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International Balance of Payments -  
Classified Material: Cabinet  
Committee on B/P, 8/65-12/66

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By pc, NARA, Date 1-12-09

MEMORANDUM FOR THE PRESIDENT

Your Cabinet Committee on Balance of Payments met on September 30 in the first step toward an intensified and comprehensive review of our present position and the outlook for 1965 and 1966. Two or three more meetings will be held during October in order to complete this detailed study. The next one is scheduled for Monday, October 18. Specific recommendations with respect to the balance of payments program will then be forwarded to you. This is an interim report.

Although a firm evaluation and appropriate recommendations must await further detailed analyses and assessment, some broad conclusions seem warranted, as follows:

- We are reasonably on target with your balance of payments program; results for the entire year 1965 promise to be close to those we anticipated at the beginning of the year. The specific balance of payments items contributing to this performance vary significantly from those we expected but the total result indicates a successful over-all program thus far.
- Some immediate actions are necessary to guard against a sharp worsening of the payments situation during the fourth quarter of 1965. The actions required are outlined below.
- The preliminary outlook for 1966, on the basis of the present program, is for modest improvement; reinforcement particularly of the Commerce Department program is essential if satisfactory progress toward equilibrium is to be assured.

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FEDERAL RESERVE BANK  
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The Federal Reserve program with respect to banks and nonbanking financial institutions is paying off handsomely, far in excess of our expectations, and promises effectiveness at least through next year. Banks have more than done their job: they are now \$600 million below their permitted ceiling on credits to foreigners. This very success, however, poses a threat to the fourth quarter results if banks move vigorously toward the ceiling during the rest of 1965. To help guard against such a sudden outflow, the Federal Reserve has

-- advised the institutions concerned that the ceiling for 1966 will employ the same end-of-1964 credit base. Banks therefore need not rush out to make loans to bring them up to their current ceiling in fear that a new base will be established which would penalize their failure to be at maximum lending capacity to foreigners. Even with this precautionary step, some adverse effect in the fourth quarter remains a clear possibility.

Substantial reinforcement of the program administered by the Department of Commerce is clearly in order in view of the very heavy increase in direct investment abroad this year and the indications that this will continue. A reinforcement of that program is now in the making. It essentially will involve

-- the establishment of firm guideposts for corporate behavior in investing abroad, sharp tightening of performance standards and improvement in the Department of Commerce's ability to analyze performance results and undertake frequent discussions with the laggards. We believe such tightening could bring about substantial improvement, yet retain the essentially voluntary nature of the program.

Improved performance in this corporate sector is essential in the very practical sense of balance of payments results -- but also to insure that other parts of the over-all program remain acceptable as being fairly imposed.

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More immediately, Commerce will

-- re-emphasize to the corporations the need to continue to repatriate earnings, to borrow abroad and bring back all dollars held abroad not absolutely needed for working purposes.

This should help to minimize strains even while the new measures are being developed and issued.

Also, I took advantage of the presence here during the Bank and Fund meeting of Lord Cromer, head of the Bank of England, to urge the deferral by the United Kingdom of any further action on their part this year (such as a drawdown of their long standing Export-Import Bank Credit) that might adversely affect the 4th quarter picture. I believe they will be in a position to cooperate and are willing to do so.

Other measures are also now under critical review to determine those further gains that can be recorded with the application of feasible measures to exports, tourism, military and economic aid -- particularly important over the longer-run.

The above observations suggest that your present program, suitably reinforced but basically voluntary, can bring the improvement needed in our balance of payments this year and a further stride toward equilibrium in 1966. We must, however, continue to be constantly alert to any indication that the program is faltering since the balance of payments results remain critical to world wide confidence in the dollar and to our ability to gain any meaningful step toward substantial improvement of the international payments system. We do not foresee at this time any need for more drastic measures. Indeed, these could be sharply counterproductive. Nevertheless, contingency planning within a small interagency group will continue at the top of the working agenda. Your Committee is fully aware that this phase of interagency planning must be strictly guarded since rumor of it could bring about substantial speculative or anticipatory outflows of funds.

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Our final report will also look further ahead to the U.S. balance of payments position at the end of our current temporary program and set forth the alternative courses of action which might be taken to assure sustained equilibrium in our balance of payments beyond the immediate period ahead.

Committee would be on Monday, October 18, at 4:30.

The Secretary turned to the balance of payments projections which has just been made by the late **Henry H. Fowler** and said that he had had a very violent reaction to it. He said that those things cross in his mind as a result. One, he would talk to the British about their borrowing \$250 million from the Eu-In Bank, in the hopes of discouraging them. Secondly, it will be necessary for the Fed to announce very soon that the 1966 base would be based on the end of 1964 status as now. Third, that some changes might be necessary in the Commerce program and he would want to hear from Secretary Connor on that.

He also suggested that it might be necessary to raise the IRT rate above the current one percent for next year.

He also suggested that we might want to limit all non-bank assets, that is more than ten years as well as less than ten years to the 121 percent ceiling.

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