dependent on the quantity and quality of goods and services which it can purchase. It is the strength and soundness of the American economy which stands behind the dollar."

It is quite obvious, Mr. Chairman, that foreign nations do not hold our economic strength in very high esteem as witnessed by their wanting our gold—not our dollar. It's not that these countries have complete disrespect for our economic strength. But they wonder how any government that seemingly refuses to put its financial house in order, both at home and abroad, can continue to remain economically strong.

The printing of more and more paper fiat money isn't going to keep us economically strong no matter how much juggling of figures the Administration goes through.

The cause of foreign concern over the stability of our dollar hinges on our inability to correct the deficit in our balance of international payments.

William Martin, Chairman of the Board of Governors of the Federal Reserve System told this committee that in order to arrest the decline of gold, "we must achieve a major improvement in our balance of payments."

Secretary Fowler, appearing before the House Ways and Means Committee, January 22, 1968, told that committee, "The keystone to this balance of payments program is the surcharge proposal you have before you."

As far as I am concerned, Mr. Chairman, the "keystone" to our balance of payments program has been our failure to drastically curb foreign economic aid which pours more paper dollars into the hands of our foreign creditors.

In hopes of easing our balance of payments deficit, our government was counting on the International Monetary Funds special drawing rights to come to the rescue. This "paper gold"—or to put it more basically—our I.O.U. to the special drawing rights did not exactly meet with roaring approval by the European nations. They're not interested in pitching in to solve our balance of payments problem.

It is interesting to me, Mr. Chairman, that while the Treasury Department and the Admiinstration express great concern over our vanishing gold, they adamantly oppose the gold subsidy bills before Congress on the grounds it would trigger a run on the dollar. What did the Treasury people think we have had for the past seven years if it was not a run on the dollar.

By the stroke of a pen some 34 years ago, the price of gold was at $35 an ounce. This action was taken as a depression measure when gold was selling at $20 an ounce. Since the depression days, costs of all commodities including mining, have more than doubled but the price of gold has remained the same. Ever since the end of World War II many efforts have been made to increase the price of gold to its rightful height in the market place. Invariably these efforts were met by incantations by Government spokesmen, over and over again, that the currency of the free world would be tossed into chaos by any effort of the American Government to increase the price of gold for domestic producers. Even efforts to appease the money managers through offers to have bills declared legislative that the official U.S. Government price for gold would remain at $35 an ounce and that any higher prices paid for mining domestic gold would be considered a subsidy by the American Government to its domestic gold producers have failed. Such efforts have been counter-acted by charges that this action would create a two-price system for gold and would be very upsetting to foreign bankers.

For these reasons, many proposals, and among them measures which I have sponsored, to increase the price of gold paid to the domestic producer have failed to win approval. It would be most prudent at this time to take steps to increase our domestic gold production through the enactment of a realistic gold relief bill providing financial incentives to reactivate the production of gold. Such a subsidy would reveal to the world that our government is aware of the importance of gold as money.

Canada has for some time paid production bonuses to its gold mining industry. Australia has seen fit to provide incentives for gold production. Yet these acts have not stirred foreign bankers to view with apprehension the strength of the monetary systems of these two countries.

It does not seem logical, Mr. Chairman, that foreign nations or bankers would object to the United States paying an adequate price for domestically mined gold. Such a bill as I have introduced in Congress providing such incentives would in no way violate the Bretton Woods Conference agreement, or the International Monetary Fund, since this legislation does not propose to change the price of gold per ounce.

To me, Mr. Chairman, this would solve our gold problem. At least it would be one way. The other way, of course, is to cut our foreign aid program with its torrential outpour of U.S. dollars. Removing the gold backing from the dollar is opening the door for financial chaos. What will we use as a basis for our monetary system when our gold supply is gone? Fiat money?

In closing, Mr. Chairman, I would like to end with this quote by Raymond Rodgers, Professor of Banking, New York University, and author of the article on money in the current edition of "Encyclopedia Americana":

"It is the indisputable lesson of history that sooner or later, and usually sooner, all paper money declines in quality—representative money becomes credit money, credit money becomes fiat money, and fiat money becomes the epitome of worthlessness."

Thank you.

AMERICAN FEDERATION OF LABOR
& CONGRESS OF INDUSTRIAL ORGANIZATIONS,
Washington, D.C., January 30, 1968.

Hon. WRIGHT PATMAN,
Chairman, Banking and Currency Committee,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: Would you be good enough to enter the enclosed statement on the gold cover legislation in the proceedings of the hearings which your Committee recently held on this matter.

Thanking you for your cooperation, I am,

Sincerely yours,

ANDREW J. BIEMILLER,
Director, Department of Legislation.

STATEMENT OF AFL-CIO

The AFL-CIO urges the Congress to remove the 25 percent gold cover on Federal Reserve notes.

The AFL-CIO has a consistent record in support of complete removal of the gold cover on both notes and deposits of the Federal Reserve System. On August 13, 1963, the Executive Council of the AFL-CIO declared:

"* * * at the earliest opportunity, the U.S. should eliminate the 25 percent gold cover on its currency. Most other nations abandoned such gold covers long ago. There is no rational reason for the U.S. not to make all of its gold available for international transactions if necessary."

On February 10, 1965, the AFL-CIO statement on this issue to the Senate Banking and Currency Committee declared:

"The sensible and rational action, therefore, would be complete removal of the gold cover on both Federal Reserve notes and deposits—as proposed in S. 743.

"To remove only part of the gold cover at present, as provided in S. 797, is not better than removing all of it, as some have suggested. There is no rational economic reason to remove the cover on Federal Reserve Deposits and keep it on notes. The entire requirement of the gold cover is an outmoded, harmful anacronism—all of it, not merely part of it. And it should be removed rationally, without fear or the potential panic of acting under the gun.

"If only part of the present cover requirement is removed, the Congress will probably have to review this issue again, because the cover should be completely removed as soon as practicable."

However, only part of the gold cover was removed in 1965—the 25% cover on Federal Reserve deposits. The 25% cover on Federal Reserve notes was permitted to remain.

The resolution on the balance of payments, adopted by the Seventh Constitutional Convention of the AFL-CIO in December 1967, stated that "the gold cover should be completely removed as soon as possible."

The legal requirement that 25 percent of Federal Reserve notes be covered by gold is an anachronism. American citizens can no longer convert their Federal Reserve notes into gold. If the gold cover ever had any real utility, it has none at present.

Moreover, the gold cover ties up nearly all of our monetary gold stock, except in an emergency. Most of the gold stock plays no active part in either the domestic economy's spending stream or in the international economic arena, as the basis for settlements among central banks.

The gold cover is not only useless, it is harmful. The persistence of this outdated gold cover has contributed to unrealistic fears about America's ability to meet its international financial obligations—playing into the hands of speculators and those who wish to undermine confidence in the American dollar.

Temporary action may be taken under the existing statute to make the gold stock available for international transactions, if an emergency demands it. However, such temporary, emergency action—taken under the gun—would generate needless fears and concerns.

Students of this issue have long advocated removal of the anachronistic gold cover. In its report in 1961, the Commission on Money and Credit, composed of bankers, businessmen and trade unionists, declared:

"The Commission believes that the threat of a confidence crisis would be greatly reduced if it were generally recognized, both here and abroad, that all of the U.S. gold is available to meet our international obligations. Any doubts about the U.S. policy should be removed by elimination of the gold reserve requirements at the earliest convenient moment so that all of the U.S. gold stock is available for international settlements."

Walter S. Salant and Emile Despres, in their study, "The United States Balance of Payments in 1968," published in 1963, stated:

"The statutory requirement of a gold reserve against Federal Reserve notes and deposit liabilities long ago ceased to serve any useful purpose. It should be abolished. Although the requirement can be suspended in an emergency, its abolition now would release U.S. gold reserves for normal international settlements in the future. This would make clear that the reserves are available to the full and at all times, not merely in emergencies, to serve their only useful function."

There are domestic, as well as international, economic considerations for complete removal of the gold cover. The AFL-CIO and many others advocate an expansionary monetary policy—and adequate expansion of the money supply, at relatively low interest rates, to encourage the expansion of sales, production and jobs. With the persistence of significant amounts of unemployment, particularly among Negroes and youth, and the persistence of idle productive capacity, there is a continuing need to reduce unemployment and add strength to the domestic economy, which is the foundation of our international economic strength.

However, the 25 percent gold cover can be used as a dangerous curb on monetary expansion. The cover should be removed to permit our monetary managers to pursue policies to help the economy achieve and maintain full employment and maximum use of our plants and machines.

The remaining gold cover should be completely removed, without further delay. Partial action, again, can only cause future embarrassment and the need for another Congressional review.

Of the $12.4 billion of U.S. Treasury gold stock on December 20, 1967, approximately $10.6 billion was held as the required cover for Federal Reserve notes. Congress should not permit this situation to perisist, with the possibility of drifting into needless emergencies and related fear and speculation. Such emergencies should be avoided.

The U.S. government's entire monetary gold stock should be made available to back up the international position of the dollar.

(The folowing statment on H.R. 14743, in opposition to proposals to remove the Gold Cover from Federal Reserve was filed today by the Independent Bankers Association of America with the House Banking and Currency Committee. Comparable letter was likewise submitted with Chairman John Sparkman, Senate Banking and Currency Committee, referencing S. 2857)

INDEPENDENT BANKERS ASSOCIATION OF AMERICA,
Washington, D.C., January 31, 1968.

Hon. WRIGHT PATMAN,
Chairman, Banking and Currency Committee, U.S. House of Representatives, Rayburn Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: We appreciate the invitation to submit the views of the Independent Bankers Association of America with regard to the President's recommendation for removal of the Gold Cover from Federal Reserve currency.

We oppose the recommendation, and the legislation that goes with it, as contained in H.R. 14743, as contrary to the best traditions of our great land, and contrary to the lessons of history that clearly show that no nation has been able to survive the deliberate removal of the gold backing from its currency.

We consider it a matter of first importance, and a matter of great urgency, that our Government, and specifically the incumbent Administration, continue our Nation's support for the substance of the dollar, which government witnesses so far heard at hearings on this legislation have thus far refused to acknowledge.

Treasury officials, in direct correspondence and conference room consultation with our Association officers and committmen, insist that the gold backed dollar no longer has a role in our domestic economy, but is only of value internationally, and that it is strictly old fashioned, outdated and outmoded, to any longer insist on gold backing for the dollar.

In almost the same breath high Treasury officials, representing the Administration, have joined together with our international "friends" in the Group of Ten at Rio, to become partners in a world "paper gold" pact that will shortly begin to crank out printing press paper currency. Unless, as we sincerely hope, the U.S. Senate declines to confirm the pact.

We have been exposed to the usual four-syllable language that the international "paper gold" pact is only a "supplement" to gold, but we reject this as unrealistic and untrue, and note, as is generally the case, that the United States will provide most of the real money for the operation of this international paper structure.

We must state to you, that after our Association officers and fiscal policy, debt management committeemen conferred with ranking Treasury officials and were severely reminded that a gold cover for currency is old hat in the extreme, our Government Fiscal Policy Committee recommended, and our Executive Council, at its semi-annual meeting, at the Chase-Park Plaza Hotel in St. Louis, last October 26, adopted the following resolution:

"The Independent Bankers Association of America expresses unanimous opposition to a proposal for removal of the 25% gold backing from the U.S. Federal Reserve notes, even though this action might be calculated to enchance this country's position in the international liquidity situation.

"The lesson of history clearly reveals that no nation has been able to survive the deliberate removal of the gold backing from its currency. The likelihood is that if this universally recognized basis were eliminated, gold would rapidly flow out of this country.

"The Association fears that depriving the United States currency of its gold backing would do irreparable harm to the nation's economy in the years ahead."

As far as we can tell, and we regret this because we should have company, our Association seems a lone voice in financial and banking circles being heard responsibly in opposition to this hurried and urgent "crash" legislation. We repeat and insist, with emphasis and vigor, that history shows no nation has survived calculated removal of gold backing from its currency.

Respectfully and sincerely,

(S) STANLEY R. BARBER,
President,
Independent Bankers Association of America.
(S) MILTON J. HAYES,
Chairman,
Government Fiscal Policy Committee.

STATEMENT ON H.R. 14743 SUBMITTED BY MR. DONALD M. GRAHAM, VICE CHAIRMAN, CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO

The simple answer to the question of removal of the present 25% gold reserve backing our currency as proposed in H.R. 14743 is: "Yes". I believe that is the correct answer. But I come to that conclusion only after considerable soul-searching, and with full realization that the gold cover issue is of far less economic significance than what we do about rectifying our chronic—and worsening—balance of payments deficit and what we do about fiscal responsibility in the United States. Proper solutions to both of these problems—and they are inseparable—are the real key to the financial soundness of the free world.

At no time in modern history has the economic future of the free world faced a greater challenge than today. This challenge did not appear suddenly from some unexpected and extraneous source. It is the natural culmination of many years of rapid growth of the free world and the problems of financial instability and stress associated with that growth.

The responsibilities of the United States in international financial stability are unmistakable. As the political and economic leader of the free world, the role of this country in shaping the structure and determining the evolution of the postwar international economy has been decisive. Through the Marshall Plan and other post World War II aid, the United States did much to rebuild a war-torn world. This outflow of dollars—and gold—was essential. It originated from conscious and carefully considered policy decisions. As years went on, however, we have failed to adapt our international financial position to changing times and conditions.

The nature and magnitude of these problems and the challenge to us can be considered under four major headings:

1. Worldwide economic growth and stability.
2. International monetary system and liquidity.
3. The chronic U.S. balance of payments deficit.
4. Domestic economic soundness.

First—a few thoughts about the general problem of worldwide economic growth and stability. The postwar record of economic growth has been impressive—but not without important deficiencies. On the one hand, we have seen tremendous advances in the standards of living of the economically developed countries of North America and Western Europe, and in Japan, Australia, New Zealand, and a few other countries. On the other hand, the economic disparity between these "haves" and the large mass of remaining "have-nots" has widened despite billions of dollars of aid freely granted by the United States. This gap has widened largely because of the failure of the less-developed countries to come to grips with their economic, social, and political problems and to establish a sound and viable economic base on which to build their future. The challenge to bridge this gap is becoming increasingly urgent if we expect to create a world of political tranquility and continued economic progress.

At the same time, we are discovering—I hope—that we cannot simultaneously fight a major war, provide economic and military assistance for many other parts of the world, and still expect to expand our government activities on a sound basis at home at the same time. Part of our problem has arisen from attempting to do too many things at the same time. We must obtain greater participation from other developed nations throughout the world; after all, they have now fully recovered from the ravages of World War II. The less developed countries must also put forth extraordinary efforts to marshal their own available resources. But they must also be willing to exhibit some patience and control and not expect to become mature nations overnight. Obviously, the solution is difficult and will require a new and closely coordinated approach from all nations.

A second major area of great immediate concern involves the international monetary system and the need for increased international liquidity. Events of the past year, and especially recent weeks, have sharply underscored the immediate and vital need to provide for greater flexibility and manageability in the international monetary system. On balance, the present system created at Bretton Woods almost 25 years ago has served the free world well—particularly the industrial countries. But it has become quite evident that the present tools and resources at hand are no longer adequate to meet the needs of today's volatile and capital-hungry world. The challenge here is for an innovative but responsible approach to international monetary reform which will restore financial stability and confidence and prepare a sound basis for further economic growth.

The question of whether or not the volume of international liquidity is appropriate today is the subject of much debate and is difficult to determine. Events of the recent past, however, provide support to the argument that in an increasing number of countries monetary reserves have fallen below the levels considered adequate to support temporary payments imbalances. The inadequacy has been reflected in a growing tendency of governments to resort to restrictive monetary and fiscal policies for purposes of reserve protection. In some cases, such policies are fully justified—as in the United Kingdom. In others they are urgently needed—as in the United States. A steady increase in the need for such measures only for balance-of-payments purposes, however, tends to point toward an overall decline in reserve adequacy. Furthermore, wide disparities have developed over the years between the rate of growth in world trade and the smaller rate of growth in international liquidity. We cannot tolerate adjustments which strangle trade growth rather than expand liquidity.

The present international monetary system has no built-in mechanism permitting the level of international liquidity to adjust to a desired or required level. Current liquidity shortages cannot be alleviated on short notice. As you know, additions to the gold stock are haphazard, depending largely upon the volume of gold production and fluctuations in private demand. For many years the U.S. dollar has provided the necessary additions to the stock of international reserves. It is now ironic that to continue in this role the U.S. would be required to run continuous sizable deficits in our balance of payments. It is also ironic that we have quickly seen the reaction in terms of complaints that we are unduly restricting world trade from the announcement and proposal of various moves by the U.S. which would limit our deficit.

For the future then, the dollar cannot provide the whole answer to liquidity needs. And obviously the role of sterling as a world currency has received a severe blow from pound devaluation. Automatic drawing rights on the International Monetary Fund have served well in a restricted sense in recent years but for the future they too represent only a partial solution.

We must move forward, therefore, with the creation of new reserve instruments as proposed at last year's annual International Monetary Fund meeting. This proposal envisages the creation of "Special Drawing Rights"—SDRs—by the IMF which would have the dual characteristics of a credit instrument and a reserve asset. This proposal offers an attractive solution to the need for a flexible and manageable reserve-creating process. But it is not without its problem areas also. An initial, difficult question concerns the volume of SDRs to be periodically created. Again, we cannot escape making judgments as to proper reserve adequacy for a given situation. There would continue to be maldistributions of SDRs between the "have" and "have-not" countries just as under the Fund's current system.

The SDRs would not provide an international financial panacea. Their creation would in no way excuse a country, including the United States and the United Kingdom from the discipline of pursuing and maintaining a long-run balance in its international payments position. It would remain the responsibility of each country to keep its own house in order through appropriate monetary and fiscal policy actions. Considering the rather unattractive alternatives to SDRs, however. it is hoped that the current proposal will be implemented as soon as possible. Unfortunately, obstacles remain in the form of required ratification by the legislatures of the Fund's member countries and France's express demand that SDR creation must wait until both the United States and the United Kigdom have restored balance in their international payments positions. Given these circumstances, the United States should exert particular efforts in both the economic and political areas to overcome these obstacles as quickly and decisively as possible.

The Third very obvious problem area centers on the U.S. balance of payments. Years of complacency, and an unwillingness to come to grips with economic reality, have unavoidably but predictably placed our balance of payments in its current untenable position. While it is easy to criticize other countries for their restrictions on imports of specific American commodities—or their central banks and private citizens for hoarding gold—the plain fact remains that the United States is itself responsible for the management of its balance of payments. And in this we have failed.

It is quite clear that pressure on the dollar and the resulting drain on our gold stock that developed following the devaluation of the pound required prompt and dramatic action to improve our balance of payments position. The various controls imposed and proposed by the President on January 1 restricting capital investment, bank credit, foreign travel, etc., it seems to me are steps of the type which had to be undertaken in the present emergency situation. They, of course are unpopular. They will be disruptive. They will be difficult to administer. If continued for any prolonged period they will cause serious harm to the flow of capital and trade and hurt rather than help our balance of payments position.

In sponsoring these measures, however, the Government is following an already established trend of selective interference which started more than four years ago with the Interest Equalization Tax. Given fiscal procrastination in Washington, it is hardly surprising that we have had to fall back on the various selective restrictions as temporary expedients to relieve our balance of payments deficit. Nevertheless, we must take the view of these controls as at least "doing something" in an area which has seemed barren of effort at the Government level for too long a time.

But these steps are constructive—as I have already indicated—*only* if they are temporary. They are no substitute for the fundamental cure of fiscal and monetary soundness, and their stay in our lives should be as brief as possible. They are clearly inconsistent with our long-term goals of unrestricted international trade and capital movements.

Our primary international responsibility is to reacquire control over our balance of payments in the shortest possible time. For this we must be willing to make sacrifices in terms of short-run domestic growth objectives. Failure to do so will sharply increase the likelihood of a much greater and unavoidable sacrifice: a breakdown of the international monetary mechanism, the decline of the dollar as the world's major reserve currency, and the possibility of a prolonged stagnation in world trade and economic growth.

Let us remember again that we have just had our tenth balance of payments deficit in a row—and 1967 was one of the largest of all. Let us also remember that in the same ten year period our gold stock has fallen by almost 50%, while at the same time our liquid liabilities to foreigners have doubled. Our friends throughout the world are aware of these figures, so we cannot be surprised either about speculative flights into gold or about talk about a devaluation of the dollar. These are conditions that beget rumors, and rumors lead to irrational actions and fears. This is true even though we are stronger internationally on a balance sheet basis than most anyone realizes—with total investment abroad twice as large as foreign investment in the U.S.

I have strong faith in the determination of the London gold pool members and in the size of their resources to believe that any imminent change in the gold price is out of the question. I firmly believe that the monetary authorities of both this country and of the free world generally are rational enough to recognize that any devaluation of the dollar would be considerably more harmful than beneficial.

The fourth area of our concern relates to that domestic economy. Our economists seem to agree that 1968 will be a record year in almost all aspects. But unfortunately, the same questions that cloud the outlook internationally hang over the domestic scene.

The U.S. economy is faced with inflationary pressure and nervousness about the dollar which is more widespread today than it has been in more than a decade. The recent price increases in the economy stem in large part from the inflationary fiscal and monetary policies which are at the very root of our international problems.

After a period of relative price stability in 7 of the last 10 years, we have now seen 2 years in a row with price increases in excess of 3% per year—and we have the prospect of even larger price increases in 1968. It is difficult to expect labor to confine wage increase to increases in productivity—or management to avoid a new round of price increases—under these circumstances. The damage has already been done. Those price increases largely reflect inflation created by our government fiscal policies and an over reliance on monetary policy. Waiting month after month and year after year to take fiscal action, premised on the hope for a solution in Viet Nam, has proved to be very costly.

Apathy on the fiscal front forced a serious credit crunch in mid-1966 as the Federal Reserve was saddled with a burden which should not be expected of monetary policy. The President's request for at least nominal expenditure cuts and a tax increase in his State of the Union message a year ago encouraged the Federal Reserve to adopt the easy money policy that characterized most of

1967—too easy, as things turned out. Meanwhile, fiscal inaction grew more serious. It took the Administration until August 1967 to come up with a specific tax proposal and then White House spokesmen were unable to convince the House Ways & Means Committee to take it seriously. Congressman Mills should be thanked by all of us for his insistence on true budget spending cuts before a tax increase is even considered—and a persistence in that point of view can have far-reaching effects in restraining government expansion over the years. Nevertheless, failure of the Congress and the Administration to get together on fiscal policy action contributed importantly to an environment which made it impossible for the British pound to be devalued without creating a tremendous wave of uncertainty among American businessmen, investors, and—for that matter—all thinking citizens.

A tax increase is still needed, unpopular though it may be. Expenditure cuts are even more needed, and they are even more unpopular. Every program has a strong pressure group supporting it. But both tax increases and expenditure cuts must be accomplished.

A nation which in the current year is running a budget deficit far above that for any other year in history (except for World War II) has obviously weakened seriously its flexibility in the fiscal policy area. By acting in this manner it has also impaired monetary flexibility in producing the most explosive combination of easy money and the highest long-term interest rates in our memory.

Fiscal policy must do the job we have a right to expect of it. It can then—and only then—have a powerful effect in avoiding the stringency of further direct controls, not only with regard to emergency measures designed to meet the immediate balance of payments deficit but also direct controls over credit and over prices and wages—controls which are repugnant to all of us.

The challenge to the United States is clear. Statesmanship in our fiscal and monetary policy is the key not only to our domestic stability but also to our role as leader and banker for the free world. We have preached the doctrine of fiscal responsibility to almost every country at one time or another since World War II. Now the pressure on the dollar and the persistent and increased drain on our gold reserves is forcing us to take some of the actions we have advocated for others.

Under these circumstances, we have no real choice but to remove the legal requirement of a 25% minimum gold reserve against Federal Reserve notes. As we all know, U.S. Treasury gold stock declined in 1967 by more than $1 billion and at approximately $11½ billion it stands at less than half the level reached in the early post-war period. We now have about 25% of the free world's gold, as against 70% two decades ago. Over $10 billion of our gold is required to be held as backing for our currency and that amount will increase during 1968 as our economy continues to expand. This is an exceedingly slim margin.

Our Government has made it abundantly clear that our gold is fully committed as a backing for international transactions. In his message on balance of payments and gold to the Congress seven years ago President John F. Kennedy said:

". . . Our gold reserve now stands at $17.5 billion. This is more than 1½ times foreign official dollar holdings and more than 90% of all foreign dollar holdings. It is some 2/5 of the gold stock of the entire free world.

"Of this $17.5 billion, gold reserves not committed against either currency or deposits account for nearly $6 billion. The remaining $11.5 billion are held under existing regulations as a reserve against Federal Reserve currency and deposits. But these, to, can be freed to sustain the value of the dollar; and I have pledged that the full strength of our total gold stocks and other international reserves stands behind the value of the dollar for use if needed."

This last sentence received world-wide publicity and acceptance. It is a firm pledge. The action being asked of your Committee is action which is essential to back up that pledge. The fact that this gold is already available under present legislation, which permits temporary suspension of the gold requirement (with penalties) in case of need, provides small comfort. To deny action to eliminate the gold currency reserve now is to suggest to the world that we are entertaining ideas of further roadblocks to the free movement of trade throughout the world by limiting gold availability to pay dollar claims which have already been incurred. This must not be allowed to happen. Despite all that has happened the dollar and its tie to gold are still the keystone of world prosperity. The integrity of that relationship requires that we act to remove our gold currency reserve—a reserve which has no counterpart in Germany, France, Italy, Japan, or the United Kingdom. Removal of the gold cover, nevertheless, makes it even more imperative that we take our responsibilities of fiscal and monetary soundness much more seriously and not fall back on the crutch of direct controls that can only strangle world trade in the long run.

AMERICAN MINING CONGRESS,
January 25, 1968.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency, U.S. House of Representatives, Rayburn House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: I would appreciate your acceptance of the enclosed statement presented on behalf of the American Mining Congress for the record of the hearings held by your Committee on the subject of legislation to eliminate the gold reserve requirements for Federal Reserve notes and for U.S. notes and Treasury notes of 1890.

With warmest regards and best wishes, I am

Sincerely,

J. ALLEN OVERTON, Jr.,
Executive Vice President.

STATEMENT OF DR. DONALD H. MCLAUGHLIN, CHAIRMAN OF THE BOARD, HOMESTAKE MINING CO., ON BEHALF OF THE AMERICAN MINING CONGRESS

Mr. Chairman, as a representative of the American Mining Congress and as an officer of the Homestake Mining Company which operates the largest gold mine in the western hemisphere, I am appearing before you to voice the opposition of the mining industry to the principle embodied in the bill before this Committee, the objective of which legislation is to remove the 25 percent gold cover on Federal Reserve notes.

We object to this legislative action which will sever the last remaining link between gold and our domestic currency system. With some justification it has been said that the 25 percent gold reserve now required by Federal law is more or less symbolical since dollars held by our citizens are not redeemable in gold. With the passage of this legislation the domestic dollar will be completely reduced to fiat currency. Incongruously enough, the dollar internationally still will be convertible into gold. In fact, the purpose of the removal of the "gold cover" is to free up our entire national gold reserve to pay off claims presented by foreign citizens at the bargain price of $35 per ounce.

The original intent of imposing a gold cover requirement upon the Federal Reserve System was to impose a restraint upon over-expansion of our currency. Unfortunately, successive Administrations in the conduct of their fiscal and monetary policies have paid little heed to the discipline of gold, and our money managers are confronted with the embarrassing necessity of urging this legislation to make our national gold stockpile available for redemption of dollars held by foreign banks to a total that now far exceeds the gold we have in our reserve and for sale to hold the price on the London market as well as to supply gold for industrial uses.

On January 19, 1968 the Federal Reserve Board reported that the gold reserves held against Federal Reserve notes of $40.876 billion have fallen to a dangerously low 27.4 percent, with our national gold reserves reduced to $11.984 billion. Our "free gold", non-committed to the Federal Reserve System, available to meet foreign claims is now approximately $1.3 billion. Quite obviously a reoccurrence of heavy gold withdrawals of the magnitude which occurred in the closing weeks of 1967 would soon exhaust our supply of "free gold", at which point costly penalties would be imposed upon the Federal Reserve by existing Federal law if the 25 percent gold cover were not removed. Still further losses of gold would, in all probability, lead to an embargo on gold followed inevitably by a reevaluation of gold, which would mean a higher price for gold not only in dollars but in all major currencies.

In spite of the positive statements of the Treasury Department, the Federal Reserve and the Administration that this will never occur and that the dollar will be defended to our last bar of gold, it is all too likely to occur when our gold reserve reaches some critical point in its decline. The time to face the issue is now while we still have gold and can speak with more strength than we will have when our supply is approaching exhaustion.

The conception that our dollar is as good as gold was rudely shattered by the gold buying abroad triggered by devaluation of the British pound, which only too clearly demonstrated weakness and distrust of the American dollar as a store of value. Confidence in the stability of the dollar has been weakened by the continuing and increasing deficit in the United States balance of payments now estimated by the Administration at from $3½ to $4 billion and by the prospects of an even greater internal Federal deficit which may be in the range of $20 billion with increasing danger of even faster inflation.

While the Administration has proposed certain measures to correct the balance of payments deficit and now comes forward with this proposed legislation to remove the 25 percent gold cover from Federal Reserve notes, these proposals come too late with too little to offer as a solution to the magnitude of our monetary problems. Rather than strengthening confidence in the dollar, we believe removal of the gold cover may well be regarded in foreign circles as a further admission of weakness since some of our foreign creditors may well be worried over whether claimants at the end of the line will be able to receive gold when settlements are made. Notice served on the world that our limited national gold reserve is being freed of all restrictions is not likely to be reassuring to our creditors unless accompanied by clear indications that we intend to live within our means.

We wish to raise two pertinent queries: To what point will this nation permit its gold stocks to be depleted without imposing an embargo? To what low level will our gold reserves drop before our military authorities warn that the security of the country is being placed in jeopardy in the event of conflict?

We appreciate the gravity and complexity of our monetary problems which may cause the Congress to decide that removal of the gold cover is necessarily inevitable. We appreciate further that confidence in the dollar and a sound currency is a matter of concern, not only to gold operators, the mining industry and the entire business community, but to every American citizen. However, if a majority of the Members of Congress see fit to enact the legislation now before this Committee to remove the gold cover, we earnestly submit that due consideration should be promptly given to legislation to permit our citizens to own gold coins or gold bullion without limitation and to stimulate and increase our production of gold through incentive payments to domestic producers.

BANK OF AMERICA,
San Francisco, January 22, 1968.

Hon. WRIGHT PATMAN,
Chairman, Banking and Currency Committee,
Rayburn House Office Building,
Washington, D.C.

MY DEAR MR. PATMAN: You will find attached a statement covering my views on the proposed legislation to remove the "gold cover" on Federal Reserve notes which I believe is coming up for discussion in your Committee.

Sincerely,

R. A. PETERSON,
President.

STATEMENT OF R. A. PETERSON, PRESIDENT, BANK OF AMERICA, ON GOLD COVER LEGISLATION

The Bank of America fully supports the President's recommendation for removal of the present requirement that Federal Reserve Notes outstanding be covered by a 25 per cent gold certificate reserve. Retention of this requirement can only contribute to uncertainty in the international financial markets.

The major argument for retention of the gold cover is that it precludes excessive growth in the domestic money supply which would contribute to inflation. However, Federal Reserve Notes account for less than one-fourth of the money supply. Therefore, as a restraint the present gold cover requirement is largely ineffective. The demand for currency in circulation is principally a function of commercial activity in the United States, and the supply of currency should be responsive to these demands.

Most of the U.S. gold stock is currently required as reserves for domestic currency. As the U.S. economy grows, increased issuance of Federal Reserve Notes will require abandonment of the gold cover requirement within a few years in any case.

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Stability of the international monetary system requires continued confidence in our willingness and ability to provide gold to foreign governments and central banks at the $35 per ounce price. This confidence would be greatly strengthened by removal of the gold certificate reserve requirement for Federal Reserve Notes.

However, it must be recognized that removal of the gold cover from Federal Reserve Notes in no way lessens the necessity for reduction in the U.S. balance of payments deficit. Nor will removal of the gold cover reduce the immediate need for more fiscal responsibility (expenditure reductions as well as tax increases) in the domestic budget. A return to more stable prices in the domestic economy is a must if we are to achieve sustainable economic growth at home and a balance in our international payments.

ALEXANDRIA, VA., *February 2, 1968.*

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: The Banking and Currency Committee's action yesterday, to recommend passage of H.R. 14763, is cause for regret in several ways.

This judgment is reached even though the basic idea of the bill—that the Federal Reserve should have ample power to supply paper currency to satisfy the wishes of owners of bank deposits to convert the latter into "pocket money" and that locking up gold certificates and gold as a 25% reserve "behind" such currency is a highly questionable guide to policy—is plausible enough. Relaxation in those regards in the intermediate future is not opposed to this statement.

Reasons for regarding yesterday's speedy action as meriting regret include the following:

1. The Administration's arguments in support of the urgent enactment of the bill were a collection of truths, half truths, and substantial untruths. In the interest of arriving at policies well designed to overcome some of the deplorable results of recent years, some Congressional committee should "smoke out" and clarify the incomplete truths and the untruths. Much of the relevant subject matter falls within the responsibilities of this Committee.

Among the Administration arguments in which there were substantial degrees of untruth or error were:

a) That all of our depleted gold stock ought to be made completely and immediately available "to support this country's international monetary commitments," whereas in fact a great deal of U.S. gold has recently been sold—and apparently will be sold in the future—in the London open gold market (and perhaps similar markets in other financial centers). There presumably most (or perhaps all) of the buyers are not central banks but a host of unidentified persons. Under this practice the United States and six associated countries are furnishing gold at close to the monetary parity price to any racketeer and lawbreaker, foreign or domestic, who wishes to exchange dollars for gold; any exiled dictator with a fortune obtained by looting his own country; any international plotter, or hoarder—while this gold is forbidden to all U.S. citizens at home or abroad and the law-abiding citizens of various other countries.

There seems to be no reliable public information on who the buyers of this gold in London are, or even on its general destination.

This gold, moreover, was mostly bought by the United States Government in the 1930's paid for with dollars of far greater value than the dollar today, and held in the Treasury's gold stock ever since at an obscure but real sacrifice of cost in potential receipts to the U.S. budget and the taxpayers. (This cost was briefly described to the Senate Banking and Currency Committee by Professor Roy Blough several years ago. Time and space do not permit a careful restatement of the cost at this point.)

The contention here is not that stabilization of the London open market price is conclusively unwise. Such gold sales, however, should not be lumped as an "international commitment" and as an implied debt of honor of the United States, along with selling gold to foreign central banks. The practice was adopted only a few years ago and was rejected in the early post-war years. (The open market in those years was not in London but elsewhere.) Furthermore, unless Governmental agencies are to be told to use the nation's assets in any way they see fit—which the Congress more or less did with respect to gold in the Gold Reserve Act of 1934—there should be some Congressionl and public review and endorsement of the principle.

There was no significant discussion of these sales to the faceless public abroad during these hearings on this bill. The question was not even raised. So far as the writer's very incomplete knowledge goes, there has never been a formal airing of the policy since it was begun.

b) The Administration position on gold has been to insist in the strongest terms that, on the one hand, unrestricted international convertibility of dollars abroad into gold at $35 an ounce was indispensable to both the value of the dollar and the continued healthy operation of "the international monetary system," while also insisting on the other hand that U.S. citizens ought not to be allowed to hold any gold, would not obtain any benefit from owning gold, and could not legitimately ask to do so. This contrast in assertions seems irreconcilable, except superficially.

At the same time, both the Administration and this Committee are to be applauded for their determination against any U.S. increase in the $35 per ounce level of official gold buying and selling, and also for their repudiation of a "floating exchange rate" for the dollar. In fact, the full case against both is much stronger than was stated.

c) At least one Administration spokesman in these hearings grossly overstated the probable effects on world trade and payments and on the foreign exchange value of the dollar in case of suspension of the present form of gold convertibility. The tendency of repeated assertions that the international monetary system and world trade would collapse into chaos if such convertibility should terminate, as if it were an unquestionable consequence—which the spokesman may have sincerely believed but which many others of greater experience in the international monetary field have judged to the contrary—served to frighten the Committee into unnecessarily hasty action. This erroneous view has also foreclosed desirable balance of payments policies.

d) The Administration argument that demonstrating that our entire $12 billion of gold is available for sale and will be sold "down to the last bar" will be an effective discouragement to "gold speculators" likewise ought to have been incisively challenged. In fact, the frequency with which some Government officials have said this, with emphasis on the "selling down to the last bar," makes one suspect a sort of Freudian "death-wish" that this stage will be reached and will be a variety of moral triumph. In any case, the persuasiveness and effectiveness of this demonstration seem doubtful.

e) The Administration presumption that of course the rate of growth of Federal Reserve notes in circulation should be free to continue as in recent years blotted out any question whether the Reserve System may have fostered too great a rate of expansion in the money supply in recent years—perhaps ever since World War II, as well as after World War I—including bank deposits along with currency. Will this Committee, so specially charged with Congressional responsibility for policies of money and credit, have any better opportunity this session to press the Administration, including the Federal Reserve System, for whether and how they expect to improve the record of the last 23 years? In that period the purchasing power of the dollar has fallen almost by 50 per cent, and the ownership of Savings Bonds, savings deposits, most insurance, etc., has been turned into a net loss of purchasing power, due to the price inflation, despite the illusory receipt of "interest" (after taxes).

f) It seems regrettable, further, that the hearings did not contain a challenge of some of the statistical assertions in the Treasury brochure introduced in part in the testimony, entitled "Maintaining the Strength of the United States Dollar in a Strong Free World Economy," as well as of some of the theoretical principles asserted, such as those listed above. The data on the trade surplus of this country and on the labor component of U.S. exports are two which might well have been analyzed further.

2. Turning now from dubious Administration arguments in these hearings, it seems regrettable that this Committee did not go further into the money and credit aspects of the Administration program for dealing with the nation's balance of payments, other than H.R. 14763.

In this connection, the writer has long deplored the fragmentation of integral and essentially inseparable programs among several scattered committees of the Congress. It leads to failure anywhere adequately to survey the problem as a whole. Joint hearings by several committees seem to an outsider to be the most plausible solution, despite the difficulties entailed.

As a result of the quick conclusion of these hearings, the writer is forced to submit to the forthcoming House Ways and Means Committee's hearing on the proposed taxation of American tourists a substitute program for handling the entire balance of payments problem, most elements of which have more to do with money and credit problems than with taxation.

3. It is regretted that this Committee in these hearings could not have had the time—though of course the almost prohibitive demands on the Members' time is kept in mind—to permit the publication in the hearing record of written statements following the oral hearings, which might have helped reconcile some of the perennial and almost tragic disagreements among economists and financial specialists of all kinds, before the Committee voted on the bill. In problems of the complexity and controversiality of monetary policy, domestic or international, satisfactory solutions seem impossible of attainment in statements limited to ten or even twenty minutes of oral presentation, or in Committee questioning under the five-minute rule and similarly curtailed answers to difficult questions by the witnesses.

Sincerely yours,

GEORGE A. EDDY.

BANK OF KENNETT,
Kennett, Mo., January 22, 1968.

Hon. WRIGHT PATMAN,
Chairman, House Banking and Currency Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: I do very much urge upon you and your Committee the prompt passage of legislation to remove the gold cover against Federal Reserve Notes.

Regardless of how one might feel about actions and events of the past related in any way to this problem, it seems to me that it is absolutely necessary for this legislation to be enacted now.

I know that you are fully knowledgeable on this whole matter and I will not bore you with any of the arguments or reasons with which you are so thoroughly familiar. Suffice it to say that I am completely convinced that this action is both desirable and necessary and that time is of the essence.

Respectfully yours,

JOSEPH C. WELMAN,
Chairman.

ORANGE, CALIF., *January 22, 1968.*

Hon. WRIGHT PATMAN,
Chairman of House Committee on Banking and Currency,
Washington, D.C.

DEAR MR. PATMAN: It seems that the government is about to remove the so-called gold cover for our currency (Federal Reserve Notes), so it becomes inceasingly difficult for people who have studied the matter to justify the government in selling its securities to commercial banks in exchange for bank credit. Is this not an exchange of government credit for bank credit, with government paying interest on the exchange? Further, after acquiring the bond, the commercial bank has enlarged its reserves for the purpose of expanding its loans under the fractional reserve banking laws. It seems to me that this practice is a great abuse of the rights of taxpayers, and causes them to pay unnecessarily a huge um of money on account of servicing this debt.

Should not the laws prevent commercial banks from using funds other than those behind savings accounts, for the purchase of government securities? Banks should not be allowed to monetize the national debt at a profit to them. Can you not write to our newspapers and magazines (such as Fortune) and show good cause why some of these manifest abuses should not be eliminated? If the news media are so tied in with finance, as to make it impossible to tell the public what the public ought to know about these things, then we do not have freedom of the press in actual practice but only in theory.

It seems to me that now that our gold is no longer a factor to support our currency inside the United States, that the government should, with statutory limitations imposed, pay directly into circulation in payment of government obligations, United States notes which would be legal tender in payment of all debts, public and private, and be recalled from circulation by payment and collection of taxes. Who needs the banks for this process, when the banks have no title to gold or silver and nothing to give government but bank credit (an intangible thing).

The people who bring about a revolution in the creation of new money in the United States will go down in history as great benefactors of the people.

Hoping to hear from you, I remain,

Sincerely yours,

ROBERT L. FAUCETT.

WEST CHESTER, PA., *January 22, 1968.*

Congressman WRIGHT PATMAN,
U.S. House of Representatives,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: Enclosed is a copy of my letter to the Treasury, which you may want to print in the record of your hearings. I oppose removing the gold cover because it would be the final emasculation of our currency, and it will not prevent an increase in the gold price. Inflation is rampant throughout the world, even in the industrial countries. Revaluation is a joint responsibility of the industrial countries. I invite you to read my data and draw your own conclusions.

Respectfully,

WILLIAM B. RETALLICK.

WEST CHESTER, PA., *January 1968.*

Hon. FREDERICK L. DEMING,
Hon. HENRY H. FOWLER,
Hon. WILLIAM McC. MARTIN,
Hon. ROBERT A. WALLACE.

DEAR SIRS: This is a note on gold, silver, and paper currency. It contains a suggestion for revaluing all paper currencies to bring them into equilibrium with gold and silver.

Table I shows the inverse relationship between gold remaining in the U.S. Treasury and gold in private holdings. This results from selling gold at 35 paper dollars per ounce, when the price would have to be increased to $90 just to compensate for the inflation since 1933.

Also shown in Table I are the decline in our Reserve Position in the IMF, and the increase in Roosa bonds sold to foreign governments to dissuade them from taking gold.

Table II shows that the silver outflow continues, despite the write-off of silver certificates.

Table III traces the disappearance of our silver coins. Americans are now hoarding over a billion ounces of silver coins. This is only natural, since they cannot own gold.

I suggest evolving a convertible paper dollar as follows:

	Dollars per ounce	
	Silver	Gold
Present monetary price	1.29	35.00
New price in silver certificates and silver coins	1.29	20.67
New price in all other present paper dollars	5.17	82.68
New price in convertible dollars	1.29	20.67

	Present dollars to buy 1 new convertible dollar
Silver certificates, silver coins, nickels, and pennies	$\frac{1.29}{1.29}=\frac{20.67}{20.67}=\$1$
All other paper dollars and clad coins	$\frac{5.17}{1.29}=\frac{82.68}{20.67}=\$4$

The par value of all other currencies would be changed simultaneously and in the some proportion. Such a revaluation can be voted through the IMF by means of Section 7 of the Fourth Article of Agreement. The United States, plus England, Canada, and the six Common Market Countries have 52% of the voting power in the IMF, which is more than the simple majority needed. The 52% voting power is calculated in Table IV, which also shows that all other major currencies are depreciating faster than the U.S. dollar. Revaluation is a joint responsibility of the industrial nations.

Some features of this revaluation are:

1. The new convertible dollars would be freely convertible into coins of gold or silver, as well as bullion, by American citizens or anyone else.
2. The new gold price is not even high enough to compensate for the inflation since 1933, as shown in Table I. A lower price might now draw gold back into the monetary system.
3. The new silver price restores the historic gold/silver ratio of 16, and should be high enough to draw silver back into the Treasury. It should also draw hoarded silver coins back into circulation, and permit silver coins to be minted again.
4. No more clad coins would be minted. Those returning to the Treasury would be destroyed. Some of them would remain in hoarding, like the wartime steel pennies, but the Treasury would retain the seigniorage profit on the hoarded coins.
5. The purchasing power of silver coins, nickels, and pennies is increased fourfold in this revaluation which would require a new small coin for sales taxes and parking meters. I suggest a half cent coin, possibly of steel, like the wartime penny.

I believe that a world-wide revaluation is inevitable, and cannot be avoided by removing the gold backing from the Federal Reserve notes. Once we put our entire gold stock up for sale, it will sell rapidly, just as our silver did, and soon we will have too little gold to control the price.

Respectfully,

WILLIAM B. RETALLICK.

TABLE I.—THE GOLD OUTFLOW WOULD BE GREATER, BUT FOR BORROWING FROM THE IMF AND SALES OF ROOSA BONDS

[In billions of dollars]

Year	Treasury gold stock at year end	World private gold holdings [1]	New gold coming to market [2]	Gold added to Free World monetary stock	U.S. reserve position in the IMF	ROOSA bonds outstanding	Number of current dollars having purchasing power of 35 1933 dollars [3]
1955	21.8	11.4	1.0	0.7	1.0	----------	72
1956	22.1	11.9	1.1	.5	1.6	----------	74
1957	22.9	12.4	1.3	.7	2.0	----------	76
1958	20.6	13.8	1.3	7	2.0	----------	78
1959	19.5	13.2	1.4	.7	2.0	----------	78
1960	17.8	13.8	1.4	.3	1.6	0	80
1961	16.9	14.7	1.5	.6	1.7	.5	81
1962	16.1	15.5	1.5	.5	1.1	.7	82
1963	15.5	16.5	1.8	.8	1.0	1.3	83
1964	15.4	16.8	1.8	.8	.8	1.7	84
1965	13.7	18.0	1.9	.2	.9	2.4	85
1966	13.2	20.0	1.5	0	.3	1.5	87
1967	[4] 12.0	22.0	1.4	−1.0	.4	----------	90

[1] From Pick's Currency Yearbook.
[2] Annual reports of the IMF and Bank for International Settlements, and annual gold reviews of First National City Bank.
[3] Calculated from Consumer Price Index of U.S. Bureau of Labor Statistics.
[4] $1,030,000,000 of this gold is owed to the IMF.

TABLE II.—THE SILVER OUTFLOW CONTINUES

[Millions of ounces of Treasury silver]

	Backing silver certificates	Free silver bullion	Outflow during month	Released by canceling certificates
June 1965	687	315	32	42
December 1965	532	272	28	18
June 1966	465	224	19	7
December 1966	440	154	10	2
1967				
January	437	131	26	3
February	434	116	18	3
March	432	100	18	2
April	430	88	14	2
May	428	51	39	2
June	307	135	36	120
July	306	111	26	2
August	301	103	12	5
September	299	92	14	3
October	296	80	15	2
November	292	71	13	4
December	289	62	12	3

Source: Daily statements of U.S. Treasury.

TABLE III.—SAMPLES OF CIRCULATED QUARTERS SHOW THAT SILVER QUARTERS ARE DISAPPEARING

	Date of sample (number in sample)					Millions put into circulation
	March 1967 (2,000)	June 1967 (2,000)	November 1967 (800)	December 1967 (800)	January 1968	
Silver, 1959 and earlier	506	493	146	84		[1] 1,560
Silver, 1960 and earlier	35	37	10	4		[1] 88
Silver, 1961 and earlier	42	36	21	13		[1] 119
Silver, 1962 and earlier	61	70	18	10		[1] 163
Silver, 1963 and earlier	76	109	17	11		[2] 210
Silver, 1964 and earlier	472	493	160	75		[2] 1,265
Total, silver quarters	1,192	1,238	372	197		3,405
Clad, 1965	716	704	283	313		[2] 1,817
Clad, 1966	81	46	49	35		
Clad, 1967	11	12	96	255		
Total, clad quarters	808	762	428	603		
Fraction of 1965 clad in the sample	.36	.35	.35	.39		
Total silver/1965 clad	1.66	1.76	1.31	0.63		1.87
Approximate millions disappeared since 1962 coins			[3] 1,010	2,250		
Ounces of silver [4]			180	410		

[1] Coins in circulation at end of calendar 1962, from working memorandum 22, case 64904, by Arthur D. Little for U.S. mint.

[2] From mint reports.

[3] (1.87–1.31) 1,817~1,010.

[4] An additional 760,000,000 ounces disappeared in halves and silver dollars.

TABLE IV.—VOTING POWER IN THE IMF, AND VALUE OF MONEYS

	IMF quota (millions of dollars)	Votes (in thousands)[1]	Percent of total vote	Value of money, 1956=100[2]	
				1961	1967
United States	5,160	51.9	21.9	91	81
United Kingdom	2,440	24.7	10.4	89	73
Canada	740	7.7	3.3	91	78
Germany	1,200	12.3	5.2	92	78
France	985	10.1	4.3	74	60
Italy	625	6.5	2.7	92	70
Netherlands	520	5.5	2.3	88	71
Belgium	422	4.5	1.9	93	80
Luxembourg	17	.4	.2	94	--------
Total	12,109	123.6	52.2	--------	--------
Total for 106 IMF members	20,988	236.6	100.0	--------	--------
Switzerland	----------	----------	----------	94	76
Sweden	----------	----------	----------	85	66
Japan	----------	----------	----------	88	65
Austria	----------	----------	----------	90	73

[1] Calculated from IMF Articles of Agreement XII, sec. 5, "Voting."
[2] From IMF and First National City Bank.

THE UNDER SECRETARY OF THE TREASURY,
Washington, D.C., February 1, 1968.

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

DEAR MR. CHAIRMAN: I am enclosing for insertion in the record of your committee's hearings on H.R. 14743 our comments on a list of ten points which were brought up by the minority during the hearings.

Sincerely yours,

JOSEPH W. BARR.

1. U.S. ability to maintain or increase balance of *trade* surpluses. Since 1962, the U.S. share of total world export of manufacturers significantly has declined. Without P.L. 480 and foreign aid grant programs tied to U.S. exports our trade surpluses would be virtually eliminated.

2. The extent to which the growth of "regionalism" and worldwide commodity agreements have adversely affected our balance of trade, together with a full review of foreign non-tariff barriers.

3. Full disclosure to the extent possible of the factors accounting for the huge 4th quarter (1967) balance of payments deficit and the extent to which further liquidation of U.S. securities by foreign nations could cause recurrent balance of payments dislocations.

4. A full review of the role of the gold speculator and the extent to which various devices could be employed to counter gold speculation.

5. The extent to which the U.S. can maintain bilateral and multilateral assistance at current levels in view of the Treasury Department's admission that "tied" grants and loans create a significant degree of substitution resulting in little net gain in exports.

6. Whether or not domestic labor costs have adversely affected U.S. exports to the degree suggested by the Johnson Administration. Treasury figures indicate they have not.

7. The adverse impact on U.S. trade balances that would be caused by threatened postponement of purchases by foreign flag carriers of U.S. commercial jet aircraft in retaliation for the proposed clampdown on U.S. tourist travel. In this connection, the B/P impact of the F-111 contract cancellation by the United Kingdom and the degree to which the balance of trade surplus depends upon arms sales.

8. The charge that less than 10% of U.S. dollars accruing to the government of Vietnam from piaster sales for the support of U.S. forces in Vietnam find their way back to the U.S. The House Committee on Government Operations estimates that for 1967 the government of Vietnam expended about $300 million of its foreign exchange derived in this manner for imports, and that less than 10% will be spent in the U.S.

9. Long-term effects on U.S. overseas business interests caused by controls over capital flows, direct investments, and forced repatriation of profits. Does the President's program suggest extraterritorial law with regard to the internal operation of joint ventures?

10. The extent or lack of international cooperation in the operation of the London "Gold Pool".

We recognize that the primary responsibility for conducting our international monetary affairs rests with the Executive Branch. Nevertheless, the role of Congress is one of review and independent assessment. Congress has failed to assume this responsibility in connection with a specific legislative request of major importance, such as the bill before us.

We urge that these hearings on the gold cover bill include witnesses representing the best talent available from business, labor and banking, as well as the academic community.

COMMENT ON ITEM 1

The President's January 1st message stressed the vital importance of increasing our export surplus and his program calls for a variety of short- and long-term measures to accomplish this. The most important and most urgent of these is enactment of the tax surcharge. A sharp resurgence of excessive demand pressures in our economy would not only spill over quickly into disproportionately rapid increases in imports. It would also add further to the cost-price pressures already working their way through our economy as a result of previous excessive boom conditions, with serious and lasting damaging effects on the competitiveness of our exports in world markets.

Our relative share of total world export markets for manufacturers reflects a great many factors—including certainly, over time, our changing cost and price competitiveness relative to other major exporters. Over the period 1961–64, at least, improvements in our competitiveness helped us to roughly maintain our share of world markets, in the face of other, adverse, factors such as the continuing growth in effective manufacturing capacity in countries such as Italy and Japan, and the faster growth of trade within the EEC and the EFTA groups of countries.

Although a deduction of all Government-financed exports from our trade account does of course give a correspondingly smaller surplus, the period from 1960 through at least the first three quarters of last year has nevertheless shown substantial trade surpluses even on this basis.

U.S. GOVERNMENT FINANCED AND TOTAL TRADE, BALANCE-OF-PAYMENTS BASIS, 1960-67

[In millions of dollars, annual rate]

	1960	1961	1962	1963	1964	1965	1966	January–September 1967 [1]
Exports	19,489	19,954	20,604	22,071	25,297	26,244	29,168	30,716
Less estimated Government financed	1,898	2,209	2,333	2,721	2,801	2,758	3,012	3,209
Exports excluding Government financed	17,591	17,745	18,271	19,350	22,496	23,486	26,156	27,507
Imports	14,723	14,510	16,187	16,992	18,621	21,472	25,510	26,367
Surplus (excluding Government financed	2,859	2,325	2,084	2,358	3,875	2,014	646	1,140

[1] Partly estimated; 1967 total trade data represent seasonally adjusted data for the 1st 3 quarters at an annual rate. The Government financing for 1967 isjestimated on the basis of seasonally unadjusted January–September data.

Note: The 4th quarter 1967 data on Government financed exports are not available as yet, so that the full year surplus excluding such exports cannot be computed.

Source: Department of Commerce, Survey of Current Business, June and December 1967.

COMMENT ON ITEM 2

Available evidence does not permit a definitive judgment to be made as to whether the trade generating effects of the regional integration arrangements presently in existence have or have not tended to outweigh trade diverting effects.

Between 1960 and 1966, total United States exports expanded from \$20.6 billion to \$30.4 billion, an increase of 48 percent. During the same period, United States exports to the European Economic Community rose from \$3.5 billion to \$5.3 billion, an increase of 52 percent.

The growth of exports, particularly to Western Europe, can be attributed to a number of factors. Rising incomes, stimulated to some extent by the formation of these integrated communities, have increased demands for American-produced goods. An upgrading of efficiency on the part of European industry has been reflected, in part, in greater demand for high quality capital goods which embody the latest technology. Relative price stability in the U.S. made American goods more competitive and permitted increased penetration of some markets. Moreover, the growing effectiveness of American marketing techniques and servicing ability in foreign areas has also increased sales of U.S. products.

United States exports to the European Free Trade Area (EFTA) during the same period increased from $3.2 billion to $3.8 billion, an increase of 22 percent. This is less than the average increase in United States exports to all areas during the period, and reflects primarily the relatively low rate of increase in United States exports to the United Kingdom during the period.

There are two other regional groupings of some significance in international trade, the Central American Common Market and the Latin American Free Trade Area (LAFTA). From 1961, at which time the Central American Common Market became effective, to 1966, U.S. exports to the Central American Common Market countries increased by 70 percent ($207 million in 1961 to $362 million in 1966). The regional grouping represented by LAFTA has not yet developed to a point at which it has a major impact on the trade patterns of its member countries; however, it can be noted that U.S. exports to the countries now included in LAFTA rose from $2.9 billion in 1960 to $3.5 billion in 1966, an increase of 21 percent.

Commodity Agreements

The United States is participating in negotiations for the renewal of the International Coffee Agreement and the establishment of a cocoa agreement. The aim of these agreements is the moderation of price fluctuations without distorting production and consumption patterns. The elimination of sharp fluctuations in export prices is particularly important for many less developed countries whose foreign trade is dependent upon a limited number of commodities.

The stabilization of price fluctuations, if it can be done without distorting the long-term trend, can benefit both the IDC's and the developed countries in some cases. Absence of wide price fluctuations can provide the LDC's with stable foreign exchange receipts with which to import the goods and services needed to diversify and develop their economies. These goods and services will come from the developed countries, and since the United States is the major world exporter, much of these goods and services will be of American origin, when the United States is a competitive supplier.

Another type of commodity agreement is the Grains Agreement negotiated in the framework of the Kennedy Round. The United States approaches the question of commodity agreements on a case-by-case basis to assure that any agreement developed is on balance beneficial to the United States.

Non-Tariff Barriers

Inasmuch as the President has asked the Special Trade Representative, Ambassador Roth, to carry out a far ranging review of trade policy, one of the most important aspects of which is an analysis of non-tariff barriers, any substantive comment at this time would be premature. Now that tariffs have been significantly reduced, these non-tariff barriers can play a critical role in restricting the growth of world trade in general and U.S. exports in particular.

COMMENT ON ITEM 3

Final data are not yet available to provide a complete accounting of the deficit in the fourth quarter. *Trade* data show, however, that there was a sharp decline in our trade surplus. There was a fall-off of almost $700 million from our $1,072 million quarterly average earlier this year, of which about $500 million was accounted for by increased imports and the remaining $200 million by a decline in exports. An additional significant adverse factor in the fourth quarter was the liquidation by the U.K. of the remaining $570 million balance from its long-term investment portifolio of U.S. securities.

Basically, the upsurge in imports, which became particularly noticeable in November and December, reflects the further warming up of the domestic economy. As of now, we have again moved into a situation where more rapid growth in our GNP will almost inevitably bring a more than proportionate rate of increase in our imports. In addition, wage and price increases of the kind we are already experiencing as a delayed effect from our previous period of booms, accentuated by the further push of a new outburst of excessive demand, could seriously undercut the competitiveness of our exports on world markets. This development underscores the importance of the tax surcharge, the delay in the enactment of which has already cost us important balance-of-payments dollars in the trade account. All doubts should now be resolved: this tax surcharge is the single most important action we can take to defend the dollar.

Foreign holdings of United States securities

The large adverse impact of securities liquidations by the U.K. Government on our balance of payments during the fourth quarter of last year represented the final step in the conversion into liquid form of the remaining balance of a large investment portfolio of U.S. corporate securities which the U.K. Government had requisitioned from private U.K. citizens and firms at the outset of World War II.

While there are no available statistics which would show the existence or extent of possible holdings of U.S. corporate stocks and long-term bonds other than Treasury issues by other foreign governments or central banks, we are not aware of, and have no reason to believe that there are likely to be, any other cases similar to that of the United Kingdom involving significant holdings of investment portfolios of U.S. stocks and long-term bonds by foreign official institutions.

What the United Kingdom did in the fourth quarter, and the reason that this had an adverse effect on our balance of payments, was to convert the remaining balance of these long-term investment holdings into forms that are treated in our balance-of-payments accounting as liquid liabilities to foreigners. This act of converting, therefore, appears as a capital outflow on the liquidity balance.

All of the long-term U.S. securities that we know to be held by other foreign governments and central banks represent either marketable U.S. Government bonds and notes or special nonmarketable Treasury securities, a good part of which are convertible into marketable issues. The foreign holdings of marketable and convertible nonmarketable U.S. Government securities are already included in our statistics on liquid liabilities to foreign official institutions and for this reason their possible conversion into other types of liquid dollar assets would have no effect on our balance-of-payments deficit.

We previously submitted three tables (p. —). The first shows foreign holdings, by country, of U.S. Government bonds and notes. This table includes private foreign holdings as well as official foreign holdings. The second table shows, by country, the special nonmarketable securities held by foreign official institutions. The third table is a summary table showing total official foreign holdings of long-term U.S. Government securities by type since 1959, the first year for which these data are available.

COMMENT ON ITEM 4

While gold is primarily a monetary asset it is also a commodity. It has been estimated that recognized industrial and artistic demands account for about one-half the annual amount of new production. This means that there must be some private use of, and markets for, gold. The remaining one-half of new gold production, or about $700 million per year, would normally be expected to flow into monetary stocks to the extent not taken up by speculation and hoarding demands. The latter may be differentiated. Gold hoarding takes place in certain areas of the world, particularly in Asia and Europe, and has been traditionally practiced as a reflection of lack of confidence in the security and value of domestic currencies and other assets. Speculative demand may be defined as that demand associated with a presumption that the price of gold—especially in terms of the dollar—will be changed.

This speculation is presumably based on three factors: first, the overall demand and supply situation for gold; second, the belief that an increase in the price of gold will be needed to supply international liquidity; and third, that the dollar price of gold may not be maintained because of U.S. balance-of-payments deficits. Speculative demand for gold, then, is symptomatic of basic questions and uncertainties about the international monetary system.

The only effective way to counter speculation is to clear away its basic causes. Many devices designed to restrict access to existing free markets in gold would tend to accentuate speculative demand and drive it elsewhere. In view of the major role of gold for monetary purposes, speculative demand probably cannot be completely eliminated. Nevertheless, new production is expected to continue to exceed legitimate private requirements for some years. Through adoption of the SDR plan to assure that the world's growing need for reserves can be met, and by strengthening confidence in the dollar through our balance-of-payments program, speculation in gold can be substantially reduced.

COMMENT ON ITEM 5

A very important part of our government-wide effort to improve the U.S. balance-of-payments position comprises aggressive steps to insure the effectiveness of AID's tied procurement policies, i.e., to assure that AID financing covers additional U.S. exports rather than exports which might otherwise have been paid for with the recipient country's free foreign exchange. Elements of this "additionality" oriented program include, but are not limited to, increased emphasis on the promotion of U.S. exports in selecting goods and services for AID financing, further orienting U.S. commercial staffs in the more important AID recipient countries, selectively limiting the list of goods eligible for AID financing, and taking advantage of opportunities for special arrangements to make AID-financed goods attractive to importers through such measures as reduced surcharges, the waiver of import deposits and favorable terms for bank credit.

These efforts to minimize or eliminate the substitution of AID-financed goods for U.S. commercial exports have been going on both in Washington and in the field for many months and there are numerous indications that the program is meeting with considerable success. As evidence of the government's determination to pursue this program with the utmost vigor, President Johnson directed the AID Administrator, on January 11, 1968, to take further steps to reduce the balance-of-payments cost of the U.S. AID program. Improvement of the effectiveness of our arrangements with the individual countries to assure that AID-financed goods are additional to U.S. commercial exports was an important element in this Presidential directive.

A related program, designed to improve the U.S. balance-of-payments position while at the same time seeking to strengthen multilateral development finance institutions and preserve their multilateral character, is also under way. This program comprehends improved burden-sharing by capital exporting countries in their contributions, improved access of the development finance institutions to wider world capital markets, and mitigation of the impact on our balance of payments of access by these institutions to our own capital market. In general we are seeking to insure that the provision of development finance through the multilateral institution makes an active contribution to the international payments adjustments process.

In the case of the World Bank, there has been a positive effect on the U.S. balance-of-payments position, partly as a consequence of the Bank's borrowing capital in markets other than the United States and partly through the investment of the proceeds of bond issues floated in the United States in a manner that neutralizes for a time any impact on our balance of payments. The Inter-American Development Bank has also raised sizeable amounts of money abroad and has invested the proceeds of its U.S. borrowings in ways compatible with our balance-of-payments policy. The IDB has, furthermore, taken added steps to attract non-member capital by limiting procurement under its loans in accord with the amount of financial resources that non-member countries make available on appropriate terms. Finally, with respect to the International Development Association we have indicated our readiness to participate in a substantial replenishment of IDA resources provided adequate balance-of-payments safeguards for the U.S. are built into the replenishment operation.

COMMENT OF ITEM 6

The data on comparative unit labor costs given in Table 7 of the Treasury document were full-year averages, and thus not available beyond 1966. Even these figures show, however, a 2-point increase in the index of U.S. unit labor costs in 1966 over 1965, compared with decreases of 3 and 4 points, respectively, for France and Italy.

A similar comparison through September 1967 of available quarterly data on this subject (expressed in terms of percentage changes from year-earlier levels) is shown in the following table.

RECENT TRENDS IN UNIT LABOR COSTS IN MANUFACTURES

	Percent increases (from year earlier levels)				
	United States	United Kingdom	Japan	Germany	France
1965 (average)	−0.7	−4.4	6.0	7.0	2.7
1966—I	.9	4.5	4.2	4.2	−3.5
II	2.9	6.2	2.5	5.8	−.9
III	2.5	3.5	−3.2	5.6	−2.6
IV	2.8	4.4	−4.8	2.4	.9
1967—I	5.5	.9	−5.6	−0	.9
II	5.4	−.8	−.8	−0	.9
III	5.5	(1)	4.2	(1)	(1)

1 Not available.

Sources: Based on available quarterly (or monthly) indexes: For the United States, from Business Cycle Developments, Department of Commerce; for other countries, from Economic Review, published by (United Kingdom) National Institute of Economic and Social Research. These data differ from those given in table 7 of the Treasury document "Maintaining the Strength of the U.S. Dollar in a Strong Free World Economy" in that the latter are based on GNP accounts (not available on a quarterly basis for most industrial countries) whereas the quarterly data are based on production indexes.

What these more recent data show is that:

—our own unit labor costs, following a persistent though moderate downward trend over the four years 1961–65, turned upward again early in 1966 and have since the beginning of last year been rising at an accelerated rate;

—whereas the corresponding cost indices of several of our major foreign competitors, which had during the 1961–65 period been rising at rates ranging from 3.5 to 6 percent per annum, have since the beginning of 1966 either levelled off sharply or actually declined.

The recent sterling devaluation will, of course, tend to add to the weakening of our international competitiveness implied by this new adverse trend in our domestic-currency costs relative to the U.K. and other countries.

It is this comparatively recent reversal of previous moderately favorable trends in our cost and price situation relative to foreign competitors—subsequent to, and in large part resulting from, the late-1955 and early-1966 period of excess boom in our domestic economy—which underlies the Administration's stress on prompt enactment of the tax surcharge and other measures to stabilize our domestic costs and prices as the most important single action needed to correct our balance-of-payments deficit.

The improving trend in our relative cost and price position which was evident through the early 1960's did not, admittedly, bring as much improvement in our export position and trade surplus as would have been necessary to eliminate our payments deficit. However, it was certainly one of the important factors helping to offset various other developments adversely affecting our trade position, such as the continuing growth of effective manufacturing capacity in countries such as Italy and Japan.

In considering either this earlier period of relative improvement or the current danger of relative deterioration in our cost and price competitiveness internationally, there are several further points as to the causal relationships between cost and price developments and international trade patterns which should, however, be noted:

The trade effects of changes in relative costs and prices are not immediate, but instead occur gradually, after some delay. By the same token, however, they also tend to persist for a considerable period.

In addition, there are many other factors which—particularly in the short run—also affect the levels of both our exports and our imports. These include: (a) absolute and relative changes in over-all levels of business activity and incomes here and abroad; (b) the commodity and country pattern of the aggregate increases in world demand; (c) the extent to which we or our competitors have slack resources available; and (d) changes in tariff structures and various other arrangements affecting trading relationships.

The one basic point which ought to be clearly apparent, however, is that any further increase in our unit labor costs or return to faster increases in our wholesale prices for manufactures which might follow the current renewal of upward movement in our domestic economy would over time seriously worsen our competitive position in international trade.

COMMENT ON ITEM 7

It should not be necessary to expect any postponement of aircraft purchases "in retaliation" for U.S. efforts to reduce our tourist travel deficit. Many countries—some of them in comfortable balance-of-payments positions—have restricted the tourist expenditures of their nationals. Many of the countries which may expect to see their tourist earnings temporarily reduced are now in surplus and have shown understanding and support for the President's program to bring the U.S. international accounts into better balance.

The question, however, embraces also the possibility that earnings forecasts of foreign airlines may need to be adjusted if U.S. tourist travel is to decline and that these airlines may decide to postpone aircraft purchases—not for reasons of retaliation but out of business prudence.

It is not clear that business prudence will dictate that course of action for these reasons:

1. The President's request is for a *temporary* curtailment of dollar outflows for travel. A curtailment of limited duration probably would not lead to substantial changes in the airlines' long-range plans for expansion and modernization of their aircraft fleets.

2. To the extent possible, the program to curtail travel outflows will be designed not to reduce the number of travelers—the factor upon which aircraft requirements depend—but rather to encourage a reduced level of expenditures overseas by travelers.

3. Our travel program includes and stresses measures designed to increase foreign travel to the United States which would increase the traffic of foreign airlines as well as that of U.S. airlines.

International air transport has become a highly competitive field and no airline can maintain its position without continuous up-dating of its equipment as technological advance continues. For many of the newer aircraft the potential buyer must establish his place in the queue for future deliveries. For these reasons it may well be that a temporary curtailment of U.S. tourist travel will have no substantial impact on United States sales of aircraft.

The B/P impact of the F–111 contract cancellation by the United Kingdom

We now expect to receive, over the next ten years, about $700 million less than we would have received if the British had not cancelled their F–111 orders. A more exact figure is not possible at this time because the amount of cancellation charges is still to be determined. The British purchase was largely being financed by a series of Eximbank credits, which would have been repaid over the period indicated above. The figure mentioned includes estimated interest earnings on these credits.

Because cancellation charges will become payable mainly over the next year, and also because repayments to Eximbank were exepected to be relatively small this year and next, the impact of cancellation will be felt mainly in the period beginning with 1970.

The degree to which the balance of trade surplus depends upon arms sales

Most arms sales by the U.S. are made through the Department of Defense and are shown in our balance of payments statistics, when the goods and services are delivered, as "transfers under military sales contract". These are *not* included in our merchandise trade balance. The British purchase of F–111 aircraft, now cancelled, was made entirely through the Defense Department; therefore, cancellation will not affect our merchandise trade surplus as such.

The merchandise trade surplus does include commercial exports of military equipment. These commercial exports of military equipment are not separately identified in our export statistics. They are, however, relatively small in comparison with Defense Department sales.

During January–September 1967 our merchandise trade surplus was $3 billion (not seasonally adjusted), representing $22.7 billion of exports and $19.7 billion of imports. For comparison, transfers under military sales contracts amounted to $884 million. In addition, we had advance receipts under DOD military sales contracts amounting to $237 million.

If one adds transfers under military sales contracts to merchandise exports, the former was less than 4 per cent of the total.

COMMENTS ON ITEM 8

The U.S. share of merchandise imports into Vietnam financed by Vietnam's own foreign exchange earnings is undoubtedly small. There are signs of improvement however. In 1966 arrivals from the U.S. financed by GVN-owned foreign exchange came to 2.8 percent and for the first seven months of 1967 the percentage, based on licensing, is 7.8 percent.

For geographical and historical reasons the U.S. has not been a big factor in the Vietnamese market. Japan is getting the largest share of the market and other countries in the area such as Taiwan, Hong Kong and Singapore are also getting large shares. There are also special factors, such as the Vietnamese fondness for motor scooters and light weight motorcycles of types for which the U.S. is not a major producer.

Vietnam is thus a new market for the U.S. It will take aggressive salesmanship and export promotion on the part of U.S. industry if our market share is to be increased significantly.

The U.S. Mission in Saigon and the Washington Agencies are well aware of the basic facts in this situation. The Mission is actively engaged in determining which commodities the U.S. is or could be competitive in, in the Vietnamese market, and based on such information will explore with the Vietnamese Government ways in which sales of such U.S. products can be increased.

In considering direct actions which might be taken to assure that funds from the U.S. are used for purchases from the U.S., care has to be taken that international agreements are not violated. However, U.S. officials have had discussions with Vietnamese officials on this problem and are seeking to work out with them measures which can be taken to increase U.S. market shares.

COMMENT ON ITEM 9

The President's program proposes to reduce the amount of new direct foreign investment in 1968 by about $1 billion. The program recognizes the value of foreign investment to American business in terms of the diversification of operations and the expansion of their total markets through operations in foreign countries. Direct investments have also benefitted the economies of the countries where made and have been a significant factor in their economic growth and foreign exchange earnings and the return on investments of years past is a fundamental and large stabilizing element in our balance-of-payments picture.

The problem is not the intrinsic value of foreign direct investment, but rather the rate at which we can presently afford new investment in terms of our balance-of-payments situation. The rate of new direct investment has increased rapidly over recent years, but investment outflows do not produce an immediate and offsetting return to the investor or to the U.S. balance of payments.

The direct investment program requires that our companies in order to continue expanding in Europe will have to finance more of their operations there by borrowing in Europe. In fact they have done so to an increasing extent in recent years under the voluntary restraint program. For example, borrowings of American subsidiaries in European capital markets which in earlier years were very small amounted to $451 million in the first three quarters of 1967 (this is in addition to their substantial borrowing in local currency). Borrowing abroad will finance expansion abroad and in so doing will give added stimulus to the development of European capital markets, which European countries and the United States have long considered desirable in the interests of the world economy. Over the last five years international borrowings in Europe have increased from $360 million in 1962 to $1.3 billion in 1966.

The long-term effect of the degree of restraint called for in 1968 may prove to be quite moderate, in terms of the over-all growth and strength of U.S. overseas business interests. In the first place, the program authorizes an actual increase in direct investment in the developing countries, as a group, to 110 percent of the base period 1965–66. In the oil-producing areas, the United Kingdom, Japan and Canada, a target of 65 percent of the base period is fixed. The major impact of the program relates to Continental Europe, which has been the persistent surplus area corresponding to the United States deficit. However, both in this area and in the intermediate Schedule B countries, there are wide possibilities for obtaining financing from European and other foreign sources of capital, either through the flotation of securities or through the borrowing of Euro-dollars or local currencies. It has been our understanding that under the Voluntary Program of the Commerce Department, programs of physical investment have proceeded with relatively little delay or interruption, although financing has been shifted to other sources, thus reducing the United States deficit. There is some slack in European economies, and conditions are favorable for relatively low interest rates and for policies on the part of European central banks that should help to augment the supply of loanable funds in Europe banks, in the Euro-dollar market and in the European capital market. Under these conditions, the postponement of investments in most instances would be limited to those marginal cases in which some added cost of raising funds abroad would make the carrying out of the investment a questionable business venture.

Concerning the "repatriation of profits" the general principle under the program is that foreign affiliates should continue to repatriate to the United States the same share of their earnings as was repatriated during the 1964–66 base period. There are a few instances in the Schedule C countries (most countries of Continental Europe and South Africa) where a more rigorous standard may apply. In these few instances firms may find that the amount of funds which may be re-invested will be limited by an alternative rule which establishes a direct investment ceiling at 35 percent of the average annual direct investment (capital outflows plus re-invested earnings) during 1965–66.

While the objective of this provision is only to assure maintenance of the historical rate of dividend disbursement, the Administration is aware that the requirement for the repatriation of earnings might cause problems in the case of some joint ventures with foreign nationals. The handling of these cases will depend upon the circumstances. For example, a United States direct investor might be in a position to increase the repatriation from other foreign corporations in the same Scheduled Area thereby meeting his area target.

COMMENT ON ITEM 10

The gold pool, which operates to maintain the price of gold in the free London market in line with the official price, has been operating efficiently since 1961. The countries which are providing this support are—in addition to the United States—Belgium, Germany, Italy, the Netherlands, Switzerland, and the United Kingdom. The only change in the membership since inception of the pool was the withdrawal of France as a contributing member last summer. The extent of the cooperation among the members of the pool has been amply demonstrated, especially since the reaction in the market to the devaluation of sterling. On November 26, they issued the following communique:

"The Governors of the Central Banks of Belgium, Germany, Italy, Netherlands, Switzerland, United Kingdom and the United States convened in Frankfurt on November 26, 1967.

"They noted that the President of the United States has stated:

" 'I reaffirm unequivocally the commitment of the United States to buy and sell gold at the existing price of $35 per ounce.'

"They took decisions on specific measures to ensure by coordinated action orderly conditions in the exchange markets and to support the present pattern of exchange rates based on the fixed price of $35 per ounce of gold.

"They concluded that the volume of gold and foreign exchange reserves at their disposal guarantees the success of these actions; at the same time they indicated that they would welcome the participation of other central banks."

QUESTION SUBMITTED BY CONGRESSMAN REES TO MR. REIERSON

Mr. REES. Will the use of the SDRs eventually take pressure off the dollar with reference to its use as a reserve currency?

Mr. REIERSON. The SDRs were conceived as a supplement to gold and the dollar as an international monetary reserve. A supplemental reserve asset is believed to be necessary because the stock of gold reserves has been declining in recent years and is expected to decline in the future and because the United States will have to bring its payments position into equilibrium or face a progressive loss of confidence in the dollar.

For some time to come, even when and if the SDRs are approved, the volume of gold and dollar reserves will be much larger than the volume of SDRs.

NEW YORK, N.Y., *February 1, 1968.*

Re H.R. 14743.

Hon. WRIGHT PATMAN,
House Office Building,
Washington, D.C.

DEAR SIR: Pursuant permission, I extend herewith my remarks of yesterday relative H.R. 14743, Repeal of 25% gold coverage for Federal Reserve notes.

1. The alternatives are between conquest and resort to nuclear war as pointed out in the pamphlet referred to (par. 1 page 1) of my written statement (i.e. entitled "South Vietnam's Indispensable Beachhead") and memorandum of 1963, in which I foresaw weakening the dollar (Hearings p. 2911)

"and so weaken our conventional military capabilities in general and seapower in particular whose effectiveness depends on confidence in, and purchasing power of, the dollar *in foreign countries*, making nuclear war more likely"

that it may

"win elections but lose wars" (p. 2912)

"there is incompatability between Keynesian deficits and that same conventional strategy" etc. (p. 2913)

and foresaw what we are now encountering in Korea and the Mediterranean

"set ablaze the seven seas" . . . (p. 2916)

"there are too many critical situations over the seven seas that could develop simultaneous necessity for American naval operations. Such would be a general, but non-nuclear non-European naval-economic war of attrition" . . . etc.

that Keynesian deficits

"pose a peril to our seapower to win such protracted conflict" . . .

that our strategy is

"menaced by the gold outflow" (p. 2917)

2. Mr. Polk erred too significantly if I understood him correctly to allege the foreign earning assets of this country to be 115 billion. The U.S. News and World Report, February 5th, p. 41 shows the figure to be 57.5, and most of which are since 1962 and I believe represent the flight from the dollar I predicted in 1962 in the Wall Street Journal, August 1, 1962, and in the above mentioned memorandum to House Ways & Means (op cit p. 2916).

3. I am informed there are between 7 and 15 billion dollars, Euro dollars all American owned which will be turned into gold directly or indirectly if this fatal bill is passed, and how much of which is owned directly or indirectly by members of the administration need investigation.

4. The allegation of over-extension of our foreign political commitments is nonsense, if we use our military resources intelligently, as long as our GNP exceeds that of Russia and China, or else the GNP figures are themselves completely false.

5. It is patently absurd and illogical to assert the economic value of the dollar without gold is greater than, or even equal to, its international value with gold coverages. It is mathematical that A+B is greater than A, unless B is a minus quality.

6. I charge bad faith on the part of this bill's proponents. If eventually why not embargo now?

Respectfully submitted.

CHARLES A. WEIL.

(The pamphlet referred to follows:)

SOUTH VIETNAM'S INDISPENSABLE BEACHHEAD

Hush Hush Bone of Contention

FOREWORD

Recent Hanoi feelers and rumors of Ho Chi Minh's death indicate possibly imminent "negotiations". It is urgent to warn that the American people will not tolerate negotiating away, by Democrat or Republican, what the enemy has failed to deny by force of arms; **an East Asiatic power balance to which access to a potential Vietnam beachhead is indispensable to American security.** The word "Beachhead" has never been uttered in all the discussions of Vietnam. All attempts to let the cat out of the bag by testimony to Congressional Committees, in articles or letters to the press have been unsuccessful. WHY?

Therefore I had this brochure printed to invite attention to **vital aspects of the issue that have been suppressed before too late.**

It is being sent all Presidential candidates; members of Congress and cabinet; state governors; leading college and university faculties of history, political science, economics, and international affairs, newspapers and TV networks, and leading citizens and organizations.

RES IPSA LOQUITUR

CHARLES A. WEIL
130 East 75th Street
New York, N. Y. 10021

WHY DISSENSION

The country is torn by violent dissension about Vietnam. Until recently opposition, according to public opinion polls, was only an articulate, perhaps enemy instigated, minority. Since rising casualties, gold outflow, taxes, and cost of living have been attributed to the war, the protesters have gained strength, according to the same polls, and it is reflected in Congress.

To cope with it, the administration has been driven from confining itself to hackneyed altruistic, moralistic-legalistic and ideological grounds; that are arguable, but become more and more irrelevant to the pragmatic rank and file American as the costs rise; to reasons of national security, and which, if justified, would be incontestible and conclusive to the vast preponderance of grass roots Americans.

The same polls indicate much of the responsible, respectable dissent stems from indecisive conduct of the war; in turn due to failure, even in Congress, to appreciate why, in fact, Vietnam is indispensable to the national security.

SURVIVAL — THE SUPREME RIGHT AND LAW

At San Antonio, October 16, 1967 Mr. Johnson declared:

> the key to all we have done is really our own security — I am not prepared to gamble on the chance that it is not so. I am not prepared to risk the security — indeed the survival of this American nation on mere hope and wishful thinking.

President Eisenhower also stressed the strategic importance of Vietnam. In a letter to Churchill, April 4, 1954 he wrote:

> if — Indochina passes into the hands of the Communists the ultimate effect on our and your global strategic position — could be disastrous and I know unacceptable to you and me

President Truman significantly joined his order of June 27, 1950 to U.S. troops to defend South Korea, with acceleration of military assistance in Indochina and dispatch of a "military mission to provide close working relations" with the French military forces there, that caused the Supreme U.N. Commander in Korea to state, the two wars were one and the same conflict.

Despite manifestos signed by ex-Presidents Truman and Eisenhower corroborating Mr. Johnson that our security is at stake in Vietnam, but without explaining why, buttressed by signatures of over a hundred leading citizens, civilian and retired military leaders; doves talk, and demonstrate ever more violently, and newspapers editorialize for elections, peace, withdrawal, negotiation to bring into the Saigon government members of the Vietcong, notwithstanding the many such coalitions that have delivered, or almost toppled, their governments into the hands of the enemy. **As if an election resulting in a "peaceful" take-over by North Vietnam would any the less jeopardize national security.**

Opponents also overlook Mr. McNamara's remarks at San Francisco, September 18, 1967:

> security depends upon taking a "worst plausible case" and having the ability to cope with that eventuality

He might have added, for the next quarter century.

The trenchant question *why* our security is at stake in Vietnam should, therefore, be answered clearly lest failure result in erosion of support for the war and inadequate methods of its prosecution.

The administration may well not deem it politic to enunciate such answer fully. Meanwhile protest grows militant, demonstrations continue, fomented by wily "copperheads" among dupes uneducated in the realities of American history, who charge a "credibility gap".

Many Americans support the war only out of loyalty, but sincerely do not understand why, hence do not believe, Vietnam 8,000 miles away, has any genuine relation to the national security. Nevertheless, Mr. Johnson has given no decisive explanation, only the domino theory, that has been unconvincing to many, and the danger to maritime communications through Malacca Straits, whose vital character is either misapprehended or minimized because of alternate routes through Sunda Straits or Timor Sea. However, one line of reason that has been overlooked or suppressed, and is conclusive, will be dealt with here; the indispensability of a friendly and independent South Vietnam as potential ally and beachhead to cope with a "worst plausible cause".

THE EDUCATIONAL GAP

Unfortunately, the interpretation of American history in our schools has not educated the American rank and file to comprehend Mr. Johnson's bare declarations, despite the fact that we have been involved in three prior defensive, overseas, power balance, preventive wars since we became, what Theodore Roosevelt said we were in 1910, the "balancer of the whole world" for our own security. Unfortunately power balance, power politics, "real politik", preventive war have all been given bad names by utopists, so American history has never been explained in such terms, though power equilibria have been decisive factors in the war for our independence, our growth, security, and prosperity.

Part of the pernicious paraphernalia parrotted by "dovey" gulls has been the cliché against "land war", suspiciously echoing the Moscow line, despite, or perhaps because, of our five previous transoceanic expeditionary forces.

Not a history text book used in the New York public schools that this writer is aware of, attributes our 1917 entry into war, the anti-Japanese and anti-German policies that precipitated Pearl Harbor, and the instantaneous military reaction to the North Korean invasion of South Korea, to apprehensions of a power balance upset.

How much more than to a matter of credibility, the squealing demonstrations of teenagers is due to this "educational gap", student publications, and influential news media pandering to "doves", might bear Congressional inquiry. Much of the dissent is innocent, chargeable to the way American history is taught. Hence administration allegations, the national security is at stake, are either misunderstood or disbelieved, especially in the intellectual community, torn between two cultures and two methodologies.

One culture is realistic; hard, common sense, pragmatic and proven generally effective. The other is quixotic; perfectionist, mythical, romantic, do gooder, shown by experience not to work. Each proceeds from separate methodologies. The quixotic stems from that of the natural sciences requiring foolproof empirical, laboratory and/or authenticated, hence secret, documentary evidence, beyond a reasonable doubt; almost beyond a mathematical doubt; which social scientists who write history seek to apply. The realistic is that of a jury which may bring in a verdict on a fair preponderance of evidence, even circumstantial, guided by the common sense principle, it is better to be safe than sorry.

The quixotic culture has not only produced false history, but ineffective, false reactions to problems of international character that require objective, dispassionate consideration and distorts priorities at home and abroad.

Castelreagh said the fundamental task of true statemanship is the due adjustment of international and national interests. The first priority in building a house is not the wall to wall carpeting, but a sound foundation and solid frame. The first priority in a society must be its safety, before "greatness" can be made lasting, whether at home or abroad, and whether to deal first with an enemy's armed forces or the "battle for his heart and mind", his form of government or the conduct of his strictly internal affairs.

Domestic policies, however, whose effects spill over into the international arena, like many economic issues of foreign trade and finance, must, therefore, be tailored to meet transcendently objective requirements of foreign relations.

The result of the contrary is an evaluation of foreign affairs in terms of often contradictory abstractions, slogans and clichés that have only produced endemic confusion in policymaking among those responsible for its formulation, even including the erudite present Chairman of the Senate Foreign Relations Committee.

POWER BALANCE MISAPPREHENSIONS

After the Spanish Armada in 1588, the world balancer was England. She exercised that function by seapower with the help of other nations on the European continent having parallel vital interests to preserve their independence and security from any other continental nation that sought to dominate them and the world they lived in, mislabelled "Pax Britannica".

With her changed circumstances since 1914, England is unable to continue the role of world arbiter and citadel of the maritime powers. We inherited her mantle and burden, now being mislabelled "Pax Americana", libelled with charges of aggressive imperialism and arrogance of power when both Pax's were defensive, really the "Pax Maritima" deterrence by the maritime world, of unbridled supreme world military power by continental Eurasian land powers of Mackinder's Heartland and World Island.

Despite academe's anathema on power politics, the Johnson administration has, notwithstanding nuclear arms, reaffirmed our vital interest in the world power equilibrium, but the "credibility gap" charge is sustained by the educational gap and failure to give a bill of particulars such as is submitted herewith, that discloses no classified military intelligence, of which no foreign office or intelligence agency of any potential enemy is unaware, but with which few American citizens are familiar, some of which this writer has never seen in print, except written by Russian generals and British statesmen.

The enemy have long been propagandizing the South Vietnamese not to fight "America's war". What can be lost by candor that will disarm domestic dissidents and rally nations with parallel interests and respectable capabilities?

President Johnson proclaimed our concern with the power equilibrium at Honolulu, October 17, 1966: the basic policy —

> that no single nation can, or should be, permitted to dominate the Pacific region

reaffirming General Marshall, when Secretary of State, in testifying before the House Foreign Affairs Committee, May 5, 1948:

> the United States is now considering the steps necessary to bring the national military establishment to the minimum level necessary to restore *the balance of power relationtionships required for international security* (italics ours)

echoed by Secretary Rusk before the same committee, August 3, 1965 as to Vietnam, that its loss would constitute a serious shift in the balance of power

and Undersecretary Bundy, February 12, 1966:

> today there cannot be an effective deterrent military force and thus a balance of power

around China's frontiers without major and direct military contributions by the United States

Assistant Secretary Ball, January 30, 1966 reiterated the policy of maintaining an equilbrium of power in the world

Naked opinions that: security is at stake; if North Vietnam takes over South Vietnam, "The effect on our strategic position could be disastrous"; vague references to balance of power without more; would not stand up in any court, no matter how credible or expert the witness unless the factual elements and principles indispensable to substantiate such pleading or opinion are set forth. Apparently such unsupported statements have not "shown" many "from Missouri" who do not believe this is "our war".

In this democracy people have not only the right to be "shown", but duty to demand it unless it involves secret military intelligence or subjects prejudicial to the proper conduct of foreign relations to have expressed officially. However, if any reasons why security is involved in Vietnam are in the latter category, it is, nevertheless, function of the responsible press and unofficial intellectual leaders to inform the people, without embarrassing those responsible for the conduct of foreign relations. It is to aspects, possibly in the latter category, this paper is addressed, considerations that have never been made plain.

Much can be borrowed from England's book outlined by Sir Eyre Crowe of the British Foreign Office in 1907:

> History shows that the danger threatening the independence of this or that nation has generally arisen in part, out of the momentary predominance of a neighboring state at once militarily powerful, economically efficient, and ambitious to extend its frontiers or spread its influence. — The only check on the abuse of political predominance — has always consisted in the opposition of an equally formidable rival or of a combination of several countries forming leagues of defence. The equilibrium established by such grouping of forces is technically known as the balance of power —

The security grounds for such policy are to deny any continental nation such ground force supremacy it could have no land frontiers to defend and could employ all its continent's resources to build a navy capable of defeating England then, and us today, and spare, convoy and supply expeditionary forces to this hemisphere and prevent American expeditionary forces from landing overseas, even in the Caribbean.

With command of the seas in possession of a continental hegemony, our navy and merchant marine driven off the oceans, it could blockade us and impose terms on which we could import raw materials and foodstuffs for the maintenance of our economy and living standards. With a growing population and natural resources nearing depletion or inadequacy, we might have to face the belt tightening now facing England, the people in the Confederate States suffered during the Civil War, what Germans endured during and after both World Wars and that might well result in lower living standards and paralysis of industrial production for lack of necessary industrial raw materials.

It could land its expeditionary forces at will in this hemisphere, north and south of us, forcing us to our knees, as we compelled Japan to surrender, without putting a single soldier within our frontiers. Thus would end the "Great Society" and any hope of it.

Sir Eyre Crowe's memorandum stated:

> German maritime supremacy must be acknowledged incompatible with the existence of the British Empire, and even if that Empire disappeared, the union of the greatest military

> with the greatest naval power in one state would compel the world to combine for the riddance of such an incubus.

We are thus concerned with the distribution or separation of power elements, seapower and landpower, of which our seapower would be the fulcrum, to forestall the rise of a self-perpetuating transoceanic absolutism.

Russia has now the biggest nuclear force, ground force, GNP, industry, merchant marine, and navy of Europe; China, apart from Russia, the only nuclear force, biggest ground force, navy and industry in East Asia; with Russia building aircraft carriers and a navy having overseas capabilities reaching for the Mediterranean and Indian Oceans. Both are "spreading their influence" by foreign aid, arms exports, subversion, espionage, and propaganda, for which ideology is only a camouflage, not the real danger; all the aggressive accoutrements that brought on World War I by Germany's adding the High Seas Fleet to her supreme ground forces.

Significantly when seapower's trident shifted to the United States, the chief target for the Communist epithet of "imperialism" also shifted from Britain to the United States, pursuant the universalist Bolshevik doctrine of excluding the state system and an international power equilibrium.

PRE-NUCLEAR POWER BALANCE STRATEGY

Power equilibrium developed a grand strategy and policy to implement it on the part of maritime insular countries like Britain and ourselves, stated by Sir Eyre:

> Now the first interest of all countries is the preservation of national independence. It follows that England, more than any other non-insular power, has a direct and positive interest in the maintenance of the independence of nations, and therefore must be the natural enemy of any country threatening the independence of others —

Such British policy required no external financial resources in peacetime to maintain overseas military garrisons, and produced a practice and strategy by the English balancer, described by Captain Liddell Hart:

> seaborne expeditions against the enemy's vulnerable extremities

affirmed by our own Joint Army-Navy Board of General Marshall and Admiral Stark in a 1941 report ordered by Franklin D. Roosevelt:

> by themselves — naval and air forces seldom, if ever, win important wars. It should be recognized as an almost invariable rule that *only land armies can likely win wars* (italics ours)

and in the same report, that the objectives of 1941 were to forestall hostile encirclement by

> establishment in Europe and *Asia* of balances of power which will most nearly insure political stability in those regions and/or the security of the United States (italics ours)

Such ground forces were used to impose on Britain the least manpower loss, to achieve economy of force, which Gneisenau, the German strategist advised England to employ against Napoleon by forcing —

> him to have his armies run from one end of his empire to the other

Gneisenau's advice was successfully followed with "land wars" in thirteen countries; Austria, Belgium, Denmark, Egypt and the Middle East, Finland, Holland, Italy, Portugal, Prussia, Spain, Russia, Sweden and Switzerland and the smaller German states intervening.

Franklin Roosevelt adopted it relative Hitler —

> the enemy must be hit and hit hard from so many directions that he will never know which is his bow and which is his stern

in executing the strategy of the Joint Board that won World Wars I and II, with ground force offensives in —

> distant regions where German troops excel only with a fraction of their forces

Against Germany in World War I were eight ground force fronts; France, Russia, Italy, Gallipoli, Salonika, Serbia, Mesopotamia and the Egyptian/Palestine fronts. In World War II were two fronts in France (Northern and Riviera) and in Russia, Italy, Yugoslavia, Greece, Bulgaria, Roumania, Norway and all North Africa from Morocco to Egypt. Hence American expeditionary forces to Europe in 1917, 1941, to Asia in 1941, Korea, and now Vietnam.

Prior to World War II, Britain secured the Indian Ocean equipoise and the independence of its littoral from Russia. With the decline of British capabilities since that war, those areas have to be defended from encirclement and conquest by us.

Power balance considerations were not entirely military. There are factors of wealth, economy, industry, finance and even intentions. Unfortunately intentions of foreign governments are usually top secret and subject to change without notice. Hence any estimate of a potential power pattern must be preponderantly concerned with relative military capabilities in which geostrategy plays an almost preponderant role. It involves denying potential enemies positions that increase their capabilities or detract from ours, a subject on which few academic Kremlinologists and Pekinologists and other intellectuals are particularly well qualified.

HOW TODAY

The effect of nuclear arms on power balance practice has been only to superimpose a balance of nuclear arms on the balance of conventional arms, that a nuclear holocast need only be the last resort of a world with clear and present danger of independent nations being swallowed up by aggressors seeking world domination or, initially only, transoceanic mastery.

Secretary McNamara stated at San Francisco (supra):

> nuclear weapons can serve to deter only a narrow range of threats — today our nuclear superiority does not deter all forms of Soviet support of—insurgency in Southeast Asia—
> We and our allies, as well, require substantial non-nuclear forces in order to cope with levels of aggression that massive strategic forces do not in fact deter — a whole range of graduated deterrents, each of them fully credible in its own context.

Moreover, nuclear warfare and strategy are not even yet in their infancy. They are embryonic, speculative, never having been put to the acid test and experience of battle. Their only role has been deterrent. Not so with classic warfare and strategy.

Nuclear weapons have, therefore, not dispensed with equilibrium of conventional military power or the tried, proven methods of employing it, with one crucial proviso. Unless there are widely dispersed, independent nations on continental littorals for allies and indisputably non-hostile beachheads in depth, landing places thereto, such strategy cannot succeed. Depths is necessary for deployment and security of land based, long range artillery and aviation, tactical and strategic.

The non-nuclear equipoise involves continuation of the pre-nuclear importance of seapower that Sir Eyre's memorandum postulates for his power balance implementation:

> The general character of England's foreign policy is — inseparably bound up with the possession of preponderant seapower. The tremendous influence of such preponderance has been described in the classical pages of Captain Mahan. No one now disputes it. Seapower is more potent than land power, because it is as pervading as the element in which it moves and has its being.

and because it covers three-fourths of the area of the globe.

Its pre-nuclear functions remain. Some have been superimposed with certain *caveats* and limitations, especially not to offer concentrated formations to tempt an enemy into use of nuclear weapons that could destroy a whole fleet with one bomb or missile.

Hence American "defense arrangements" with 42 countries and commitments to assist 6 more, only two of which are not rimland, littoral nations accessible to seapower: Luxembourg, which cannot be violated by Russia without violating West Germany; Paraguay, which cannot be attacked by Russia or China without attacking some other country we are also bound to defend. Significantly we have no obligation to defend a single other state without access to the sea and did not become embroiled over Hungary, Poland or Kashmir.

We intervened in the Congo and are indirectly committed to Iran, India and Pakistan, all littoral nations, and have manifested a vital military interest in the Mid-East states bordering the Mediterranean under the Eisenhower Doctrine.

One of the few countries without access to the sea in which we have evinced interest is Laos, under the 1954 and 1962 neutralization agreements, but as to which, because of its plausible use as a conduit, we reserved an option to intervene in case of failure to perform by Laos, or of breach by other parties to such agreements, in which breach Laos acquiesced or proved incapable of performing its commitments to us and to protocol nations, like South Vietnam, deemed vital to our interests.

BEACHHEADS, WHERE?

Hence without such, we repeat, **widely separated, independent coastal friendly nations, with parallel interests in strategic areas** there would have to be forced landings, that in the defended Normandy landings in 1944 required 4,000 vessels; a concentrated target of compact formations that a continental coercer; with nuclear capabilities or even only missiles with conventional explosive, such as sank the Israeli destroyer "Elath", that could affect the conduct of amphibious operations; could not resist using them against.

China already has nuclear capabilities and military experts are agreed it may be long, before she has adequate conventional capabilities. The danger is, today, China has no option. And the nuclear fat would be in the fire or we would be deterred from attempting such forced landing, to prevent the establishment of Chinese or Russian continental hegemony in Asia.

Most enemy "vulnerable extremities" are peninsular for reasons logistical and tactical. Logistically, because it involves lengthy lines of communication for the potential continental enemy, exposed to guerrilla action, aerial harassment, carrier borne as well as land based, and severance by amphibious landings; tactically, because peninsulas are salients into the jaws of seapower that can be pinched off by it and its seaborne ground forces, as at Inchon, as in Spain against Napoleon, Crimea against Russia, Italy and Cotentin against Hitler, that lend themselves to continuous fronts, as in Italy and Korea, and almost all peninsular campaigns offensive and defensive. Peninsulas cannot only be attacked offensively by seapower, as was Bataan and Huon by McArthur, but defended, as was Bataan.

Vietnam is not only on a peninsula, but far removed from the Chinese Manchurian arsenal and the Russian Asiatic terminus of the trans-Siberian Railroad, with the best terrain and shortest invasion route to threaten an important part of the South Chinese coast.

The point is sometimes urged that Europe is more important than Asia, and Vietnam diverts us from defense of the transatlantic balance. While Europe is, in fact, more important, the immediate challenge is in East Asia. Moreover, Western Europe has over 300 million people;

more than Russia; with military traditions, an important GNP and industry which can and should fight at least a delaying action against Russian encroachment there. But East Asia, outside of China, has a relatively smaller popuation, is poorer, with little industry or military tradition to fight an even delaying action against Russia and/or China.

Also, there are 23 strategic peninsulas on which a maritime power can land in Europe to preserve power equilibrium there. In East Asia there are only five; Korea, Liaotung, Shantung, Luichow and South East Asia. But the first three are all near each other, China's Manchurian arsenal, and Russian Maritime Provinces.

By law of supply and demand each Asian peninsular potential lodgment is relatively more important to the Asiatic equilibrium than any one of the 23 European salients into the ocean attack on any one of which would bring us into instant war.

In view of Russian insistence at Teheran and Yalta on "friendly" governments on the approaches to her frontiers for defensive purposes: Poland, Roumania, Bulgaria; to which we agreed, so must we insist on "friendly" governments on our transoceanic frontiers on the East Asia littoral for purposes of our own defense.

General Gavin put it —

> Vietnam, Laos, Cambodia, and Thailand — constitute the frontier of freedom in Southeast Asia — SEATO is the key to the defense of the Asia-Pacific area

General Mark Clark, Supreme Commander of U.N. Forces in Korea, after a visit to Indo-China in 1953, stated Korea and Indo-China were two arms of the same conflict.

While Vietnam's significance to this country as a beachhead has never been officially formulated, Anthony Eden, British Foreign Secretary in 1954, during the Geneva conference relative Indo-China, wrote of conversations with Secretary of State Dulles, in which the latter stated in reference to Vietnam:

> they would have to hold some sort of bridgehead, as had been done in Korea until the Inchon landings could be carried out

WHY NOW

With the development of nuclear capabilities by China, an undeniable Vietnam foothold is even more imperative lest the only way to forestall Chinese or Russian control of all Asia be nuclear.

Seventy years before Vietnam, long before the atomic age, Admiral Mahan wrote as to the area south of the Yangtse Kiang:

> there shall not be established — by fortification or otherwise, any military tenure by which it — can be forcibly closed to the seapowers

That was the military expressions of Hay's "Open door" policy. It entails for littoral nations neither colonialism nor infringement of sovereignty, the limited objective in Vietnam. There remains a crucial query, why not Japan, Taiwan, Thailand, India or the Philippines rather than Vietnam to draw the line. Japan, Taiwan, and the Philippines are not on the mainland. Neither India or Thailand have shown reliable military capability or staying power and the first is separated from China by the Himalayas and vast deserts of the Tibetan plateau with few good, short lines to the heart of China. Thailand also offers poor operating terrain and difficult access to the vital areas China and/or Russia would have to defend.

General Eisenhower's 4,000 vessels had only a few miles to cross the English Channel from their safe English staging area, just off shore, to that French Norman peninsula, with overwhelming strategic and tactical air support and airborne parachute troops only possible with nearby land based planes; it took 3,200 vessels from North Africa a few miles to Sicily and the Italian peninsula with Pantelleria in safe hands. How many vessels, from how far, to force a landing on an East Asia peninsula, and from what safe offshore springboards south of Korea?

OBJECTIONS OVER-RULED

The Russo-Chinese rift may only be sham, a ruse de guerre or ephemeral. Russia is still more powerful than China, with every likelihood it could over-run Manchuria in two weeks as it did on three fronts against Japan in 1945, encircling it, and bring China to her knees. If either apprehended the other, each would welcome possibility of an American beachhead in the South.

Official American commitment to transoceanic equilibria would reassure China against Russian amputation of Manchuria, as it would reassure the Soviets against detachment of her Maritime Provinces by China, if China developed the capabilities to accomplish it in the next quarter century.

For the present, China is believed not to have such capabilities, but still to be the catspaw she was when Mahan asserted:

> the Peking authorities yield, as is the custom of Orientals, to the nearest strong pressure

though all evidence indicates she seeks capabilities Mahan apprehended when he wrote:

> it is difficult to contemplate with equanimity such a vast mass — concentrated into one effective political organization' with modern appliances — and animated by but one spirit and moved as a single man

Instead, China and Russia both support North Vietnam, all of whose sophisticated material comes from Russia. Both have avowed objectives of driving us off the Eurasian "World Island". Why, if neither seeks world domination? Why, if China is not the catspaw Mahan wrote about and the pushover Japan showed it was thirty years ago?

Despite overwhelming undisputed evidence of Ho Chi Minh's attachment to, and dependence on, Russia and China, there is the transparently hollow contention Ho is a Tito, more nationalistic than communist. It would have us run the incalculable risk of basing our security on assumptions for which there is not a scintilla of evidence.

But assuming such intentions could be verified, there is little hard evidence they will not, or cannot, be changed.

Nor is there an iota of evidence a united Vietnam would have capability to resist a Chinese military effort to capture the seat of government and overwhelm the Vietnamese main forces in the Red River Delta.

Such contentions can be equated with denial of Russian intent to conquer the world and justification for Russian hostility and expansion to counter American forward strategy since "the iron curtain descended" in 1946.

Were such views of Ho justified, a policy declaration of power equilibrium and support of independent nations, our present actions, would be the strongest possible proof to Ho of our intentions and capabilities to prevent conquest of Indo-China by either Russia or China, and could not only constrain him to welcome our presence; to join us, not fight us.

Once Vietnam's importance to the national security is crystal clear, decisions can be made what costs and risks may be incurred to realize the objective involved in the shortest time; especially when coupled with the loss of faith that would undisputedly follow in nations undisputedly and indisputably vital to our security if we failed to honor commitments in carrying out our balance of power policy. It would lend grist to de Gaulle's mill, we are not a dependable ally and be the coup de grace to NATO.

The security facets of the Vietnam debate do not detract one jot or tittle from the force, materiality, or relevance of the altruistic, moralistic, legalistic, ideological, humanistic aspects that have monopolized the controversy heretofore. On the contrary they can only bolster supporters of American policy and practice at home and abroad among nations with parallel interests and respectable capabilities to prevent a power balance upset.

It lends substance to Sir Eyre Crowe's memorandum: that every country, if it had the option, would, of course, prefer to hold itself the power of supremacy at sea, but that this choice being excluded, it would rather see England hold that power than any other state.

England was, and the United States is, and will be, the lesser evil, the choice generally made in political decisions.

As long as either Russia or China avows policy and conducts itself to deny us potential access to South-east Asia, which would keep open their hostile option to dominate the entire East Asian littoral, it would be foolhardy not to keep open our own option to forestall same. Vietnam is the best, perhaps only, place for us to keep such options open besides Korea.

Viewed from the beachhead aspect, demand for unconditional withdrawal from Vietnam is unmasked as a call for unconditional surrender, for unilateral American disarmament by denying a crucial geographical capability to the maritime world. Coming from Americans, it reveals the work of enemy agents on unsophisticated dupes who want us to surrender all we fought for and won against Japan and in Korea, and exchange an incubus which our seapower proved it could cope with, insular Japan, for one invulnerable to anything but a nuclear holocaust.

If China will not take a small calculated risk to their flimsy railroad communications with Yunan and Kunming running through Hanoi, we must make plain, on behalf of the entire maritime world and ourselves, we cannot, will not, take a scintilla of uncalculable risk that indispensable access to South Vietnam can be denied.

There would then be no basis for "negotiations" except to offer to build a railroad, within China proper, however difficult and expensive in, and behind, the rugged easily defendable terrain of the Kwangsi-Yunan mountains and rivers north of Toyen Shan, Yu Kiang and Kung Shi Kiang rivers, an independent South Vietnam over 500 miles away does not menace.

If that be rejected, it is strong evidence of intentions the positions are mutually exclusive, non-negotiable; an issue that can only be left to the arbitrament of force, once it is well understood at home and abroad.

However, the clear enunciation necessary should lead eventually to the "containment without isolation" of China sought by most responsible critics of the Vietnam war, to normalize relations with communist China.

It would be unfair to the administration and press, and leave incomplete the security case for Vietnam without brief reference to its bearing on maritime communications and strategic lines through the Straits of Malacca, a point has not received the importance it deserves, but has not been completely suppressed as has the friendly beachhead aspect.

Seapower depends on capability to sail the narrow waters, the choke points, through which flow lines of trade and for quick movements of fighting fleets and expeditionary forces; Suez, Panama, Gibraltar, Aden, Malacca, Windward Passage, and Skagerrak.

Russia has, and has been reaching for, positions, direct and by proxy, from which it can close, menace, or flank each and every one of them. She has the second largest navy in the world with a large component force of submarines suitable only for guerre de course the naval counterpart of the guerrilla wars of liberation now in Vietnam and is presently adding air carriers and cruisers for the blue waters of the seven seas.

From Vietnam, the maritime world can defend Malacca against closure, but enemies therefrom can drive overland to Singapore, close the straits and flank the lines of commerce and war that go through it, to and from the Indian Ocean, that maintain a balance of power in South Asia from the Persian Gulf to Singapore.

Viewed cumulatively, with other menaces posed now by Russia to world seapower and the potential beachhead point, the national security case against abandoning Vietnam, regardless of any vote by its illiterate, terrorized, demoralized population, is complete.

FINANCIAL NEED FOR PROMPT CANDOR

There is another angle, financial, that calls for candor on security aspects to enlist support for expediting tactics and strategy without unnecessarily or unreasonably widening the military ground action, keeping it short of ground force invasion of China itself, before exhausting our financial and economic resources.

Liddell Hart wrote of Britain:

> our historic practice was based on economic pressure exercised through seapower. This naval body had two arms; one financial which embraces the subsidizing and military provisions of allies —

Lloyd George said much the same in his memoirs quoted by Marshall Sokolovsky with a significance that cannot be overlooked.

That defense capability necessitated a currency acceptable in foreign countries for imports to prosecute war and for support of overseas military forces.

It compelled a policy of stable purchasing power for sterling that made Britain not only the naval fulcrum of the maritime world, but its banker and central reserve, financial as well as military. It established sterling as a currency which other maritime countries could hold as monetary reserve for their currencies, as medium of payment in international trade, and store of international credit for capital flows. It made London the money hub of the world that helped its balance of payments.

Such policy required and created a strong credit standing for sterling to pay for indispensable imports and, if necessary, as medium in which to borrow abroad to carry on war if, and when, her gold and foreign assets were exhaused. It gave confidence that when peace came Britain could, and would, return to sound money, that in most countries depends on some relation to gold, and a sound balance of payments position.

The present dollar and gold outflow which weakens the dollar in foreign financial markets is due to the excess of payments abroad over receipts, i.e. the balance of payments, a substantial and growing part of which is due to the Vietnam war.

Sooner or later, unless such a war of attrition is shortened, we risk external strain on the dollar and our gold stock, which added to internal strains and dissention, might compel us to admit defeat, unless we state promptly that all may understand at home and abroad, our security stake in Vietnam and conduct the war more vigorously.

Such foreign financial coercion to withdraw from Vietnam before national security objectives have been realized, can happen to us. France experienced it in 1922, when compelled, by stress on the franc, to withdraw from the Ruhr; and for fear of which financial duress again in 1936, France desisted, without English support, from marching into the Rhineland, which would have overthrown Hitler and probably prevented World War II.

Pressure was brought against the English pound sterling and franc in 1956 that compelled withdrawal from Suez. The 1962 American confrontation over Cuba was accompanied by a run on the dollar.

Devaluation of the pound sterling in November, 1967 again sounds an alert that attacks on the dollar may cripple the financial power of our country to implement its strategy of financing the maritime world in case of general conventional war, with or without special drawing rights to add to reserves that continuation of balance of payments deficits and/or the war will delay or prevent being ratified.

We financed and won World Wars I and II with the strategy described by Liddell Hart and Lloyd George. In 1941 we had almost two-thirds of the world's gold stock and a national debt of only $40 billion, short term obligations to foreigners of only three to four billion, a favorable balance of payments and a money supply (currency and checking accounts) of only $42 billion covered by $24 billion in gold, a ratio of better than ½ and no need of foreign exchange for support of troops abroad in defense of the maritime world.

We have lost half our gold stock, only $11.5 billion remain of which $900 million went in the gold panic since sterling devaluation a few weeks ago. We have a national debt approaching $350 billion and, instead of a surplus, have a persistent international payments deficit for 17 years, currently worsening with an annual rate of two to two and a half billion. As a result, the U.S. currently owes about $35 billion to foreigners. Our domestic budget deficit has risen to over $20 billion currently, a money supply of $182 billion against gold cover of 11.5 billion, a ratio of 1/15 and need of external foreign exchange resources to pay for vast military forces outside the dollar area.

In 1941 the Federal Reserve discount rate was 1%, it is now 4½%, with much higher for long term financing that can only make war financing a most difficult problem at home as well as abroad.

Together these are jeopardizing both our adequacy to finance another non-nuclear war and any confidence in our credit that stood Britain in such good stead for four centuries.

The French monetary expert, Jacques Rueff, de Gaulle's financial adviser, stated his disbelief in letting gold slip out of the country as it certainly would, if we remove the 25% gold cover from Federal Reserve notes:

> I am not sure that your military people, for reasons of national security in case of emergency want to be left with so little gold

There is a unverified report ascribed to Dr. Leland Howard, formerly Director of the Office of Domestic Gold and Silver Operations of the U.S. Treasury, that when General Rommel might be defeating our forces at Kasserine Pass in 1943, General Mark Clark had to pay for military supplies in gold, that suppliers would not accept dollar paper money and following Pearl Harbor our commanders in the Pacific were also refused supplies payable in paper dollars and had to be paid in gold.

Failure of the American people to grasp and approve American balance of power policy and strategy, coupled with the dissipation of the dollar, may well account for de Gaulle's misgivings to stake France's survival on the United States and insistence on his nuclear "force de Frappe" instead of supporting NATO with as many divisions as Germany's twelve and opposing the Vietnam war. This is apart from other aspects of French policy that raise unfortunate misgivings whether we can count on France as ally in our policy to keep any war non-nuclear.

But once the public and Congress show they grasp the security significance of Vietnam and that Hanoi cannot hope to win the war by domestic dissidence, as it won against France in 1954, it will either come to the negotiating table or the adminstration can wage war more effectively.

It is not the scope, purpose or province of this paper to suggest particular tactics or strategy. That is the province of the Joint Chiefs of Staff in consultation with State and Treasury. Many have been mentioned which do not appear to exceed the afore-mentioned limitations:

1. anti infiltration barrier from Thailand to the sea
2. quarrantine or blockade of ports through which the enemy receive supplies, Haiphong and Sihanoukville in Cambodia
3. Crossing boundaries of neighboring conduit states and when and where the enemy takes sanctuary and is using them as staging areas and for regrouping, and such neighboring states fail, or lack capabilities, to repel or expel them
4. invasion of North Vietnam, as at Inchon, to destroy enemy elements well south of the Red River Delta, at the narrow neck Vinh — Pak Sane

There may be more. It is probably wiser to spend 50 billion one year and win, than 25 billion annually indefinitely and adopt such emergency financial measures to conserve financial strength, i.e. what remains of our gold stock for other emergencies some of which have already threatened in the Middle East.

Neither is it within our purview to suggest the elaboration of policy towards Asia in detail after settling the basic issue of Vietnam, perhaps by its ironclad, foolproof neutralization.

Why has the foregoing been suppressed? The beachhead aspect is novel, as plausible as any reason for our war in Vietnam heretofore published. IF VALID IT IS DECISIVE, CONCLUSIVE. Once such factors are dealt with and debated candidly we can get on with the war.

And once Russia and China realize they can be, are, and will be contained, but left to develop in peace within their frontiers, they will be deterred from expansion that jeopardizes the maritime world. Vietnam is the stitch in time to save the nine, to save the country and its dollar. It must be held at all costs.

If Russia and China can be brought to perceive that this country has a defensive strategic doctrine relative the Vietnam beachhead, as well supported by our population, allies and capabilities, as the Soviet doctrine of the defensive Polish glacis and China its Yalu deadline, it is most unlikely any conventional steps to defend such beachhead will be allowed to reach the crisis intensity of the Cuban missile confrontation.

If loss of the Vietnam beachhead is equated to loss of the beachhead in Spain, it is unlikely that the cost and risk to Russia and China will be equated by them with the gain from successful denial. However, no deterrent effect is possible without clear comprehension by the American people of the indispensability of a free and independent South Vietnam and reasons therefor. At the least it would prevent a fatal miscalculation by potential enemies. At most, continued support for North Vietnam can be viewed as a declaration of intent for unlimited objectives that can only lead to total war.

Both sides have kept silent on the beachhead subject. The enemy can't concede evidence that convicts beyond a reasonable doubt of objectives and strategy for world domination. Whom is our silence fooling but ourselves and dupes of our educational gap?