CF Box 53

MEMORANDUM

C.F.

(7)

See items 8-12 (pg. 2) for Ackley's preferred plan for demonetizing gold

THE WHITE HOUSE

WASHINGTON

FO 4-1
FG 110
FG 11-3
FO 4-3
FG 155
FG 233
FG 627
FI 9

December 23, 1967
Saturday, 7:25 p.m.

FOR THE PRESIDENT

FROM Joe Califano

Attached are papers Secretary Fowler wanted you to have as background for consideration of the balance of payments question. For the most part they elaborate on the cable I sent you yesterday, a copy of which is also attached for your convenience.

If we go the route of mandatory controls on capital investment abroad and tighter regulation by the Federal Reserve Board of bank loans, we would not need all of the elaborate paper work attached, and you could probably move promptly next week.

The interested agencies in the government outside the Treasury have just received the long papers attached and will require some time to staff them out.

The Deming working group will be meeting tomorrow to put together a mandatory control program and to consider the gold questions raised in your cables to me today.

Fowler is away with his family and will return early Tuesday morning. I believe the others are in town and available should you want to have a meeting tomorrow. I will be at home, awaiting a call from you. I will bring Rostow up to date.

Also attached is a memo Gardner Ackley wanted you to have.

Attachments

~~SECRET~~

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

December 23, 1967

DECLASSIFIED
Authority CEA letter 4-12-78
By ___, NARS, Date 8-1-79

MEMORANDUM FOR THE PRESIDENT

Subject: Alternatives to the New Balance of Payments Program

1. The basic object of the new balance of payments program is to get through 1968 without an international financial crisis. It is intended

   -- to reduce the deficit in 1968 and beyond;

   -- thereby to give European central bankers greater confidence and make them more willing to hold dollars and to cooperate in other ways; and

   -- thereby to calm speculation both on a rise in the price of gold, and on a possible devaluation of the dollar relative to foreign currencies.

2. It could very well succeed in this basic objective. On the other hand, there is at least a chance that it could provoke such a crisis, by setting off either a chain of devaluations, or a series of retaliatory actions leading to a general state of economic warfare in the world. However, in what follows, I assume that it would achieve our 1968 objective. But where would it leave us?

3. Some elements of the program are aimed at long-run improvement in our basic balance-of-payments situation. This is particularly true of the export financing and export promotion measures, the encouragement of foreign tourism and foreign investment in the United States, and the effort to get other countries to reduce non-tariff barriers. However, none of these is new, and one can doubt how much fundamental improvement they will make. Although end of the Vietnam war could bring a substantial improvement, we will have to continue to spend heavily in Southeast Asia for development programs -- perhaps nearly as much as we're spending there now, in terms of foreign exchange.

~~SECRET~~

4. Most of the improvement sought by the program, however, is not long-term. It will continue only so long as we continue doing things that are distasteful, and that we wouldn't want to and shouldn't do in the long run. This is surely true of the voluntary (or nonvoluntary) control of bank and corporate investment, the tourist tax, the buy-American policies of DOD, the tying of aid, and the border tax adjustment. It is also true of high interest rates designed to pull in funds from abroad.

5. There is the hope that -- with the program -- we can avoid a crisis long enough for the SDR plan to start pumping out increasing amounts of "paper gold," after which the problem will fade away. However, even SDR's will not directly help our balance of payments. They may make other countries a bit more relaxed about their reserve positions, and thus more willing to follow expansionary policies, tolerate a little inflation, liberalize trade unilaterally, etc. -- all of which could indirectly help our situation. Operation of the SDR plan could also, eventually, calm the gold fever and resultant speculation.

6. However, a good case can be made that we are only buying time with our program; that the fundamental difficulties will not go away but will only be repressed; that a crisis will only be postponed, not avoided. One can argue that we should face up to the more fundamental alternatives now rather than later.

7. One alternative -- which we surely must reject -- is to raise the price of gold. This may appear an easy solution; but its long-run costs and even short-run consequences are most unattractive. To save time, I won't detail them, unless you wish me to. In any case, it solves none of our basic problems.

8. Another alternative would be for the United States to "demonetize" gold -- quickly, and at one stroke. There are various ways to do it. My own present view as to the best way is this. We suddenly stop all gold sales, and announce our intentions:

- We will invite all official holders of dollars (governments and central banks) to let us know how many of their dollars they want to cash in for gold. If the sum of what they want exceeds our stock, we will pay out pro rata.

- If it doesn't, and it most probably won't, we will give them all they ask for and use the remainder to buy a stock of foreign currencies from the IMF or from the countries concerned.

- We make it clear that we will never again buy an ounce of gold at any price and, of course, won't sell any.

- We will, however, carry out our obligation under the IMF to stabilize our currency against others -- at the existing parity -- in the same way as every other country does -- by buying and selling foreign currencies.

9. We would, of course, urge all other countries to follow our example in demonetizing gold. We would thus be taking the initiative in freeing the world from the tyranny of the "barbarous metal" -- to use Bill Martin's nice phrase -- appropriate characterizations by William Jennings Bryan are also available. (If a number of major countries wanted to follow our example, it would be necessary for IMF or some other international institution to take over all monetary gold stocks, in exchange for some kind of automatic drawing rights. With all or most of the world's monetary gold stock locked up in the IMF -- which would neither buy nor sell -- the price of newly-mined and dishoarded gold would probably drop well below $35.)

10. If it subsequently developed that we could not maintain the parity of the dollar with other currencies, we would have to let the dollar "float," or else to announce a change in its parity. But with no gold commitment, we wouldn't need to feel guilty towards anyone who was holding dollars because he thought they were convertible into gold.

11. The initial reaction could well be one of panic, domestic and international. Financial markets would probably go haywire. But after a few months, people would see that it really made no difference, and that we were much better off in terms of being free to pursue the domestic policies that are correct for us, without worrying about gold. This means that -- if it were to be done in 1968 -- it should be done early in the year, not next summer.

12. I'm not necessarily advocating this course. But I think you should know that there is this alternative -- one which most economists would probably favor.

13. There is also another alternative to the drastic program that Joe Fowler proposes. It would omit the border tax adjustment and the tourist tax, and would keep the capital outflow programs voluntary. It would do all the other things he proposes. This obviously would have considerably less impact on our balance of payments. But it would minimize any danger of retaliation, or of touching off a crisis. We would then throw the ball back to the Europeans, in much the way Joe Fowler did in his Granada speech last year:

> "Against this background, how should the United States react beyond intensifying its existing program? Should we take the narrow, nationalistic view that in the interest of the United States, the United States' balance of payments must be brought into equilibrium no matter what the cost to the Free World?
>
> "Should we attempt to solve this problem through a reduction in our overseas military commitments?
>
> "Should we attempt to solve it by slashing our foreign economic assistance programs?
>
> "Should we attempt to solve it by reversing the entire trend of our trade policy and the world's trade policy?
>
> "Should we restrict travel?
>
> "Should we impose mandatory controls on capital flows?
>
> "Should we solve it, in short, at the expense of the other important, constructive decisions that remain to be made -- that must be made -- in international economic affairs in 1966? Should we solve it at the risk of unravelling the carefully woven fabric of international cooperation that has served us so well during the last 20 years?

"We all know that the United States could, if it decided that it must do so, solve this problem alone, but it could do so only at great cost to the economies, the aspirations and, indeed, the safety of all the nations of the Free World.

"Is this the direction in which we should move at the crossroads in 1966?

"Other nations -- many of them represented here today -- have a vital interest not only in whether the United States solves its payments problem but in how we solve it.

"We believe that we should and that we shall find the solution to this problem where we have found the solutions to so many other problems during the last 20 years. That is, we shall find it in a combination of measures which will be consistent with the responsible role of the United States as a good partner in international financial cooperation."

14. The Europeans might well again refuse to catch the ball. In that case, the weaker program might not be enough to get us through 1968. However, staring the alternatives in the face, they might catch it this time.

15. It is clear that there are serious risks in whatever we do or don't do. These risks have been building up ever since 1959, but are stronger in 1968 than in any previous year. Many of them are the result of things entirely beyond our control, and it is hard to see how they could have been avoided. Looking back, I see very few things we might have done better, except, perhaps, for the politically-impossible tax increase in 1966.

Gardner Ackley

Gardner Ackley

THE SECRETARY OF THE TREASURY
WASHINGTON

DEC 2 3 1967

EYES ONLY FOR THE PRESIDENT

MEMORANDUM FOR THE PRESIDENT

Subject: Major Issues To Be Resolved in New Balance of Payments Program

Attached you will find another draft of my proposed letter to you recommending a new balance of payments program, revised in the light of the week of discussions since your departure.

In a separate envelope is a draft of the Treasury White Paper which is the Report referred to in the letter. It will serve as a supporting Brief for the program, as well as an account of past actions, and an educational document for interested members of Congress, the public here and abroad, and officials of other countries and international organizations concerned, as well as our own personnel in the Executive Department here and abroad who must sell, defend or negotiate the proposed actions.

The major substantive issues to be resolved are:

1. To Expand Our Trade Surplus (See Section I of attached HHF draft letter, pp. 9-12a)

Alternative A -- Act on some part of discrimination and negotiate on remainder -- see HHF letter I, par. 4, pp. 9, 10 and 11

The announcement as part of the package (Dec. 29 or Jan. 2) of (a) a legislative proposal on the rebate of United States exports of all or some substantial portion of secondary, indirect and property taxes and an equivalent border adjustment tax on imports to offset partially the varying trading advantage of Common Market countries and (b) an intention to negotiate a harmonization of the rebate and border taxes to remove the disadvantage and discrimination against United States trade which will still remain even after the U. S. legislative action.

Alternative B -- Negotiate on all before announcing proposal

The omission of any legislative proposal in the package but the statement that U. S. representatives (Roth & Co.) were initiating immediate discussions in Bonn (and perhaps a few other capitals) to see if the German government would recommend to the Bundestag a temporary withholding of a new and larger border tax adjustment scheduled to go into effect January 1. If this were possible, we would simultaneously begin discussions in Geneva (GATT) under Article XXII of the border tax problem.

2. To Increase Current Income From External Investment and Reduce Current Outflow (See Section III)

(a) The level of the program on direct investment

The program proposal would call for action assuring $1 billion of benefit to the balance of payments in 1968 as compared to 1967 through reduction in the use of outflows and retained earnings abroad for direct investment in developed countries.

Secretary Trowbridge would fix the target at a lesser amount -- approximately $800 million on the ground that the program could not be successfully administered on a voluntary basis at any higher level.

Most of your other advisers believe that the target should be at least $1 billion and that mandatory controls under the Trading With the Enemy Act should be invoked to assure that result, be convincing here and abroad in the score of determination, and make more palatable the legislation proposals for taxation of tourism, etc.

Chairman Ackley has strong reservations on the effect and desirability of controls.

Secretary Fowler believes the target must be $1 billion, but has reserved judgment on the choice of means (mandatory controls v. continued voluntary program).

The draft letter does not address this issue. I felt you would want the full option on this point.

(b) The inclusion in the proposal of a program to hold down any further <u>increases</u> in 1968 of direct investment in less developed countries above the level of 1967 which showed a sharp increase. (See Part III)

An alternative proposal would not put this area under any positive hold down but ask for regular reports from the 708 companies in the Commerce program so as to keep some track on what is happening.

(c) <u>Tightening of Federal Reserve Program on Bank Lending Abroad</u>

There is more of an open question, and less of an issue on a <u>toughening</u> of the Federal Reserve Board program on bank lending abroad. The initial Federal Reserve Board program called for reducing the leeway to increase total bank lendings abroad in the year 1968 from 109 percent of the base date (December 31, 1964) to 105 percent. There is agreement that this percentage should be reduced further. In fact, the Federal Reserve Board on December 20 proposed that it be reduced to 103 percent which would leave only a small margin of increase ($100-$200 million). It has now been proposed that, in view of a tough firm program on direct investment calling for $1 billion of balance of payments benefits in 1968 over 1967, that the Federal Reserve Board reduce the bank lending ceiling (see HHF letter III, 2, on page 18) to a percentage level that would not only eliminate any leeway for increased loans or a potential drain, but also result in $500 million of inflows as existing bank loans are paid off and the scale of relending to Western Europe for non-export credit is reduced.

This matter is under active consideration by the Board.

(d) Treatment of the Gold Cover Issue in the Program

This is not a substantive issue, but a matter of procedure and public relations. Everyone is agreed that you must seek a mobilization of our gold reserves beyond the old gold cover arrangement early in the year and that a specific statement to that effect should be included either in the balance of payments program, the State of the Union Message, or the Economic Message.

It is also agreed that the Treasury White Paper and my letter to you should anticipate action by the Congress on the Amendment to the IMF Articles of Agreement (the Rio proposal) and action on the gold cover. The only difference is one of shading -- whether inclusion of a specific and definitive announcement by you on the gold cover should be one of the numbered points in your statement.

One way of handling it would be along the lines of pages 23, 24 and 25 of the draft HHF letter.

\- - - - - - - - - - -

This is a rough summary of the major substantive questions to be resolved. You will have received from Mr. Califano a memorandum on the discussion held at your request Friday afternoon. I have not included anything on the travel question because everyone is in agreement on the objective -- to reduce the travel deficit by one quarter or between $500 and $600 million. The question that remains is the details of the proposal in which I do not think you should become embroiled.

For a flavor of the range of reaction on these issues, in addition to the Califano memorandum on yesterday's meeting, I am enclosing a copy of the minutes of the meeting of the Cabinet Committee on the Balance of Payments held last Thursday.

Henry H. Fowler

Henry H. Fowler