



(23)
THE SECRETARY OF THE TREASURY
WASHINGTON

C.F.

FDH
FHM
FCB

December 9, 1964

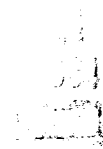
L

MEMORANDUM FOR THE PRESIDENT

As background for your meeting tomorrow with the Cabinet Committee on the Balance of Payments, I am attaching a memorandum on the outlook for the balance of payments including recommendations for possible action. The original draft of this memorandum was prepared in the Treasury and reviewed this afternoon by the Cabinet Committee on the Balance of Payments. The current draft represents my own views taking into account the comments at this afternoon's meeting. It does not purport to be a fully agreed paper.

Douglas Dillon

Attachment



CONFIDENTIAL

December 9, 1964

BALANCE OF PAYMENTS PROSPECTS AND POLICIES

1. Progress to Date

Our deficit on regular transactions now looks to be between \$2-1/4 and \$2-1/2 billion for 1964.

-- That will be roughly \$1 billion below the \$3.3 billion 1963 deficit, but short of the widely shared expectations of a decline to \$2 billion or less. ✓

-- Deficit has widened to about \$3 billion rate for second half, perhaps reflecting in some part side effects of U. K. crisis.

With the deficit smaller and good first half results contributing to confidence, the net gold outflow was eliminated during the first 10 months of the year. Increased outflows in November and December are expected to bring the gold drain for year to an estimated \$175-\$200 million -- still less than half last year's total.

-- The earlier stability was partly fortuitous -- reflecting largely heavy Russian sales early in year.

2. Looking Ahead

Our technical experts foresee further limited gains in 1965, bringing the deficit on regular transactions slightly under \$2 billion. If realized, that would be the smallest deficit since the balance of payments became a problem in 1958 -- but little if any better than what had been hoped for this year. With this outlook, and in the absence of unusual sales by the Soviet Union, the gold outflow can be expected to increase substantially. ✓

3. Elements in the Problem

Our commercial trade surplus should reach a record \$3.4 billion in 1964 -- a better-than-expected gain of \$1.1 billion.

DECLASSIFIED

Authority Treasury 1/29/80, NLT-79-104 CONFIDENTIAL

By AT/ER, NARS, Date 2/4/80

CONFIDENTIAL

- 2 -

Strong markets abroad helped, but in addition, our own price stability is beginning to pay off in strengthening our world-wide competitive position. ✓

- However, on present reading, we cannot count on so large a commercial trade surplus in 1965; our experts now foresee a decline of about \$750 million. The U.K. import surcharges and slower growth in Canada and some other markets will tend to restrain export growth, while an inventory buildup in steel and elsewhere is expected to swell imports.

On Government overseas account, President Kennedy scheduled a \$1 billion reduction in dollar outlays abroad from the 1962 level by the end of this year -- with full effect in 1965. This included savings of \$500 million through tying of aid, \$300 million from lower defense spending, and \$200 million from reduced purchases by AEC abroad. That target, on present schedules, should be closely approached.

- AID has virtually reached its target.
- Defense is about \$45 million behind its spending goal, partly reflecting pay increases and expenditures in South Viet-Nam. This forecast does not allow for the cost of possible further increases in activity in South Viet-Nam. Suggestions for certain additional military reductions have been set aside, largely for reasons of foreign policy. A brief recapitulation of results to date under July and October 1963 reduction programs is attached. (Defense is \$175 million ahead of its receipts goal and therefore \$130 million ahead on balance.)
- Purchases by AEC are being reduced on schedule.

Clear slippage is apparent in private capital outflows, despite the restraining influence of the Interest Equalization Tax on purchases of foreign securities.

CONFIDENTIAL

CONFIDENTIAL

- 3 -

- Bank loans -- only partly related to exports and special Japanese needs -- ran at a record \$2.2 billion annual rate in first three quarters, despite declines in short-term lending over the summer.
- Direct investment is reaching a new peak of over \$2 billion.
- Some liquid funds have moved abroad, despite effort to maintain short-term interest rates at competitive levels.
- New Canadian securities -- exempt from IET -- turned out to be larger than expected, particularly in recent months.

The travel account is another important drag on progress. Tourist spending abroad continues to rise rapidly, reaching \$2.9 billion, \$1.7 billion more than foreigners spend here.

4. Evaluation

Continuing, visible progress toward reducing our deficit is essential to assure adequate financing for our deficit and to maintain confidence -- already affected by side effects of the U.K. crisis.

- In this context, the technicians' current forecast would be judged disconcertingly high by European creditors -- too high to be fully certain of orderly financing.
- Present policies must be continued and reinforced -- and additional backstops prepared -- to assure some improvement on the current CY 1965 forecast and lay the ground for further significant progress in CY 1966. The "safety margin" today is too thin.

5. Indicated Program

A. Basic to all else is continued price and cost stability -- the key both to export expansion and continued confidence in our longer-run prospects.

CONFIDENTIAL

CONFIDENTIAL

- 4 -

- This suggests reiteration of "guideposts", close attention to key wage and price decisions, and continued emphasis on measures to spur productivity and cost-cutting.

B. On that foundation, our export effort should be further strengthened through:

1. Increased emphasis by Commerce on locating foreign markets, contacting potential new exporters, and promotion of cash sales which are more immediately productive than credit sales on extra liberal terms. Strong Presidential backing will be needed for adequate appropriations to carry out this program.

2. Stepped up efforts to develop more flexible policies in the maritime field to (a) permit shipment of Government-financed exports in foreign ships where necessary to make sale, and (b) correct shipping cost differentials that discriminate against U.S. exports.

3. Exploration by affected agencies of opportunities for developing Iron Curtain markets, including judicious use of credit where this leads to accompanying cash sales.

C. Re-examination of targets for reductions in dollar outlays abroad by AID and Defense is required to prevent slippage and to seek out further areas for savings.

In addition, action should be taken to assure Germany meets commitment for military orders and payments to U. S. which fully offset U. S. defense spending in Germany during 1965 and 1966.

D. A reduction in the net capital outflow is essential, to achieve the needed reduction in the balance of payments deficit. To assure this:

CONFIDENTIAL

CONFIDENTIAL

- 5 -

1. Renewal of the basic Interest Equalization Tax legislation will be required.

2. Implementation of tax changes and other measures required to improve climate for foreign purchases of U.S. securities should be expedited.

3. Monetary policy is doing what it can at the moment to minimize outflows of short-term funds while supporting domestic growth. Its flexibility in meeting future contingencies must not be impaired. Monetary policy will also need continued support from Treasury debt operations and from intervention in foreign exchange markets to meet objective of avoiding incentives to shift liquid funds abroad.

4. As further backstops:

- a. Unless increasing domestic loan demands slow the rise in foreign bank lending, the IET will need to be extended to bank term loans.
- b. We must be prepared to close the Canadian IET exemption if anything like present borrowing rate is maintained (\$380 million in fourth quarter). However, the Canadians have indicated clear recognition of need for lower rate next year.
- c. Study should be undertaken of problems entailed in extending the IET to direct investment abroad.

E. To restrain the losses on travel account, it is essential to:

1. Extend legislation limiting duty-free tourist imports, and study desirability of reducing present \$100 per trip limit.
2. Invigorate the "See America Now" program with adequate appropriations, centralized responsibility, and top level support.

CONFIDENTIAL

~~CONFIDENTIAL~~

- 6 -

3. Assure that fare decisions by the CAB take into account balance of payments implications of foreign travel.

4. As a "backstop", we should devise a workable tax on overseas U. S. tourists for possible implementation well before heavy summer tourist season.

F. In the best of circumstances, we must be prepared for further gold losses. Declining ratio of gold to Fed note and deposit liabilities (now near 28 per cent) underscores need for relaxing 25 per cent gold cover requirement, making gold unambiguously available in defense of dollar. (The primary public justification for this move lies in coming need to provide for the long-run expansion in the monetary base required by domestic growth).

6. Recommendation

A tentative decision should be taken to send a special balance of payments message to the Congress on or about March 15, when detailed figures on 1964 results first become available. This message could reiterate Presidential determination to substantially improve our payments and to take all needed measures to that end. It could report results of effort to reduce Government expenditures overseas, request extension of Interest Equalization Tax, emphasize need for action on other items in legislative program and announce any further steps which may be necessary.

Attachment

~~CONFIDENTIAL~~

CONFIDENTIAL

DEFENSE OUTLAYS ABROAD

SUMMARY OF
PHASE I AND PHASE II REDUCTIONS
HAVING EFFECT IN CY 1965 (\$m)

	<u>Original estimate</u>	<u>Present estimate</u>	
		<u>Total program</u>	<u>To be realized in CY 1965</u>
Phase I	361	320	320
Phase II	<u>375</u>	<u>117</u>	<u>80</u>
	736	437	400
Less other increases	<u>-63</u>		<u>-145</u>
	673		255

CONFIDENTIAL