THE INTERNATIONAL FINANCIAL CRISIS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND RESOURCES

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

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THE INTERNATIONAL FINANCIAL CRISIS

WEDNESDAY, MAY 30, 1973

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND RESOURCES
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2221, Dirksen Senate Office Building, Senator Harry F. Byrd (chairman of the subcommittee) presiding.

Present: Senators Byrd, Jr., of Virginia, Hartke, Mondale, Fannin, Hansen, Roth, Jr., and Dole.

Also present: Senator Haskell.

OPENING STATEMENT OF SENATOR BYRD

Senator BYRD. Gentlemen, the Subcommittee on International Finance and Resources today commences 3 days of hearings on the subject of the international monetary crisis.

These hearings are being held with two purposes in mind: First, we intend to explore the causes and effects of instability in the world financial markets. Second, we intend to examine various alternatives for restoring monetary stability in the short term and achieving monetary reform for the longer term.

The experience of the past 18 months offer ample justification for these hearings. The fever, pulse, and other vital signs of the international monetary system serve notice that the system is approaching a final shutdown.

Twice, in the past 14 months, the dollar has been devalued. A $10.2 billion balance-of-payments deficit in the first quarter of 1973 overshadows April's brightening trade prospects. The rising price of gold, fueled by speculation and the prospect of easy profits, makes it difficult to recall that not long ago $35 bought an ounce of gold.

These indicators make it clear that the world economy is moving through a period of transition, marked not by a series of monetary crises but by a continuing crisis which we must understand and manage if we are to shape a more stable system. There are, in the words of William McChesney Martin, "disquieting similarities" between the financial chaos of today and that of the turbulent 1930's.

Our inquiry in these hearings is how we can best manage the present situation and how we can move toward a new system for conducting the world's monetary affairs.

There is no adequate way to separate monetary issues from trade and investment issues, or from domestic economic issues. There is a relationship, however difficult to understand, between the price of gold in London and the price of beef in Richmond.

The price of gold reflects confidence in the U.S. economy; that confidence has been eroded by uncontrolled inflation, which in turn is fueled by enormous budget deficits.

We are fortunate that a number of very distinguished witnesses have consented to testify before our subcommittee today, Friday, and next week. This morning we will hear from Hon. Dewey Daane, a distinguished member of the Board of Governors of the Federal Reserve System, and from Dr. Pierre Rinfret, a private economist, who has a well-deserved reputation for candid and perceptive insights on economic issues. We welcome both of you here.

On the next 2 days of hearings, we will have as witnesses Hon. William McChesney Martin, former Chairman of the Board, Federal Reserve System; Mr. Eliot Janeway, financial writer and analyst; Hon. Jack Bennett, Deputy Under Secretary of the Treasury for Monetary Affairs; and Mr. Edwin L. Dale, Jr., international economic writer for the New York Times, Washington bureau.

Before you begin your presentation Governor Daane, I will put in the record a background staff document which raises the issues which this committee will be discussing in this hearing.[1]

We are delighted to have you Governor Daane and in a few moments we will call on you but, first, I would like to yield to the distinguished Senator from Kansas, Mr. Dole.

Senator DOLE. Thank you, Mr. Chairman.

I share the same concerns expressed by the chairman and appreciate his leadership.

STATEMENT OF SENATOR DOLE

Senator DOLE. Mr. Chairman, our hearings today coincide with recent tremors in the international monetary system and a rising concern for the future of trade, exchange, and economic stability between the nations of the world. Recurring monetary crises leave little doubt that the structure erected in the first International Monetary Conference at Bretton Woods almost 30 years ago is breaking down under the stress of changing economic relationships. Renewed speculation in the European gold markets is driving the price of gold to new heights, and in the opinion of many this upward instability reflects an erosion of confidence in paper currencies, particularly the dollar.

The United States persistent balance-of-payments deficit—$10.2 billion in the first quarter of this year—is adding to the glut of dollars abroad. Of course, news of the April trade surplus—the first in 19 months—was welcome and hopefully indicates that the dollar devaluations and other currency realinements are beginning to take hold. But I believe we must await further developments before attaching long-range significance to the statistics of 1 or 2 short months.

POWERFUL FORCES

There are many contradictory and powerful forces at work in the international financial climate today. Our surplus trading partners urge us to put our economic house in order, yet few show any willingness to make the concessions required for us to do so. Private capital

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[1] The briefing material prepared by the staff entitled "The International Monetary Crisis," appears as appendix A of this volume, p. 167.

is being moved from country to country—from currency to currency—to gain windfall profits and is fueling the instability in the world financial markets. Our balance-of-payments deficits breed speculation, and speculation adds further to our deficits. At home we are faced with persistent inflation and a skittish stock market.

For most Americans—and, I think, not a few economists—the international monetary system is a mystery. Yet it is a mystery we cannot afford to ignore if we are to restore confidence in our currency and order in the world economy.

IMPORTANT RESPONSIBILITY

In this regard, Mr. Chairman, I believe these hearings and our distinguished witnesses can do a great deal to penetrate this mysterious subject and cast light on the basic issues and realities which we must confront in our search for effective and realistic policies.

The Finance Committee, through its jurisdiction over trade and monetary matters, has an extremely important responsibility in the formulation of America's international economic policy. I look forward to these hearings and to our committee's continuing efforts in this field.

As a new member of the Finance Committee and this subcommittee, I wish to extend my appreciation to you, Mr. Chairman, for your leadership in calling these hearings. And I look forward to working closely with you as we explore and examine these important matters.

Senator BYRD. Thank you, Senator.

Governor Daane, you may proceed.

STATEMENT OF HON. DEWEY DAANE, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ACCOMPANIED BY RALPH BRYANT, DIRECTOR, AND JOHN REYNOLDS, ASSOCIATE DIRECTOR, OF THE BOARD'S DIVISION OF INTERNATIONAL FINANCE

Mr. DAANE. Thank you, Mr. Chairman. I am accompanied by Mr. Ralph Bryant on my right, the Director of the Board's Division of International Finance; and the Associate Director of that Division, Mr. John Reynolds, on my left.

I am pleased to be here today to testify on behalf of the Board of Governors of the Federal Reserve System. It is useful to have these hearings at this time. In recent weeks, as the chairman of this subcommittee has noted, there has been some renewed uncertainty in foreign exchange markets about the future of the U.S. dollar. The restoration of confidence in the dollar requires, basically, a substantial improvement in our international balance of payments.

Parenthetically, I would add an improvement in our performance on the inflation problem.

These hearings provide an opportunity to make clear that the outlook for the U.S. international payments position, and hence for the dollar, is considerably better now than it has been for some time.

The outlook has been greatly improved by the exchange rate realinements of 1970–71 and early 1973. Altogether, the U.S. dollar has been effectively devalued against all other currencies by about 17 percent since mid-1970, and by substantially more than that against our strongest competitors. This is a very large adjustment, which greatly improves the international competitiveness of U.S. goods.

Senator MONDALE. Mr. Chairman, could we have that broken down by countries? Maybe you have that, Governor. Do you have a table of the net devaluation adjustments?

Mr. DAANE. I am not sure I have it for each country, but I am sure——

Senator MONDALE. It must be available, though.

Mr. DAANE. I am sure we can find it for you.

Senator MONDALE. Oh, here it is. I guess we have it. I would ask that the table appear at this point, Mr. Chairman.

Senator BYRD. Without objection, so ordered. The table on page 43 will appear at this point.

[The table referred to follows:]

TABLE 9.—PERCENT APPRECIATION (+) OR DEPRECIATION (—) AGAINST THE DOLLAR [1]

	Apr. 30, 1971 to Dec. 18, 1971 [2]	Pre-February 1973 to May 18, 1973 [3]	Apr. 30, 1971 to May 18, 1973
Currency of—			
Australia	+8.6	+11.0	+26.3
Austria	+11.6	+12.8	+25.8
Belgium-Luxembourg	+11.6	+14.4	+27.7
Canada	+.8	—.1	+.8
Denmark	+7.5	+11.8	+20.1
Finland	+2.4	+5.7	+8.2
France	+8.6	+15.2	+25.0
Germany	+13.6	+15.9	+31.6
Greece	0	0	0
Iceland	0	+8.3	—3.3
Ireland	+8.6	+8.6	+6.4
Italy	+7.5	—1.2	+6.2
Japan	+16.9	+16.5	+36.2
Netherlands	+11.6	+12.7	+25.7
Norway	+7.5	+12.7	+21.1
Portugal	+5.5	+7.9	+13.84
Spain	+8.6	+10.9	+20.4
Sweden	+7.5	+6.7	+14.7
Switzerland	+13.9	+21.9	+38.8
Turkey	+7.1	0	+7.1
United Kingdom	+8.6	+8.6	+6.4

[1] Calculated on basis of U.S. cents per foreign currency unit. Averages are weighted on basis of U.S. bilateral trade pattern in 1970.

[2] Calculated on basis of Apr. 30, 1971, par values and, for Dec. 18, 1971, new par values or central rates following Smithsonian agreement. Market rates on Apr. 30 and Dec. 24, 1971, were used for Canada, whose currency was floating.

[3] Base rates are par values or central rates prevailing in early February 1973, except for Canada and the U.K., for which base rates of U.S. $1=C$1 and $2.35=1£, respectively, were taken as an approximate average of rates prevailing in the weeks preceding the February market disturbances. Rates for May 18, 1973, are market rates for most countries, and par values or central rates for a few of the smaller countries whose rates are not available regularly.

Senator BYRD. Proceed.

Mr. DAANE. Yes, we can furnish that. I can either run through it now or——

Senator MONDALE. No, I just wanted to have it in the record.

Mr. DAANE. Fine. In any case, you are quite right, there have been differing results with respect to different countries, and it has been very noticeably changed with respect to Japan where the devaluation has been something over 25 percent. It is certain to have large effects, even though the size and timing of the expected increases in exports and slowing of import growth cannot be foreseen with precision.

The structure of our balance of payments is such that we need to earn a substantial surplus on current international transactions—specifically on merchandise trade—in order to balance the net outflows of Government aid and private capital which are natural and desirable for a wealthy country with a well-developed capital market. But the dominant tendency in our international transactions from about 1965 through 1972 was a persistent worsening in our current balance—and especially our trade balance—to the point where they moved into deepening deficit. Last year, as you know, we had a trade deficit of almost $7 billion and a deficit on all current and long-term capital transactions combined of over $9 billion.

World business cycle conditions were adverse from a U.S. balance-of-payments viewpoint during 1972. Last year, our economy and our imports were vigorously expanding while demand abroad, including demand for our exports, was still rather slack. But even after making a rough allowance for the adverse cyclical position, the underlying trend rate of our trade deficit last year was probably at least around $4 billion. So compared with the mid-1960's, when we had a trade surplus averaging more than $5 billion a year, there had been a deterioration on trade account of around $10 billion. U.S. imports of finished manufactures rose particularly rapidly during this period while the U.S. share of world exports of manufactures declined steadily.

The adverse trend in our trade balance from 1965 to 1972 is attributable to a variety of factors. First, after 1965, the United States experienced greater increases in costs and prices, and lower rates of productivity growth, than most other industrial countries. Second, this occurred at a time when a number of other countries—European countries, Japan, and various other countries in Asia—were reaching a point at which they had built up the capability to take advantage of existing price-cost differentials. Third, and more recently, rapidly rising imports of petroleum have added to our foreign expenditures.

Now, as a result of the exchange rate changes, together with other factors, one can be cautiously optimistic. The worsening of the trade balance was halted during the course of 1972. The low point was reached early in that year, when the trade deficit approached $8 billion at an annual rate. The U.S. share in world exports of manufactures stopped declining in 1972.

So far this year, there has been a marked improvement in the trade balance. The annual rate of deficit on trade in January–April 1973 decreased sharply to around $2 billion, compared to $6.8 billion for 1972 as a whole. Much of this recent improvement reflects an exceptionally large bulge in agricultural exports which is likely to prove temporary, so that the underlying gain is not nearly as large as the raw data suggest. We should be prepared for some temporary setback during the months ahead, as the dollar prices of imports will be pushed up further in delayed reaction to the devaluation, while the volume of imports will not yet have fully reacted to the price rise. But there have been solid gains. The value of nonagricultural exports in January–April 1973 was 14 percent larger than it had been 6 months earlier, a near-record rate of increase. New foreign orders for machinery in the first quarter of 1973 were up by 16 percent from the third quarter of last year. Meanwhile, the value of total imports after rising sharply through January, has not risen at all since then, despite becoming domestic demand, a sharp rise in prices of imported raw materials, and a continuing rise in imports of petroleum.

Thus, the increased competitiveness of U.S. goods as a result of devaluation is beginning to have perceptible beneficial effects on both our exports and our imports. The corresponding opposite effects are beginning to be evident in the trade figures of other countries, notably Japan, where import expansion has accelerated and export growth is slowing down.

Parenthetically, I might add, in the morning paper, I see where Soviet Russia is having a trade balance problem of its own, if the figures are meaningful and meaningfully interpreted.

Later this year and in 1974, we expect to see further gains in our foreign trade balance, not only because of the cumulating effects of our strengthened competitive position, but also because business cycle conditions are likely to be moving in our favor. Growth in the U.S. economy will be slowing to a more moderate and sustainable rate from now on, while expansion abroad is likely to be continuing vigorously. It seems clear that there can be a substantial improvement in the trade balance beginning this year, and gathering momentum in 1974 and 1975, by which time we should be experiencing a sizable trade surplus for the first time since the late 1960's.

The reallocation of resources that follows upon sharp changes in exchange rates and competitive positions is, of course, not instant or automatic. It takes time and it takes effort. Sellers must alter their marketing strategies. Buyers must shift to new suppliers. New investment decisions have to be taken and implemented. The lags in this process are considerable. That is why we are only now beginning to experience substantial benefits from the Smithsonian exchange rate changes of 1971. The benefits of the early 1973 exchange rate changes probably will mainly become evident in 1974 and 1975.

So far, I have been discussing primarily the way we expect the trade balance to evolve in the period ahead. And as indicated, the trade balance is crucial. Of course, there will also be changes in other current transactions and inflows of private long-term capital. As to nontrade current transactions, the balance on these has tended to change rather slowly. We should be able to rely on further strong gains in returns from U.S. investments abroad. In recent years, however, these gains in income receipts have tended to be largely offset by mounting interest payments on our debts to foreigners, especially in foreign official holders of liquid dollar claims on the United States.

Flows of investment capital are volatile, and difficult to predict. Over time, however, the influence of the recent exchange rate changes on these flows should also contribute to improvement in the U.S. balance of payments. American firms may find that there is less need than before to meet the competition by manufacturing abroad; their U.S. plants can now deliver U.S. goods abroad at much lower prices in terms of the currencies of the importing countries. By the same token, foreign producers may increasingly find that it now makes sense to think in terms of establishing plants here.

Portfolio investors are also likely to be favorably influenced as our overall balance moves toward equilibrium. In particular, foreign investors should be encouraged to continue the large purchases of U.S. corporate stocks and bonds that have become an important feature of our balance of payments. More generally, there will be a reversal of the tendency to borrow dollars for the purpose of switching into foreign-currency denominated assets now that the possibility of large gains from exchange-rate changes has been taken out of the picture.

On the other hand, the phasing out of existing controls on outflows of U.S. capital will tend to work in the other direction. On balance, this country is likely to remain a net exporter of both private and Government capital to the less-developed world, which is surely the appropriate posture for a wealthy country.

During the transition period when international transactions are gradually coming into better balance, the United States will still have a deficit—albeit a diminishing one—on current and long-term capital transactions. And we cannot rule out the possibility of occasional periods of uncertainty in foreign exchange markets, as the experience of recent weeks indicates. The present regime of floating exchange rates provides a useful buffer during such episodes, allowing surplus countries to avoid the massive inflows of funds that caused them serious domestic difficulties for monetary management earlier this year, and thus preventing the development of a crisis that could induce large changes in currency par values.

More importantly the main impetus for very large speculative movements has been removed by the adjustment of exchange rates to levels that are now widely regarded as realistic, and will, we think, come to be increasingly recognized as realistic as the U. S. payments deficit diminishes. Once the trend of underlying improvement becomes clear to the market, the residual basic deficit from then on should be fairly easily covered by a return flow of short-term funds that went abroad during earlier periods of currency speculation.

What further actions are needed by us and by other countries to insure that the needed adjustment toward better international balance will in fact take place?

First, as indicated at the outset, the inflationary pressure arising from excessively rapid domestic economic growth and credit expansion must be curbed, so that our prices and costs do not again get out of line with those of other countries. In addition, sufficient resources will need to be available to meet the increased demands coming from export expansion and import substitution. Second, U.S. businessmen must take advantage of the new competitive opportunities, vigorously and imaginatively. Third, foreign countries need to be willing to accept some reductions in their foreign trade surpluses. They must not manipulate export incentives or barriers to import in ways that would tend to frustrate the adjustment. Fourth, we and other countries need to pursue the search for a reformed international monetary system that provides a satisfactory international adjustment process.

In all of these areas, there is reason to be encouraged. On the domestic front, it is true we have recently had a very disappointing revival of inflation. But the rapid increase in prices has reflected, in part, special factors, including the food shortage, the transitional shift from phase II to phase III, and the dollar devaluation—effects which should soon subside. Over a somewhat longer period, our inflation has been less than that in other leading countries. Our consumer price index rose by 5 percent in the year from April 1972 to 1973, while the rise in European countries and Japan was 6½ to 10 percent. Unit labor costs have generally been rising faster abroad than they have here. Our hope and expectation is that inflationary pressures here will subside in the months ahead as economic expansion slows to a more sustainable rate, and as the special problem of food supplies recedes.

In this connection, I might observe that the hectic pace of consumer expenditure experienced during the past winter seems to have moderated somewhat in April and May. Housing starts have receded recently toward a more sustainable pace. The deficit in the Federal budget is being reduced well below earlier estimates, and monetary policy has exerted increasing restraint.

The main danger of continued strong inflationary pressures arises from the possibility of an escalation of wage demands in reaction to the recent bulge in price increases, and from the possibility of an excessively large increase in business spending on fixed investment and inventories. But so far, collective-bargaining agreements have resulted in wage increases reasonably in keeping with the 5½ percent national standard. And there is hope that business spending decisions will be tempered by good sense, and by the considerable tightening of credit conditions over the past few months.

As you know, the Federal Reserve has taken further actions within the past 2 weeks to slow down the expansion of bank lending to business. On May 16, the Board announced the imposition of marginal reserve requirements on large denomination certificates of deposit and on other money market instruments issued by large banks, in order to moderate the expansion of bank lending to major business corporations. Chairman Burns has written to all banks urging them to join in a concerted effort to curb bank credit expansion.

So far as exports and imports are concerned, U.S. businesses are already beginning to take advantage of their improved competitive position relative to foreign producers. This is evident in the figures for rising exports and export orders, and in the increasing gains of U.S. products against foreign products in our own markets—for example, in the case of automobiles. Even more vigorous and imaginative efforts in this area clearly are needed.

Foreign countries are showing a willingness to help bring about the needed adjustments. They have cooperated in achieving a more realistic pattern of exchange rates. Japan, in particular, is making a real effort to reduce its enormous trade surplus and to shift the focus of its economic growth away from expansion of exports and toward badly needed infrastructure investment at home.

The needed trade adjustments are not really very large in the aggregate, relative to the total volume of trade and economic activity, although sizable adjustments may be required for particular industries in some countries. The present expansive business climate abroad is favorable for the needed adjustments by foreign countries. They do need to slow their export growth and accelerate the rise in their imports, but they do not have to suffer actual cutbacks in exports. Indeed, at present they find that larger and cheaper imports are a welcome contribution to the relief of inflationary pressures.

In summary, I think we can feel some confidence that the changes in international competitive conditions that have resulted from the exchange rate changes of the past 3 years will bring international transactions much nearer to balance over the next 2 or 3 years.

It is true that we had a near-record deficit, on the official reserve transaction basis, of $10.2 billion during the first quarter of 1973. But all of this deficit occurred before mid-March, as a result of the heavy speculative flows before the new structure of exchange rates was established. Since mid-March, we have had an overall surplus on international transactions. During this period, the continuing basic deficit on current and long term capital transactions has been more than offset by a return flow of liquid funds.

For the longer run, the outlook seems to me promising for the achievement of a sufficiently flexible international adjustment mechanism so that we need not again experience the very large and persistent international imbalances that have been so troubling during the past few years. We are progressing down the road toward international monetary reform. Last week's meeting of the C-20 deputies again demonstrated that: while international monetary reform involves difficult technical and policy problems, there exists a will to surmount these problems and to create a new and more effective international monetary system.

I have attached some tables, Mr. Chairman, which may be useful to the committee.

Thank you very much.

Senator BYRD. Thank you very much, Governor Daane. That is a very interesting and provocative statement which you have made to the committee.

[The tables referred to above follow:]

TABLE 1.—U.S. BALANCE OF PAYMENTS, 1959 TO 1ST QUARTER 1973

[In billions of dollars a year]

Item	Annual averages			Annual		1973 1st quarter SA annual rates [2]
	1959-62	1963-66	1967-70	1971	[1] 1972	
Exports of goods and services [3]	27.6	38.1	53.8	66.2	73.5	88.0
Merchandise, excluding military	19.2	25.9	35.6	42.8	48.8	61.4
Military transactions and services	8.4	12.3	18.1	23.4	24.7	26.6
Military sales	.4	.8	1.4	1.9	1.2	....
Investment income [4]	4.3	6.7	9.9	12.9	13.8	...
Travel, including fares	1.1	1.6	2.4	3.1	3.4	
Other transportation	1.6	2.1	2.7	3.1	3.7	
Other services	.9	1.2	1.8	2.4	2.6	....
Imports of goods and services	-23.8	-31.4	-0.5	-65.4	-77.8	-89.4
Merchandise, excluding military	-15.2	-20.7	-33.8	-45.5	-55.7	-65.0
Military transactions and services	-8.6	-10.8	-16.7	-19.9	-22.1	-24.4
Military expenditures	-3.1	-3.1	4.7	-4.8	-4.7	....
Investment income [4]	-1.0	-1.7	-3.8	-4.9	-5.9	
Travel, including fares	-2.3	-3.0	-4.4	-5.6	-6.3	.....
Other transportation	-1.4	-1.9	-2.5	-3.0	-3.4	....
Other services	-.8	-1.0	-1.4	1.6	-1.8	
Balance on goods and services [3]	+3.8	+6.7	+3.3	+0.8	-4.2	-1.4
Merchandise, excluding military	+4.1	+5.2	+1.8	-2.[illegible]	-6.8	-3.7
Military transactions and services	-.3	+1.5	+1.5	+3.4	+2.6	+2.3
Military transactions	-2.7	-2.4	-3.2	-2.9	-3.5	...
Investment income [4]	+3.3	+4.9	+6.1	+8.0	+7.9	..
Travel, including fares	-1.2	-1.5	-2.0	-2.5	-2.9	..
Other transportation	+.2	+.2	+.2	+.1	+.3	..
Other services	+.1	+.2	+.4	+.7	+.8	.....
Remittances and pensions, net	-.7	-.9	-1.3	-1.5	-1.6	-1.7
Balance on goods, services, and remittances	+3.1	+5.8	+1.9	-.8	-5.8	-3.1
U.S. Government grants and capital, [5] net	-2.5	-3.3	-3.9	-4.4	-3.6	-3.6
Private long-term capital, net	-2.1	-3.7	-.8	-4.1	+.1	..
Balance on current and long-term capital transactions	-1.5	-1.2	-2.7	-9.3	-9.2	....
Private short-term capital, net	-.2	+.7	+1.5	-10.1	+2.0	...
Errors and omissions, net	-.8	-.6	-1.2	-11.1	-3.8	...
Balance on official reserve transactions (excluding SDR allocations)	-2.5	-1.1	-2.4	-30.5	-11.0	-40.9

[1] Preliminary.
[2] Preliminary estimates.
[3] Excluding transfers under military grants.
[4] Excluding undistributed earnings of subsidiaries.
[5] Excluding military grants. Including nonliquid liabilities to other than official reserve holders.
Note: Details may not add to totals because of rounding.

TABLE 2.—U.S. MERCHANDISE TRADE, 1970–73

[In billions of dollars a year; balance-of-payments basis]

Period	Exports: Agricultural	Exports: Other	Exports: Total	Imports: Fuels	Imports: Other	Imports: Total	Trade balance
Years:							
1970	7.3	34.6	42.0	3.2	36.6	39.8	+2.2
1971	7.8	35.0	42.8	4.0	41.5	45.5	−2.7
1972	9.5	39.4	48.8	5.1	50.6	55.7	−6.8
Quarters (at seasonally adjusted annual rates):							
1971:							
I	8.3	35.2	43.5	3.1	39.8	42.9	.6
II	7.8	35.4	43.2	3.9	42.9	46.8	−3.6
III	8.5	37.6	46.1	4.3	43.4	47.7	−1.5
IV	6.6	31.7	38.3	4.6	39.9	44.5	−6.1
1972:							
I	8.9	37.8	46.6	4.7	49.3	54.0	−7.3
II	8.8	37.5	46.2	4.9	48.5	53.4	−7.1
III	9.6	39.9	49.5	5.5	50.1	55.6	−6.1
IV	10.8	42.2	53.0	5.4	54.3	59.7	−6.7
1973-I [1]	15.2	46.2	61.4	6.6	58.4	65.0	−3.7
April [1]	(16.2)	(49.0)	(65.2)	(6.7)	(56.4)	(63.1)	(+2.1)
January-April 1973 [1]	15.4	46.9	62.3	6.6	58.0	64.6	−2.2
Percentage changes from:							
6 months earlier (percent)	52	14	22	22	11	12	....
12 months earlier (percent)	62	19	28	30	15	16	....

[1] Preliminary.

TABLE 3.—PRIVATE CAPITAL FLOWS

[In billions of dollars; (−) equals capital outflow]

	Annual averages 1963-66	Annual averages 1967-70	Annual 1971	Annual 1972
Private capital, net	−3.1	+.7	−14.2	+2.2
Long-term, net	−3.7	−.8	−4.1	+.1
U.S. capital	(−4.1)	(−4.8)	(−6.3)	(−5.4)
Direct investments abroad	−2.9	−3.5	−4.8	−3.3
United States purchases of foreign securities	−.8	−1.2	−.9	−.6
Other	−.5	−.1	−.7	−1.5
Foreign capital	(+.4)	(+4.0)	(+2.3)	(+5.5)
Foreign direct investments in United States	....	+.6	−.1	+.3
Foreign purchases of U.S. securities	+.2	+2.7	+2.3	+4.5
Other	+.2	+.8	+.1	+.7
Short-term, net	+.7	+1.5	−10.1	+2.0
U.S. capital	−.6	−1.0	−3.4	−2.9
Foreign capital	+1.3	+2.5	−6.7	+5.0

Note: Details may not add to totals because of rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, "Survey of Current Business," June 1972 and March 1973.

Senator BYRD. I think we should follow the 10-minute rule on questioning. I have a few questions and then I will yield to Senator Dole.

Governor Daane, the gist of your statement, as I read it, is that we have passed the critical point and the two devaluations of the dollar will restore equilibrium to our international trade and payments position. Has the Federal Reserve Board done any actual or factual studies to support this thesis?

Mr. DAANE. Mr. Chairman, I really do rest my case on the data that we have in hand and on our staff's analysis which seems consistent with that of other staffs with respect to the trends, particularly on our trade account. So that in answer to your question, I would say, yes, this represents not just a horseback judgment but a serious attempt to make an in-depth analysis of our payments position, and particularly, of our trade account. But, as I emphasized at the outset, no one can be sure of these things in terms of precision and I would not want to attach that degree of precision to any of our looking ahead.

Senator BYRD. Well, you seem to suggest that the dollar devaluations were a healthy thing for the international economy. What effect will the devaluations have on the role of the dollar as an international reserve?

Mr. DAANE. Well, Mr. Chairman, I pointed out that I believed that the present exchange rate pattern is a realistic and viable pattern of rates and certainly changes were part of this process of reaching a more realistic pattern. So that on the side of the imbalances that are attributable to the adjustment process, quite clearly the devaluations have played a part in that achievement. As to the status of the dollar as a reserve currency, this is one of the aspects that the committee of 20 in their work on international monetary reform is quite clearly looking at alongside of all of the other reserve assets. As you know, we have the special drawing rights. We still have a stock gold in the monetary system. And we have the reserve currencies, not only the dollar but other currencies.

And then there is a tendency to see some new reserve currencies emerge. So we are looking in our work on international monetary reform at the status of these various reserve assets and, quite clearly, there will be a diminished role—and, in our judgment, there should be a diminished role—for gold as a reserve asset in this process, as we look ahead. And there quite likely will be a diminishing role, although a continuing role, for reserve currencies such as the dollar.

Senator BYRD. So the role of the dollar as a reserve currency is diminishing and you would expect that it would continue to diminish?

Mr. DAANE. As I say, Mr. Chairman, we are looking at the question of what should be the role of these various reserve assets.

Senator BYRD. I know that.

Mr. DAANE. Including the dollar. And there is a reasonable expectation that there will be a somewhat diminished role or a diminished role for the dollar——

Senator BYRD. But there is a diminished role, now, isn't there?

Mr. DAANE. Pardon?

Senator BYRD. It is already a diminished role so far as the dollar is concerned?

Mr. DAANE. Well, in terms of the dollar holdings in reserves of foreign currencies, I am not so sure you can make that case but in terms of the spirit and attitude, probably, yes.

Senator BYRD. That is what I was speaking of. Devaluation in itself is not a solution to our problems, is it?

Mr. DAANE. No; I indicated that it was an integral part of the adjustments that were achieved since 1971.

Senator BYRD. Yes.

Mr. DAANE. I think looking ahead quite clearly there is no solution to be found, no further solution to be found in any way, shape or fashion by a devaluation of the U.S. dollar. The solution, as I tried to point out here, the solution is in terms of capitalizing on the new realistic rate structure and on resolving our persistent inflation problem both for domestic reasons and certainly for reasons associated with our balance of payments.

Senator BYRD. I was in Germany and England during the Easter recess and talked to a great many people and my impression is the second devaluation of the dollar, let's say, shook the people up very much over there, shook the business community, the financial community.

Mr. DAANE. As one who travels abroad, it shook me up a bit, too, when I had to pay those prices, Mr. Chairman.

Senator BYRD. I am speaking of the European business community and the European financial community. Is that the information that you have that the second devaluation had an adverse impact?

Mr. DAANE. I am not sure that that is right entirely, Mr. Chairman. There was a feeling about it in terms of some of the countries that it was not feasible to include in the negotiations, given the limitations of time, to the extent we would have preferred.

Senator BYRD. Did it not tend to——

Mr. DAANE. But in terms of the countries that were involved in the negotiation—and it was a negotiation—in terms of achieving these exchange rate changes which involved, of course, Western Germany, which involved the patterns established with respect to the floating rates in the various countries, this was a negotiated package and not a unilateral action on our part.

Senator BYRD. But did it not tend to diminish confidence in the dollar?

Mr. DAANE. Well, we have seen some reflows of dollars since then, Mr. Chairman. In fact, reflows in size.

Senator BYRD. Do you anticipate a third devaluation?

Mr. DAANE. No, as I said a moment ago. I certainly not only do not anticipate it but I see absolutely no benefit in thinking along these lines.

Senator BYRD. But if I had asked the same question 6 months ago about the second devaluation, I would have gotten the same answer, would I not?

Mr. DAANE. Central bankers have a tendency, I believe, as do ministers of finance, Mr. Chairman, to, of necessity, take a position of that sort, but I can say in sincerity to you, that I really see neither prospect nor profit in any talk of, or in any thinking about, a further devaluation of the dollar.

Senator BYRD. But you didn't see that 6 months ago for the second devaluation?

Mr. DAANE. That isn't quite right either, if I may take the opposite position from you, respectfully, sir. If you recall, going back to the Smithsonian agreement of December 1971, the United States argued—

and I was part of the U.S. team in putting this forward—the United States argued that it was clear to us from our studies, in part done by the esteemed gentlemen accompanying me today, that it was clear from our studies, not only at the Federal Reserve, but at the Treasury and throughout the administration, that we needed a swing in our trade balance of around $13 billion. The Smithsonian agreement with respect to rates, quite clearly did not accept that thesis of the United States. It brought about a major change—major changes—but the best guess—although I wouldn't want to put too much credence in a single figure—but the best guess was that it probably produced a change in rates that would yield a sum of improvements totaling around $8 billion. So the Smithsonian agreement, in and of itself, did not meet our perspective with respect to the magnitude of the swing that was needed.

As you know, a part of the swing accomplished as a result of the agreements at that meeting was subsequently reduced by the British action with respect to their rate. So, Mr. Chairman, had you asked me somewhere in between Smithsonian and now, do you see any need for further adjustment, not necessarily the United States, but do you see a need for further adjustment in exchange rates, I would have answered, well, we did not get a fully satisfactory pattern of rates at the Smithsonian.

Senator BYRD. It was hailed as one of the great monetary conferences of all times.

Senator MONDALE. Great?

Mr. DAANE. It was a very great achievement. My whole life has been in this area and we had not ever had a multilateral agreement with respect to specific exchange rates. It did result in substantial changes in exchange rates and, Mr. Chairman, whenever you talk about exchange rates in an upward direction, you are talking about something that is politically very difficult for the revaluing countries. So that I think that it is quite correct to say that this was a substantial effort and a substantial result. But it wasn't clearly in retrospect and, at least, in terms of the United States proposal at the time, it wasn't enough and now we have gone through another change in exchange rates and, in the best judgment I can give you, we have accomplished a realistic pattern of rates.

Senator BYRD. Just one additional question and then my time will be up and I will yield to Senator Dole.

You mentioned, in your statement, a tightening of credit. This would be translated, I assume, into high interest rates, would it not?

Mr. DAANE. Well, Mr. Chairman, we have been tightening credit in a moderate and a responsible way for quite some time, as you know, and we have continued down this course. During that period that we have tightened credit, you could go back to March of 1972, if you wanted to take one point of departure, quite clearly, interest rates, particularly in the short end of the market, have risen substantially.

In terms of the longer interest rates, there has been relatively little increase in rates, but there has been some. But the real principal increase in interest rates has come in the short end rather than in the long end of the market, but there, inevitably, has been along with our tightening and along with the quickening of business activity a rise in interest rates.

With respect to tightening: We also have seen a substantial slowing of the growth of our monetary aggregates and, specifically, of the money supply. If you take, for example, the narrowly defined money supply, it has been growing this year at a rate just slightly above 3 percent compared to a rate of over 8 percent in the whole of 1972. So that we have been trying to bring about a slower growth in the monetary aggregates. We have been not trying to bring about, but have accepted, the inevitable increase in interest rates that go along with that. And since we felt that the sort of critical area here at the moment was in terms of business spending, we took an action earlier this month directed specifically toward the large banks increasing their cost of funds, aimed at slowing them down in terms of their extensions of credit to business, and, in fact, we are seeing a slowing down in bank credit expansion.

Senator BYRD. I am not expressing criticism of what has been done. I am just saying—well, you said it better than I did; that an increase in interest rates was inevitable, I think you used the term.

Mr. DAANE. An inevitable part of the process of the kind of booming economy we have had along with the fact that the monetary authorities were trying to exercise restraint, yes.

Senator BYRD. Thank you.

Senator Dole?

Senator DOLE. I note in your statement that you refer to a recent improvement in the trade balance, and you indicate that much of this recent improvement reflects an exceptionally large bulge in agricultural exports. But you go on to say "which is likely to prove temporary."

We hear from Secretary Butz and others that the farmers have almost reached the promised land, and that exports will continue to expand and increase. In fact, we are about to take up in the Senate a farm bill based on that promise; that is, that there will be a strong demand for exports and exports will increase. We are talking about hard exports for dollar sales. What evidence do you have that indicates the export increase of agricultural products may only be temporary?

Mr. DAANE. Well, I don't claim, Senator, to be an expert in the agricultural area, but I would call your attention to table 2 in the material which I gave you, which shows the tremendous percentage rise in our agricultural exports.

Senator DOLE. Is that because of the Russian sale?

Mr. DAANE. And we have some special factors—pardon?

Senator DOLE. Is that because of the Russian wheat sale?

Mr. DAANE. It does include the Russian wheat sale in that time period that accounts for it, and again the best expectation of those who are closer to this problem than I am—and I won't debate here with the Secretary of Agriculture—but the people on our staff who have stayed closer to this aspect of our exports, do not anticipate that they can hold at the April level that you see in table 2, a level of over $16 billion of agricultural exports compared with the level over the years 1971–72 running from $6 billion to $8 billion, or maybe $9 billion. So it does look exceptionally high.

Senator DOLE. What if the exports were $10 billion or $12 billion?

Mr. DAANE. That would still be a very strong export pattern, and, again, I won't pick a figure here. I don't know enough to pick a figure for you, but all I am saying, again, my best advice and best judgment is that it will back down from the current levels. Now, what it backs down to, I don't know. It could still be a very strong export figure, so these positions might not be inconsistent.

Senator DOLE. How do we explain to those who make inquiries the very sharp rise in the price of gold? I don't know what the record high is—what it is today—but when we had during a 6-month period about a 100-point drop in the stock market, and I think in mid-May gold was $116 an ounce, is that construed to be a rational behavior, or is it a deliberate attack on the American dollar? How do we reconcile those two happenings?

Mr. DAANE. Well, Senator, this is not a question capable of a quick answer.

Senator DOLE. I don't know if you can answer it at all. I tried to answer it.

Mr. DAANE. Well, I will try to capsulize it a bit. When you talk about market psychology—and I have been a career man in the Federal Reserve from my early days back in Richmond, Va., back in the late 1930's, and I learned long ago that you can't really find a rational explanation at all times for market behavior, if you can at any time. So what you are seeing here is a market phychology that has driven up the gold price to the present astronomical level, and I can't give you all of the factors of the market's view of this.

The price this morning was $111.50. The chairman says that the gold has a relationship to the Richmond beef price. Well, one relationship I can readily see there is the fact that both are commodity prices, and that the commodity price of gold is one in which the people like to speculate. And there is a considerable speculative demand that has forced that price up for reasons that I really can't give you inclusively, because it is a matter of psychology. But I do think we can overplay the significance of a rise in the price of gold. The Central Bank Governors and the Finance Ministers, as you know, in March of 1968——

Senator DOLE. Excuse me. Is there any relationship——

Mr. DAANE [continuing]. In March of 1968 took a different position and, in effect, set up two different markets so that the gold market is a commodity market. The longer run forecasts are for a demand curve that outruns supply, but the present price is quite clearly not related to that sore of basic analysis, so——

Senator DOLE. Excuse me, does that reflect——

Mr. DAANE [continuing]. So it is a market psychology factor, Senator.

Senator DOLE. Does that reflect a loss of confidence in the dollar? Is that it?

Mr. DAANE. Well, how much of it relates to the foreign view or other view of the dollar and of our ability to resolve our inflation problems, the kind of general unsettlement with respect to the exchanges, the seeming slowness of progress in international monetary reform, I don't know. As I said at the outset, Senator, I long ago learned that to try to analyze market motivations is not very fruitful.

Senator DOLE. Well, if it continues to stay at what some consider it to be a ridiculously high price, should we do anything? Should we sell some of our gold at this high price and announce we will never buy it back, or should we do nothing?

Mr. DAANE. Well, I would think at the moment that we ought to do nothing. We have had under consideration again in the Group of 20, as I said a moment ago, the role of the various reserve assets, and gold is one of those, and there are a number of possibilities one could conceive of. One possibility is to, at some point in time, change this present arrangement which is an international understanding that keeps the central banks from doing what you suggested a moment ago, Senator. The central banks have made an agreement not to either buy or sell gold. Conceivably, at some point in time that arrangement could come under review again to see whether that is the wisest policy, but in answer to you, taking it as of this moment in time, I would say you wouldn't want to do anything.

We can't unilaterally, because it involves an international agreement, and it is part and parcel of the look we are taking at the role of these very reserve assets, and you wouldn't want to get out ahead of the considered work and the kind of orderly approach to these problems that is now going on.

I think I would volunteer that this applies as well to the present proposal with respect to U.S. citizens holding gold. Quite clearly, this is consistent with the U.S. position that over time, we want to phase out gold from the monetary system, just as your proposal would. It is consistent with our basic approach and philosophy regarding the role of gold in the system over time. But is quite clearly would be premature both in terms of the orderly consideration of the role of gold that is part and parcel of our monetary reform exercise that we are working on very hard. In addition to what I said, it would immediately aggravate, to put it mildly, our balance-of-payments problems, should U.S. citizens charge forward to buy gold.

Senator DOLE. Well, do you see any relationship between what some refer to as the energy crisis and what other refer to as the monetary crisis, and, in particular, based on the fact that four of the countries along the Arabian Peninsula may have by 1980, $100 billion, which would have a great impact on economics everywhere in the world?

How do we propose to deal with that problem, or is there a relationship.

Mr. DAANE. Well, again, I am not an expert on the energy problem. I would refer you to the Treasury on that, but I will make the comment—and, again, I would like to ask you to take a look with me, if you would, sir, at table 2, to try to put this thing in perspective in terms of our immediate balance-of-payments problem. I have taken a cautiously optimistic view of our trading progress and prospects, and I have done it against the background of a full recognition, at least I hope it is a full recognition, of what is happening here with respect to our imports of fuel. If you look at the figures, you will see that while there has been a rise in the dollar expenditure on imports of fuel—and this is in table 2, and I am looking at the first column under "Imports"—while there has been a rise, it hasn't been of the kind of dramatic magnitude that seems to be showing through in some of the press comments and other comments with respect to this problem. That has not kept us from having a sizable surplus in April on the trade account. It should not keep us from developing the pattern of surplus, of looking forward to a substantial trade surplus. And again I wouldn't want to pinpoint the precise moment in time.

Senator DOLE. Well, it has been suggested that figure might reach $25 billion.

Mr. DAANE. This figure for energy imports can go on up over time, yes. These are longer range forecasts, but in making an allowance for an increase in this figure on the best basis that our staff can do it, we still come up with substantial improvement on our trade account, the one we are experiencing now. So that I think one has to keep this problem in perspective. At the same time I do think it is a problem and it does relate importantly to the monetary system in that these countries will be earning reserve currencies in dollars, in particular, in substantial amounts, and where they invest those dollars is of significance to the system. So that I would both, in a sense, minimize it by saying it is not the be-all and end-all of our trade picture by any means, but, at the same time, it does have an important monetary aspect in terms of the flows of funds in the direction of those flows, as these countries earn substantial dollars in the period ahead.

Whether or not the figures are right, it will be substantial. That is quite evident.

Senator DOLE. Thank you, Mr. Chairman.

Senator BYRD. Senator Roth?

Senator ROTH. Based on your predictions for balance-of-trade figures, can you give me some idea of what we can expect our position will be with respect to fuel? Your chart on table 2 only goes up to 1973. What do you think it will be by the end of this decade? An accurate estimate would certainly help us here in the Congress in our consideration of various proposals to help solve the energy crisis. I just wondered what your opinions are.

Mr. DAANE. Well, I would be reluctant, Senator Roth, without looking into it more precisely, to give you a figure sitting here. No can, I suppose, submit for the record some indicated range, but I would be skeptical of any precise figures in this area. As I say, our staff did attempt to take into account the rise in expenditures here in their looking ahead at the likely result with respect to our trade surplus and it does not seem to us that this will inhibit or prevent a development over time of a substantial trade surplus.

Senator ROTH. With the approval of our chairman, could we have the benefit of your staff's work in this area. This is a critically important problem, and I am pleased to see your optimistic forecasts. Certainly much of the legislation that is coming before the Congress will have to be based on judgments such as yours and I think it would be most helpful if we could have included in the record at a later time the results of your staff's study.

Senator BYRD. That would be most helpful to the committee. Would that be satisfactory, Governor?

Mr. DAANE. Yes. We will try to get some indication of the magnitude that we see ahead of us here in a very rough way, but I wouldn't put any strong emphasis on the precision of these figures. We will take a look at it, Mr. Chairman, and if we can come up with anything that might be useful, in increasing and improving perspective in this area, we will certainly do so.

[Mr. Daane subsequently supplied the following information:]

Some Implications of Growing U.S. Imports of Petroleum

In order to meet its growing requirements for energy over the next decade, the United States will have to import increasing quantities of petroleum and petroleum products. Most of the increase will have to come from petroleum-exporting countries in the Middle East and Africa, where two-thirds of the world's proven reserves are located. Many of those countries have small populations and limited capacity to absorb imports, so that their sharply rising export earnings will lead them to accumulate very substantial reserves of foreign exchange.

The question arises whether either of these developments—the rapid increase in U.S. oil imports, and the accumulation by a few countries in the Middle East and Africa of large financial reserves—is likely to cause difficulties for the U.S. balance of payments and the U.S. dollar in the years ahead.

Large figures are sometimes cited as *prima facie* evidence of trouble. For example, it has been estimated that the value of U.S. imports of petroleum and products could be as high as $25 billion a year in 1980. It has been estimated that foreign assets of Arab countries could approach $100 billion by that date. Both figures seem well within the limits of possibility. But neither is evidence by itself of impending difficulty for the U.S. balance of payments or the U.S. dollar. Other relevant magnitudes will also be rising over the period.

It should be noted, first, that not all of the increase in U.S. payments for oil imports will constitute a net drain on the U.S. current account balance. There will be substantial offsets in the form of increased U.S. exports to those oil-producing countries that do have sizable populations and development needs. There will be further offsets in the form of increasing earnings by U.S. petroleum companies engaged in foreign operations, and a reduced need for U.S. financing of the future expansion of the industry.

Second, those oil-exporting countries that do add very substantially to their foreign assets over the decade will be seeking secure and profitable investment outlets for these funds. It seems likely that a substantial portion will be invested in the United States, which has a large, open, and diversified capital market. Thus any net worsening of the U.S. current account balance that does result from rising oil imports could well be largely or entirely offset by rising inflows of capital.

Third, other industrial countries in Europe and Japan will also be increasing their oil imports. They are, and will remain, much more dependent than this country on rising oil imports to meet their growing needs for energy. If balance of payments difficulties should result from rising oil imports, such difficulties are apt to be at least as great for other industrial countries as for the United States, so that no weakening of the dollar against other leading currencies would neecssarily result.

All this is not to suggest that there will be no problems. There may well be difficulties in persuading the oil-producing countries to increase their production sufficiently rapidly to meet the needs of industrial countries. There may well be disagreements with regard to petroleum prices, and increased participation by the producing countries in the management of, and profits from, petroleum production and marketing. Environmental questions will continue to arise in connection with the building of new ports and refineries. The form which long-term investment of oil countries' funds should appropriately take, and the mechanics of handling such large investment flows, will need to be worked out.

Over the long run, much will depend on the progress made in industrial countries in developing alternative sources of energy, and in conserving the use of energy. These are pressing problems, since the world's resources of petroleum will not suffice indefinitely to meet growing needs for energy. But meanwhile, it is not at all clear that petroleum imports need cause insurmountable balance of payments problems for the United States.

Mr. Daane. As I indicated at the outset, however, I think this energy problem is within the administration and hands of our very able colleagues at the Treasury, and they may be able to give you a better reading on their particular outlook than we can.

Senator BYRD. But it is a matter of great concern to the Federal Reserve Board, I would think.

Mr. DAANE. Yes, it is.

Senator BYRD. And the Federal——

Mr. DAANE. And obviously we are not oblivious to it, and, as I repeat again, we try to make a fair allowance. Within the limits of our own knowledge in this area, we tried to make an allowance as we looked ahead on the impact on our balance of trade. And on that impact, I think, is easy to exaggerate.

I am more concerned, frankly, in terms of fitting it into our system; that is, the reformed international monetary system will have to take into account the disequilibrating flows, and take into account the magnitude of the possible flows from this particular source.

Senator ROTH. Well, I would appreciate your shedding some light on this situation. It can't be taken categorically.

Back to your statement of cautious optimism. Are there any danger signs, any storm signals, that we should be watching for during the next several months?

I recall the time that we moved from phase 2 to phase 3, when many economists, both in and out of Government, were optimistic about the state of the economy. Now things don't look so good. Being a bit pessimistic for a moment, what are the danger signals you see today in our international situation?

Mr. DAANE. Well, I think it is a little difficult to do that. Again, Senator, I think we were a bit caught by surprise by some of the suddenly erupting storm signals early on in this year.

From long experience with the foreign exchange markets, and our domestic financial market, I find it very difficult to be responsive and say, well, you can look here for a warning signal and my cautious optimism was based on a trend analysis. It relates importantly to four areas. You could look at those four areas for possible warning signals. The first and most important area is our inflation prospect. Now our expectation is that there will be an improvement in terms of a more sustainable growth rate for our economy and a diminution of price pressures that would accompany that more sustainable rate of growth. So this is a general area where one would want to be sure that we are going to be on course. And a second area, again, as I have pointed out, is the area of our businesses taking advantage of the cost-price structure, here and abroad. Our price structure is relatively better.

It is important that businesses not turn inward and look only at their domestic markets even though that is a very natural phenomenon. Again, this is an area where we need to see more concrete progress and this is a general area where I would be watching to see if we are making real progress. And a third area is in the area of what foreign countries are doing. I have mentioned they have shown some willingness to cooperate in bringing about the adjustment, but if they turn inward and begin to erect more controls and more nontariff barriers or whatever, again, this is a warning to us.

Finally, if we stumble and seem to be drifting in terms of accomplishing a restoration of a durable international monetary system—I have the feeling, based on my recent work and our prior work, that we are making some progress in this area, but slippage is possible, and this is another area for caution in a general sense. But if you are looking for specific storm signals, Senator, specific warning signals, it is very difficult.

Senator ROTH. Is there anything that Congress should do to prompt businessmen to take advantage of new competitive opportunities?

Mr. DAANE. Well I am not, really, Senator, enough of an expert on the tax side to know if there is anything fruitful in that area for consideration. I can say that, in general, where I have listed the inflation problem as directly relevant, whatever we can do to maintain a fiscal posture of balance or maybe even a slight surplus against the sort of overheated or overpressed economy that we have is quite clearly useful. But I would not want to suggest specific measures.

Now you do have before the Congress, I believe, some proposals for budgetary control and there are some encouraging signs that Congress is trying to improve its control over the budget. There we would welcome the report of your Joint Study Committee on Budget Control, and further congressional attention to the whole matter of our fiscal stance, our budget control, and its relationship to the thrust of policy against inflation—where quite clearly we don't want to count on simply one instrument. These questions are within the purview of the Congress, and I would not have the temerity to make any specific suggestions, Senator.

Senator ROTH. Thank you. My time is up.

Senator BYRD. Senator Mondale?

Senator MONDALE. Has the Federal Reserve made a study of what interests speculating against the dollar helped to cause the two devaluations?

Mr. DAANE. Well, it is pretty hard to get precise figures, Senator.

Senator MONDALE. Well, have you tried?

Mr. DAANE. Senator, we have made some inquiries of commercial banks as to their activities. These inquiries or results are both revealing and nonrevealing. They are still not complete. I would be glad to furnish the results of these inquiries to the committee, Senator, when we do get the results. They wouldn't be precisely what you are asking about, though, because all they will show is some of the increased flows, it is difficult to sort out the so-called purely speculative from other flows.

Senator MONDALE. Well, I don't wish to be limited to the question of speculation. That is considered a loaded term. But what interests were swapping U.S. dollars for other currencies during the periods leading up to the two devaluations?

Mr. DAANE. We are looking into this insofar as the flows were from the United States—and the flows were quite clearly not all from the United States in this sort of speculative flurry. We talked a moment ago about the gold increase, Senator, which is a market price, a commodity price. In those markets subject to the buying, a lot of that, I suppose, goes through Switzerland as a pass through, but who is doing it is just very difficult to get at.

Senator MONDALE. And there is no way of finding that out?

Mr. DAANE. Well, I will ask my colleagues here with me, to give you the best information we have but it won't really be conclusive, Senator. We just simply can't find out. The flows are of a magnitude and nature that is impossible to sort out totally.

And my colleague reminds me that almost everyone who can hedge in a speculative situation like that. Businesses do it and——

Senator MONDALE. But I am not passing a value judgment, Mr. Daane. I would just like to know who is doing it and how much on the grounds that it might be instructive.

Mr. DAANE. It is a very valid question, Senator, and we had the same feeling ourselves. And, as I indicated, we did undertake some inquiries of commercial banks, which is our real link to this process. Insofar as those inquiries reveal anything useful, I will be happy to share it with you. We haven't completed those inquiries. We had the same question in our own minds as to who was doing this and how much was from U.S. sources and so on.

Senator MONDALE. The American consumer will be paying billions of dollars in increased costs for imports, not just petroleum, although that has risen spectacularly, but I mean in other areas, as well. And much of it is stemming from the devaluations, from the two dramatic devaluations of the American dollar. And unless our assumption is that those devaluations were inevitable and flowed entirely from innocent market forces, then aren't we drawn to the conclusion that we had better make a very complete and intensive study to the extent that data is available to find out who is doing it and whether there are not other protective measures that we should take in addition to the floating, to what I gather is a fairly clean float now, to make certain that we don't get visited with another one of these disasters?

Mr. DAANE. Well, yes, Senator. However, I think one needs to distinguish two things here, and I think that insofar as these massive speculative flows upset the international monetary system and as they had an adverse consequence, then quite clearly, we want to know all that we can about those flows. We are, within the range of our own capabilities, trying to find out what we can. But I would not want to accept the inference that, in effect, it was the speculation that led to the devaluations.

Senator MONDALE. You keep bringing it up that it was the speculations that caused this. I tried to find out who it was who was doing it——

Mr. DAANE. I know, Senator. I know that, but I simply want to say for the record, however, that I take back any inference, for the record, that the devaluations related simply to speculation. I say, for the record, that the devaluations related to the fundamental imbalances in trade and payments rather than simply a response to "speculation."

Senator MONDALE. In other words, it is your judgment that the swing in the value of the American dollar as against other currencies is almost totally the product of innocent market forces?

Mr. DAANE. Yes; that is probably a better way to put it; that is to say, that this swing is justified by market forces and by market relationships in the basic sense. And, as I said, our best analysis, the United States best analysis of our trade relationships and our balance-of-payments position in the fall of 1971 indicated a need for a swing.

Senator MONDALE. Is this the first devaluation you are talking about?

Mr. DAANE. Before the Smithsonian, yes.

Senator MONDALE. And did you feel the need for the second one, then?

Mr. DAANE. And at that time, our analysis indicated quite clearly—and you can go back over the record—it indicated quite clearly that the swing to be accomplished would involve a change in rates and here the changes, as you understand, Senator, can come from either side of this equation; the changes can come on the part of foreigners and the changes can come on the part of the United States.

Senator MONDALE. Or both?

Mr. DAANE. Or both. In fact, with the Smithsonian it was both. And, more recently, it was both, so all I am saying is, as we viewed the magnitude of the problem and leaving aside this kind of flow of speculation, we had a basic imbalance that led to the devaluations, rather than it simply being a response to speculators in the gold market, if that is the way you put it.

Senator MONDALE. Well, did you think following the first devaluation that there was a need for the second devaluation to bring U.S. currencies into more realistic alinement based on the reality of their market values?

Mr. DAANE. Senator, the difficulty in all of this is to estimate with any precision. We thought that the amount of realinement to be accomplished, the amount of the needed swing in the trade sectors, Senator, was greater, but some very knowledgeable people, not just our foreign friends, but some very knowledgeable in international organizations, thought we were setting our sights too high in terms of the amount of the swing that was needed. There was an honest difference of opinion.

So we went along with all that could be accomplished at that time with respect to exchange rate changes and then looked for the "proof of the pudding." I think the proof of the pudding is that we needed more.

Senator MONDALE. You say you are undertaking a study of the operation of the banks, the U.S. banks in the two devaluations. Is the executive branch, to your knowledge, doing a study of the role, say, of the multinationals, not just U.S. companies but others that might be involved, foreign companies and the rest in this speculation, or in transfer of money, in exchanging of money so that we might get a definition and an analysis of how truly innocent these matters are?

Mr. DAANE. If I may, Senator, I would like to ask Mr. Bryant, who is working with the other parts of the administration on this, to answer.

Senator MONDALE. All right.

Mr. DAANE. He is working on the problem of collecting what we can in the way of information, if he would care to respond?

Mr. BRYANT. Well, efforts have been made in the last few months to look again at the statistical reporting network and see if that can't be improved, both in the areas of transactions, and assets and liabilities, reported by banks and financial institutions and by the large corporations.

Senator MONDALE. Are you getting responses now?

Mr. BRYANT. Well, we are just in the middle of doing that.

Senator MONDALE. How satisfactory are the responses?

Mr. BRYANT. I haven't seen any of the individual responses myself.

Mr. DAANE. We don't know that, yet, Senator.

Senator MONDALE. Who has seen them?

Mr. BRYANT. I am not sure whether the responses are actually in. I mean, my knowledge of this is the kind of questions we were asking, what further information we were hoping to get, how we could improve the reporting forms.

Senator MONDALE. Could we have a copy of this study when it is done?

Mr. BRYANT. Well, we are not conducting the study ourselves.

Senator MONDALE. Who is?

Mr. BRYANT. The Treasury Department and the Commerce Department.

Senator MONDALE. The Treasury Department is conducting a study?

Mr. DAANE. Treasury and Commerce, Senator, are jointly engaged in this project. I don't myself know how far along it is in terms of the answers. We can find out.

Senator MONDALE. Would you submit that for the record?

Mr. DAANE. Yes, or could you ask Mr. Bennett when he is up here testifying next week?

Senator MONDALE. Well, maybe if your staff man could explain what is the structure of that study we would appreciate it.

Mr. DAANE. Yes, that we can certainly do.

[Mr. Daane subsequently supplied the following information:]

INTERNATIONAL FLOWS OF FUNDS PRECEDING THE ANNOUNCEMENT ON FEBRUARY 12, 1973, OF THE DEVALUATION OF THE U.S. DOLLAR

When large international flows of funds occur during periods of extreme uncertainty in foreign exchange markets, as in late January and early February 1973, it is always difficult to identify the transactors and their motives. A large proportion of such flows usually represent changing leads and lags in ordinary commercial payments are importers and exporters accelerate or delay payments. Some transactions through U.S. banks can be identified and transactions of large corporations are regularly reported; but a large residual typically shows up as "errors and omissions" in the balance of payments accounts.

The Federal Reserve has reviewed the outflows of funds through U.S. banks during the period immediately preceding the announcement on February 12 of the devaluation of the U.S. dollar. Its review was based on (a) regular statistical reports by U.S. banks (including U.S. agencies and branches of foreign banks), and (b) a special survey of 13 international banks that account for more than 60 percent of the foreign assets reports by U.S. banks under the Voluntary Foreign Credit Restraint program, and for the bulk of foreign exchange dealings for commercial customers by U.S. banks.

The regular statistical reports show an increase in banks' foreign loans (together with the foreign assets of the U.S. agencies and branches of foreign banks) of about $2 billion during the three week period ending February 14, and unpublished data show a roughly equal volume of withdrawals of balances held at banks in the United States (including agencies and branches) by commercial banks abroad (including U.S. bank branches) and other private foreign residents. These outflows, recorded in banking data, total $4 billion and account for about one-half of the U.S. payments deficit during the three-week period. (The deficit for this period, at about $8 billion, was almost as large as the deficit of $10 billion recorded for the entire first quarter.)

The principal conclusions of the special survey of 13 international banks are:

(1) Shifts in the banks' own foreign exchange positions and those of their foreign branches represented only a small part of the total increase in demand for foreign currencies in the period in question. The banks reported a total shift in their foreign currency positions against the dollar of less than $460 million in the 3 weeks ending February 14. More than half of this shift was in the positions of foreign branches. Changes in head office positions were thus very small, and in good part the shift in head office positions reflected the elimination of a short position in foreign currencies rather than the build-up of a long position in foreign currencies.

(2) Foreign and U.S. commercial corporate customers' gross purchases of foreign exchange (spot and forward) from the banks and their foreign branches increased significantly from a level that was already high by historical standards. In the 3 weeks ending February 14 these customer purchases were about

$600 million greater than in the preceding 3 week period—about $2 billion against $1.4 billion. About two-thirds of the estimated gross purchases by customers were from head offices, and one-third from foreign branches.

Changes in banks' foreign exchange positions, as reflected in the survey results, were clearly very small in relation to the increases in banks' foreign credit and reductions in foreign interbank balances with U.S. banks that occurred in the period.

In major part, the outflows through banks (increases in banks' foreign dollar assets and decreases in dollar liabilities to foreigners) reflected transactions initiated by commercial concerns and others abroad who during this period reduced their dollar assets or increased their dollar liabilities. Such shifts may have reflected speculation, but they would also occur as normal hedging operations, as banks' customers sought to cover previously unhedged foreign currency positions, and there is no ready way for the Federal Reserve or for the U.S. banks to distinguish between the two types of transactions.

In addition to capital flows that are recorded in these banking sources there are others between U.S. residents and foreigners that may be recorded in other ways, or may escape statistical reporting systems. For instance, they may have been large flows directly between U.S. firms and their foreign affiliates, or between foreign home offices and their U.S. affiliates, but data on such flows will not be available until first quarter reports for the balance of payments are tabulated later this month. The U.S. Treasury and the Department of Commerce, with assistance from our staff, are making efforts to determine whether major types of financial transactions that occurred during this period are accurately recorded in our regular statistical reporting system. Attached is a letter from the Secretary of the Treasury and the Secretary of Commerce to presidents of business firms in the United States asking them to ensure that their statisical reports for the first quarter of 1973 are as complete and accurate as possible.

Attachment.

U.S. DEPARTMENT OF COMMERCE NEWS,
OFFICE OF THE SECRETARY,
Washington, D.C., April 25, 1973.

NOTE TO CORRESPONDENTS.

Attached is a letter from the Secretary of the Treasury and the Secretary of Commerce to presidents of business firms in the United States which file regular statistical reports to one or both Departments for the purpose of compiling statistics on international capital transactions in the U.S. balance of payments.

The request is specifically designed to ensure that data reported within the existing statistical reporting system are as complete and accurate as possible, particularly for the first quarter of 1973.

It is hoped that the request will lead to a better understanding of the sources and nature of the unusual capital flows of recent months.

U.S. DEPARTMENT OF COMMERCE,
THE SECRETARY OF COMMERCE,
Washington, D.C., April 13, 1973.

The recent period of international monetary disturbances was accompanied by large movements of funds out of the United States and from the dollar into foreign currencies. While these flows of funds have aroused widespread public interest in this country and abroad, neither the United States Government nor the governments of countries which were the major recipients of these funds have adequate information concerning the nature of these movements. The 14-nation monetary meeting in Paris last month, in which the United States participated, announced the need to seek more complete understanding of the sources and nature of these large capital flows.

The established statistical reporting systems operated by the Department of the Treasury and the Bureau of Economic Analysis of the Department of Commerce are designed to obtain comprehensive data on international capital transactions in the U.S. balance of payments, and together provide reasonably adequate information under normal conditions. However, the extent of transactions in the balance of payments for which no data have been recorded—the so-called "errors and omissions"—indicates that many transactions escape the statistical system in periods when unusual flows take place. Because of the importance of an adequate explanation of the recent events, we are convinced that a major effort must be made to ensure that responses to the present reporting forms are thorough and accurate, and that the reporting system is properly designed.

We are asking you, therefore, to undertake a policy level review within your firm to ensure that the statistical data which are reported on the Treasury and Commerce forms for the first three months of this year are complete, consistent and accurate. They should reflect all of your financial relationships with foreigners, including those with your own foreign branches and subsidiaries or foreign parent or head office, except to the extent that the reporting exemptions apply. Please see the enclosed material for details.

Our primary objective is to ensure that the data reported for December 31, 1972 and the first quarter of 1973 in both the Treasury and Commerce data systems are as accurate and complete as possible, to enable us to analyze the movements which occurred during the first quarter. We believe the interests of the business community coincide with our own in establishing accurate information on recent flows. In addition, the review should, of course, produce continuing improvements in reporting. We would also like to be advised of any types of international capital transactions of your firm which do not fit into the categories provided in these forms, and which therefore are not reported.

We will appreciate it very much if you will give this matter your personal attention. We are sure you recognize the importance to the U.S. Government and to the business community of an objective and factual understanding of these capital movements.

Sincerely yours,

GEORGE P. SHULTZ,
Secretary of the Treasury.
FREDERICK B. DENT,
Secretary of Commerce.

Enclosure.

Senator MONDALE. Just one final question.

In your list of proposed remedies for inflation and balance of payments trade, you seem to come down hard on turning the credit screw and encouraging exports and the rest. What about tax policy or were you deliberately staying away from tax policy?

Mr. DAANE. Yes, Senator; I am not an expert in tax policies. I did give our view with respect to the importance of a fiscal policy and posture——

Senator MONDALE. Yes.

Mr. DAANE [continuing]. That would weigh in against the inflationary pressures which would point toward the development of balance or maybe even a slight surplus, but I deliberately refrained from trying to say how that should be achieved or where it should be achieved. It is being achieved in part, as you can see, in the reduction of the deficit projected and, well, I think the answer to you is, I don't think it is really my province to get into tax policy.

Senator MONDALE. Did I hear you earlier recommend that the Congress spend less?

Mr. DAANE. Pardon?

Senator MONDALE. Did I hear you earlier suggest that the Congress should spend less?

Mr. DAANE. No, I simply said that this area of fiscal policy, which involves both expenditures and the revenue side, is clearly within the purview of Congress, and I would hope that we would have a continuing policy that would help alongside monetary policy in getting at our inflation problem.

Senator MONDALE. What about defense and military aid? I noticed you didn't mention that and maybe for the same reason. What is your estimate of the total adverse impact—what is your estimate for the total military and foreign aid expenditures by this country in this fiscal year; foreign military aid and monetary expenditures overseas; what is your estimate?

Mr. DAANE. I guess I might have to submit this for the record, Senator, but looking at this table is something under $5 billion.

Senator MONDALE. Well, that couldn't possibly be correct——

Mr. DAANE. That is for military expenditures. Now, government grants are about $3.5 billion or something in that area.

Senator MONDALE. What about that, too?

Mr. DAANE. I don't—well, this table doesn't break that out. We can perhaps try to get a break out for you.

Senator BYRD. Would you submit for the record a breakdown of that?

Mr. DAANE. Well, we will try.

[Mr. Daane subsequently supplied the following:]

MILITARY TRANSACTIONS AND FOREIGN AID IN THE U.S. BALANCE OF PAYMENTS

Data on the balance-of-payments impact of U.S. military transactions and U.S. foreign grants and credits are regularly compiled by the Department of Commerce and published quarterly in the Commerce Department's *Survey of Current Business*. The data given in the attached Table 1 were abstracted from tables appearing in the March 1973 issue of that publication. Additional breakdowns of major U.S. Government transactions are given in another table in that issue, a copy of which is also attached.

These figures reflect essentially the measurable direct impact of these transactions on the balance of payments. They do not represent budgetary costs which, for related defense programs in particular, may be much larger and may have important indirect influences on our international competitive situation.

Attachments:

TABLE 1.—DATA ON FOREIGN MILITARY TRANSACTIONS AND U.S. FOREIGN GRANTS AND CREDITS APPEARING IN THE U.S. BALANCE OF PAYMENTS

[In billions of dollars; payments (−)]

	Total		Western Europe		Other areas	
	1971	1972	1971	1972	1971	1972
Military transactions, net	−2.9	−3.5	−1.1	−1.7	−1.8	−1.8
Direct defense expenditures	−4.8	−4.7	−2.0	−2.2	−2.8	−2.5
Transfers under military agency sales contracts	1.9	1.2	.9	.5	1.0	.7
Transfers of goods and services under U.S. military grant aid programs [1]	(3.2)	(4.3)	(.3)	(.2)	(2.9)	(4.1)
U.S. Government grants and credits, net	−4.4	−3.6	−.3		−4.1	−3.6
U.S. Government grants (excluding military)	−2.0	−2.2	([2])	.1	−2.0	−2.1
U.S. Government capital flows, net	−1.9	−1.6	.1	([2])	−2.0	−1.6
Certain nonliquid liabilities	−.5	.2	−.4	−.1	−.1	.3

[1] No net direct balance-of-payments impact.
[2] Less than $50,000,000.

Source: U.S. Department of Commerce, "Survey of Current Business," March 1973.

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TABLE 5.—MAJOR U.S. GOVERNMENT TRANSACTIONS

[Millions of dollars]

Line		1971	1972 p	1971 I	1971 II	1971 III	1971 IV	1972 I	1972 II	1972 III p	1972 IV p
A. 1	U.S. Government grants (excluding military) and capital flows increasing Government assets, total (table 2, lines 30, 34, and 35, with sign reversed)	6,041	5,860	1,644	1,741	1,227	1,429	1,433	1,516	1,294	1,617
1a	Seasonally adjusted		....	1,611	1,595	1,383	1,453	1,400	1,370	1,450	1,640
	BY CATEGORY										
2	Grants, net	2,045	2,208	465	524	503	553	630	582	497	499
3	Credits repayable in foreign currencies	156	80	90	24	19	23	20	14	10	35
4	Other foreign currency assets (excluding administrative cash holdings), net	−182	−135	−84	−50	2	−50	−33	25	−65	−62
	Receipts from—										
5	Sales of agricultural commodities	164	75	39	63	26	36	42	32	1	1
6	Interest	181	190	40	55	38	47	48	49	40	53
7	Repayments of principal	157	251	35	43	34	45	49	44	46	111
8	Reverse grants	1	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)	1
9	Other sources	8	13	1	3	2	2	3	3	6	2
	Less disbursements for—										
10	Grants in the recipient's currency	246	264	44	102	19	81	79	9	57	120
11	Credits in the recipient's currency	128	52	84	15	14	16	15	11	6	21
12	Other grants and credits	8	9	2	3	1	2	5	2	1	2
13	Other U.S. Government expenditures	310	339	70	95	64	81	78	81	94	86
14	Capital subscriptions to international and regional organizations, excluding IMF	246	271	35	49	99	64	44	69	48	110
15	Credits repayable in U.S. dollars	3,772	3,453	1,134	1,219	612	807	844	866	735	1,008
16	Other assets (including changes in administrative cash holdings), net	4	−16	4	−25	−8	33	−73	−40	69	27
	BY PROGRAM										
17	Under farm product disposal programs	1,151	1,238	239	429	234	249	287	437	204	310
18	Under Foreign Assistance Acts and related programs	2,626	2,259	736	762	568	560	619	627	510	502
19	Under Export-Import Bank Act	1,423	1,297	481	384	238	320	401	305	265	327
20	Capital subscriptions to international and regional organizations, excluding IMF	246	271	35	49	99	64	44	69	48	110

21	Other assistance programs	556	718	142	135	87	193	132	110	214	263
22	Other foreign currency assets acquired (lines A.6, A.7, and A.9)	346	453	76	101	75	94	100	96	92	166
23	Less foreign currencies used by U.S. Government other than for grants or credits (line A.13)	310	339	70	95	64	81	78	81	94	86
24	Advances under Exchange Stabilization Fund agreements, net										
25	Other (including changes in administrative cash holdings), net	2	−38	5	−25	−9	32	−73	−46	55	26
	BY DISPOSITION [1]										
26	Estimated transactions involving no direct dollar outflow from the United States	5,160	4,801	1,480	1,564	969	1,147	1,230	1,284	1,015	1,272
27	Expenditures on U.S. merchandise	3,322	3,105	803	1,078	720	721	915	840	586	764
28	Expenditures on U.S. services [2]	818	799	212	221	167	219	193	230	161	215
29	Military sales contracts financed by U.S. Government credits [3 4] (line B.14)	607	490	246	249	68	45	75	164	124	128
30	U.S. Government credits to repay prior U.S. Government credits [2]	396	281	216	48	43	90	50	44	53	134
31	U.S. Government credits [3] to repay prior U.S. private credits	432	579	105	121	59	148	139	88	197	154
32	Increase in claims on U.S. Government associated with Government grants and capital flows increasing Government assets (including changes in retained accounts) (line B.17)	26	19	6	−5	1	25	9	13	−2	(*)
33	Less foreign currencies used by U.S. Government other than for grants or credits (line A.13)	310	339	70	95	64	81	78	81	94	86
34	Less dollar recoveries on short-term claims financing military sales contracts and U.S. Government credits to repay private credits [3]	132	134	36	52	25	20	73	13	10	37
35	Estimated dollar payments to foreign countries and international and regional organizations through U.S. Government grants and capital flows increasing Government assets	881	1,059	164	177	258	282	203	232	279	345
B. 1	Nonliquid liabilities reported by U.S. Government, including medium-term securities and long-term obligations payable prior to maturity only under special conditions, net increase (+)	−145	403	−72	−101	−207	235	193	97	222	−109
1a	Seasonally adjusted			−105	−13	−197	170	179	155	258	−189
2	To foreign official reserve agencies (table 2, line 57)	341	189	−2	−4	−3	350	280	−4	78	−165
2a	Seasonally adjusted			−8	−8	−9	366	280	−2	78	−167
3	U.S. Treasury securities issued in connection with Columbia River downstream rights	−24					−24				
4	U.S. Treasury securities issued in connection with prepayments for military purchases in the United States (line B.13)	−2				−1	−1				
5	U.S. Treasury obligations to be liquidated against U.S. claims	−4	−4		−4				−4		
6	U.S. Treasury securities not included elsewhere [5]	375	197				375	282		80	−165
7	Export-Import Bank obligations to be liquidated against U.S. claims	−4	−4	−2		−2		−2		−2	
8	Export-Import Bank securities not included elsewhere										
9	Other	(*)			(*)						
10	To other official and private foreigners (table 2, line 48)	−486	214	−70	−97	−204	−115	−87	101	144	56
10a	Seasonally adjusted			−97	−5	−188	−196	−101	157	180	−22
11	Associated with military sales contracts [6]	−615	347	−72	−203	−201	−139	−97	91	149	204
11a	Seasonally adjusted			−99	−111	−185	−220	−111	147	185	126

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TABLE 5.—MAJOR U.S. GOVERNMENT TRANSACTIONS—Continued

[Millions of dollars]

Line		1971	1972p	1971 I	1971 II	1971 III	1971 IV	1972 I	1972 II	1972 IIIp	1972 IVp
	Nonliquid liabilities, etc.—Continued										
	To other official and private foreigners—Continued										
	Associated with military sales contracts—Continued										
12	U.S. Government receipts—from foreign governments (including principal repayments on credits financing military sales contracts), net of refunds	1,046	1,396	204	270	214	358	243	374	325	455
13	Less U.S. Treasury securities issued in connection with prepayments for military purchases in the United States (line B.4)	−2				−1	−1				
14	Plus military sales contracts financed by U.S. Government credits [3,7] (line A.29)	607	490	246	249	68	45	75	164	124	128
15	Less U.S. Government receipts from principal repayments [3]	348	374	46	122	55	124	103	119	73	79
16	Less transfers of goods and services (including transfers financed by credits) (table 2, line 3)	1,922	1,166	475	600	429	419	311	327	228	299
17	Associated with U.S. Government grants and capital flows increasing Government assets [6] (line A.32)	26	19	6	−5	1	25	9	13	−2	(*)
17a	Seasonally adjusted			6	−5	1	25	9	13	−2	(*)
18	Non-interest-bearing securities issued to IDA, to IDB, or to U.N. for special programs										
19	Foreign funds retained in U.S. Government accounts for purchases in the United States	26	19	5	−5	1	25	9	10	(*)	(*)
20	Other	(*)	1	(*)	(*)	(*)	(*)	(*)	3	−2	(*)
21	Other	103	−152	−4	111	−4	(*)	1	−3	−3	−148
21a	Seasonally adjusted			−4	111	−4	(*)	1	−3	−3	−148
22	German Government 10-year loan to U.S. Government	100			100						
23	Associated with U.S. Government nonmilitary sales and miscellaneous operations	−5	−1	−4	6	−5	−2	1	−4	−3	4
24	U.S. Treasury securities not included elsewhere [5]	8	−151	(*)	6	1	1		1		−151
25	Export-Import Bank securities not included elsewhere										

1 The identification of transactions involving direct dollar outflow from the United States is made in reports by the operating agency. However, such data for all quarters 1971 and for first, third, and fourth quarters 1972 are only extrapolated estimates by BEA, because of incomplete reports from one operating agency, and are to be revised in future issues of the Survey.

2 Line A.28 includes foreign currency collected as interest and line A.30 includes foreign currency collected as principal, as recorded in lines A.6 and A.7.

3 Lines A.29 and A.31 include some short-term U.S. Government claims, collections of which are recorded in line A.34. Collections of those short-term claims recorded in lines A.29 and B.14 are included in line B.15.

4 Consists of transfers of military goods and services financed by U.S. Government credits and of advance payments to the Defense Department (on military sales contracts) financed by credits extended to foreigners by U.S. Government agencies.

5 Includes securities payable in U.S. dollars and in convertible foreign currencies.

6 Transactions under military sales contracts are those in which the Defense Department sells and transfers military goods and services to a foreign purchaser, on a cash or credit basis. The entries for the several categories of transactions related to military sales contracts in this and the other tables are partially estimated from incomplete data.

7 Consists of transfers of military goods and services financed by U.S. Government credits (included in line B.16) and of increases in Defense Department liabilities (on military sales contracts) which arise from advance payments to the Defense Department financed by credits to foreigners by U.S. Government.

8 Excludes liabilities associated with military sales contracts financed by U.S. Government credits and included in line B.11.

p Preliminary.

*Less than $500,000 (±).

Note.—Details may not add to totals because of rounding.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Senator MONDALE. We had estimates of $30 billion in overseas military expenditures and military aid and foreign aid.

Mr. BRYANT. These are balance-of-payments figures and not the budgetary figures, Senator. That explains the difference.

Senator MONDALE. Yes. Would you recommend a review of those overseas expenditures to see if we couldn't reduce the impact in that area?

Mr. DAANE. Senator, I don't have any specific recommendations in this area. I am appearing here, in part, as you know, in lieu of our chairman and it reminds me a bit of an experience I had when I was a boy, when my family took me to New York to see the opening of a new musical, which was reported to star a famous acrobatic dancer Fred Stone and his two dancing daughters. At the last moment, Fred was in an airplane accident and his part was taken on by his good and close friend, Will Rogers. At the opening of this musical, Will Rogers came onto the stage, parked his gun at the side, and came back twirling his rope and said:

> This play was supposed to begin with Fred jumping from this scaffold up near the ceiling of the stage doing a triple somersault and landing in the middle between Dorothy and Paula and breaking into a fast shoe-shuffle. That part of the program will be omitted this evening.

So I am sorry to omit the part of the program you might have gotten if you had our chairman here, but I won't try to emulate his fancy footwork or headwork or even pipe work with you, Senator, so I won't take any position on this at the moment.

Senator MONDALE. I thought you were going to say that describes the economy.

Senator BYRD. Senator Haskell?

Senator HASKELL. Thank you, Mr. Chairman. I just have one question. I take a simple-minded view of the devaluation. It doesn't indicate a very healthy situation for the dollar. But as a fiscal expert, Governor Daane, what effect, if any, do you think a policy of repatriating profits earned by foreign subsidiaries of our companies would have either on the balance of payents or on the stability of the dollar?

Mr. DAANE. Well, as I have tried to indicate, rather than look at the question of deliberately designing a policy, I think as we——

Senator HASKELL. The assumption in my question is that we adopt the policy.

Mr. DAANE. If we look at the possibilities for repatriation in a voluntary sense, because the developments at home and developments abroad costwise——

Senator HASKELL. Excuse me. But just let's assume that we adopt a repatriation policy. I am asking you if we did adopt the policy, what, if any, monetary effect would this have on the stability of the dollar?

Mr. DAANE. Well, to the extent that you have greater repatriation, it quite clearly would have plus effect; leaving aside any consequences associated with it, it would have a plus effect on our balance of payments.

Senator HASKELL. I notice on footnote 2 in table 1, you have excluded undistributed earnings in subsidiaries. I wonder if you have that figure available to you?

Mr. DAANE. I believe we can get an annual figure on that.

Senator HASKELL. I am not a member of the committee but if the Chairman thinks it would be valuable——

Senator BYRD. Would you submit that for the record, Governor Daane?

Mr. DAANE. Yes. I think the figures come annually and not quarterly. We will submit what figures are available there.

[Mr. Daane subsequently submitted the following information:]

JUNE 19, 1973.

REINVESTED EARNINGS OF FOREIGN INCORPORATED AFFILIATES OF U.S. FIRMS

Data on the reinvested earnings of foreign incorporated affiliates of U.S. firms are compiled annually by the Department of Commerce and are published in the *Survey of Current Business*. The latest data, through 1971 (preliminary), were published in the November 1972 issue of that publication.

The U.S. owners' share in such earnings in recent years is shown below:

Reinvested earnings

Year:	*Billions*
1967	\$1.6
1968	2.2
1969	2.6
1970	2.9
1971(p)	3.1

Senator HASKELL. Thank you. I have no further questions.

Senator BYRD. Governor, you have indicated that the money supply increased 8 percent, or a little more than 8 percent in 1972. What was the increase in 1971?

Mr. DAANE. We can go on or come back to that, or wait a moment until I find it.

Senator BYRD. I would like to get 1970 and 1971. We have 1972. And you have indicated during 1973, it is 3 percent. I would like to get this into perspective by getting it for three or 4 or 5 years.

Mr. DAANE. Yes. We don't have it, Mr. Chairman, immediately here. We don't have the annual rates for yearly or quarterly, but I can certainly get it. That wouldn't be any difficulty.

Senator BYRD. If that is the case, I wish you would submit that for the record; the figures for 1969, 1970, and 1971.

Mr. REYNOLDS. Oh, here it is. Starting in 1969?

Senator BYRD. Yes, 1969.

Mr. REYNOLDS. The narrow money supply, that is, demand deposits and currency, went up 3.6 percent in 1969; 6 percent in 1970; 6.6 percent in 1971; 8.3 percent in 1972.

Mr. DAANE. You will recall with respect to the rate of increase there, that we were attempting to revitalize our economy during a part of that period and, as we then moved into the strong expansionary phase, the annual figures conceal that and, as I indicated, for this year we are turning it around.

Senator BYRD. I understand that but I think we need to know the figures. The figures were 3.6 in 1969, 6 percent in 1970, 6.6 percent in 1971, and then it went up to 8.3 percent in 1972 and now is 3 percent?

Mr. DAANE. For the first 4 months of this year, it was running a bit better than three, although it should be made clear for the record here that these are averages and the April figure alone shows a much higher rate of increase than the 3.1. The April figure might be something above 7. Probably around 7½ percent. So on the average, which means in the very first quarter of this year, you had a very, very small rate of increase. One of the problems here, Mr. Chairman, is you do get these bulges on a monthly basis and sometimes even on a quarterly basis.

Senator BYRD. Well, do you plan that it will be around 6 percent for the year? Will it be 6 or 5 percent?

Mr. DAANE. We have clearly been aiming at a range on the monetary aggregate side of quite clearly less than last year, Senator, so that my preference would be to think in terms of something in the range of 5 percent or 5½ percent or something in that area, but clearly less than last year.

Senator BYRD. Now you mentioned in discussions with Senator Roth, you mentioned the various reserve assets. Now do you have figures on the current gold holdings of the Federal Government?

Mr. DAANE. Yes; we have them, Senator.

Senator BYRD. That is say for April 30?

Mr. DAANE. Our total reserve asset holdings are about $13 billion and the gold component is about $10.5 billion.

Senator BYRD. And then what are our liquid liabilities as of the end of April?

Mr. REYNOLDS. We only have them through March.

Mr. DAANE. That is $71.3 billion.

Mr. REYNOLDS. That is to official institutions, though?

Mr. DAANE. That is to official institutions, Senator.

Senator BYRD. Wait just a minute. What is this? Are you talking about liquid liabilities?

Mr. DAANE. It is $90.9 billion to everybody and $71.3 billion to official institutions.

Senator BYRD. It is the $90.9 billion I want.

Mr. DAANE. You want the private as well as official?

Senator BYRD. I want the total.

Mr. DAANE. $90.9 billion at the end of March, Senator.

Senator BYRD. Just for the record, at the end of December which is only 3 months previously, it was $79 billion so it went up sharply.

Mr. DAANE. Our figure shows about $82 billion at the end of December.

Senator BYRD. Your figure shows $82 billion?

Mr. REYNOLDS. These are published regularly.

Senator BYRD. The Treasury gave me the figure $79 billion.

Mr. DAANE. I am using the figure we published in our Federal Reserve Bulletin, Senator, regularly. I don't know quite what the difference would be.

Senator BYRD. All right.

Mr. DAANE. They might have taken out the liabilities to international monetary organizations or something of that sort, but the total we have for the end of December was $82.9 billion and at the end of March $90.9 billion in terms of total U.S. liquid liabilities, both official and private.

Senator BYRD. Total assets as of the end of March 31, and total holdings as at the end of March 31, were what?

Mr. DAANE. Well, our total reserve assets we can give you on up through April. If you want an end of March figure, for comparability purposes, then——

Senator BYRD. Yes, end of March.

Mr. DAANE. The end of March figure of our total reserve assets were $12,931 billion.

Senator BYRD. Does that include gold?

Mr. DAANE. Yes; that includes the gold.

Senator BYRD. What was the gold?

Mr. DAANE. A gold stock of $10.487 billion but, of course, it doesn't involve the change related to the February devaluation of the dollar because that has not yet been incorporated into these figures.

Senator BYRD. Right. But the point I am suggesting of your total reserve assets, the bulk of it is in gold?

Mr. DAANE. That is right.

Senator BYRD. The bulk is gold?

Mr. DAANE. Yes, the bulk is in gold; that is quite correct, sir.

Senator BYRD. In your response to Senator Roth, you said we are exploring our various assets. What did you mean by "various reserve assets?" 80 percent is in gold.

Mr. DAANE. U.S. reserve assets are 80 percent in gold, but as for the reserve assets of the world monetary system, the gold is not that high a percentage of the total, Senator. I think it is probably near to 40 or 50 percent or even less than that.

Senator BYRD. Just several more questions: Would a reduction in Federal spending help to protect the value of the dollar and, if so, how large a reduction would be required to make a significant impact?

Mr. DAANE. Well, Senator, you are carrying me into the area of fiscal policy and my basic position on it is that anything that we can do to strengthen our fiscal posture, however it is accomplished, to bring us into a balanced fiscal position is quite clearly in order.

But how you accomplish this, whether it is done by reduction of expenditures or whether it is done in terms of the tax-policy route, I would prefer to defer to somebody other than myself.

Senator BYRD. It could either be done by a reduction of expenditures or an increase in taxes or both, would it not?

Mr. DAANE. Yes.

Senator BYRD. And you feel that we should try to approach a balanced budget.

Mr. DAANE. I think that in terms of getting the benefits of reduced inflation we should have a coordinated approach, yes, and that fiscal policy is part of a coordinated approach to our inflation problems. To the extent that we can move in the direction of balance, it is quite clearly appropriate to overcoming that problem.

Senator BYRD. Let me put it this way——

Mr. DAANE. And I am not selecting the route, Senator.

Senator BYRD. Let me state it this way: would it be fair to say that getting the U.S. Government's financial house in order would be the most helpful step that could be taken to test the dollar and improve the balance of payments.

Mr. DAANE. What I am saying, Senator, in a little more general terms, is, namely, that we need to do all that we can to resolve our inflation problem, which is a serious problem, in order to move into a balance with our payments position and that in the fight against inflation, leaving aside the income policy—the two main instruments of stabilization policy are monetary policy and fiscal policy. Quite clearly, they should be in harness.

Senator BYRD. And your concern is which?

Mr. DAANE. Our fiscal policy as well as monetary policy. And I think on the monetary policy side, we are doing what we can.

Senator BYRD. Are you or are you not concerned about the huge deficit the Federal Government has been running?

Mr. DAANE. I am very definitely concerned about the deficits and I indicated a number of times I think in my testimony, Mr. Chairman, I think it would be desirable for the fiscal posture to be one of balance or even I could conceive of a slight surplus in the kind of excess demand economy that we have.

Senator BYRD. Well, I can't see any likelihood of a surplus when we have been running for four consecutive years a $30 billion Federal funds deficit each year.

Mr. DAANE. I will settle for a balance, sir.

Senator BYRD. So would I.

Just one final question.

Just as a matter of information, what role does the—or did the Federal Reserve Board play in the decision leading to the second devaluation?

Mr. DANNE. Well, this is a difficult question to give a precise answer to, Senator. We, of course, worked closely within the framework of government with our Treasury colleagues on these problems. We were side-by-side with them in the discussions. We were side-by-side and I am referring here to our Chairman, who certainly played a part in this process. We were side-by-side in the discussions. I was alongside Mr. Volcker in some of the discussions overseas in that period, so that I think the answer to that is that we were associated with our Treasury colleagues.

Senator BYRD. It was a joint decision between Treasury and the Federal Reserve?

Mr. DAANE. That is, I think, too vigorous a description. All I am saying is that we did play a part in examining the problems and the alternatives. Our chairman was certainly involved in this.

Senator DOLE. Would it be somewhere between primary and secondary involvement?

Mr. DAANE. We are always trying to contribute helpfully in the framework of government, with our Treasury Department, to look at the problems to reach the proper conclusions and we were in on the discussions of most of these problems.

Senator BYRD. Senator Hansen has come in.

Senator Hansen, do you have a question?

Senator HANSEN. Thank you, Mr. Chairman.

First let me compliment you on calling these hearings, I think they are most appropriate.

I regret very much that I was not here for your full presentation, Mr. Daane. I have been down in the Interior Committee considering what can be done by way of establishing some strategic reserves for energy in this country and have just come from that committee. I was looking at your statement and your comments about the devaluation of our dollar which has improved our export position as compared with what it was earlier. But is it not true that in the overall balance-of-payments situation, anticipating the need for increasing amounts of oil and gas, for LNG, or whatever it may be, crude or product, that the devaluation of our currency will be a net loss for this country rather than a gain as we project our increasing dependency upon foreign sources for oil and gas?

Mr. DAANE. In this particular, Senator, in this one particular import category, quite clearly it increases the cost of imports; more generally a devaluation increases the cost of imports in the short run. This is really the purpose, that is, to balance your adjustment in terms of your exports and imports. It improves your competitive export position and it does increase the cost of imports, not only in the component which you mentioned—and I call the committee's attention as to your answer to our second table adjoining my statement—and that points to the increased import cost expenditure on fuels. I also pointed out, however, that despite this both our current performance, where we have a move to a trade surplus, and our prognosis, taking into account the increased cost of fuel ahead of us, that both point to the achievement, on a cumulating basis over time, of a substantial trade surplus. And this is, in my judgment, in no small measure attributable to the exchange rate realinements that have taken place.

Senator HANSEN. Is it true that we have had about a $10.5 billion imbalance in payments for the first quarter of this year?

Mr. DAANE. Yes, the figure I think I gave in my statement was $10.2 billion but all of that really occurred before mid-March. So it really occurred before the recent establishment of structure of rates and, since mid-March, we have had an overall surplus in our international transactions.

Senator HANSEN. Well, I have not had the opportunity, and for that I apologize, of examining your charts or reading your full statement, but I must say that there seems to be growing concern, as nearly as I can discern it, over the situation with respect to our fuel and energy imports. The prediction is that by 1985 we will probably be importing $25 billion to $30 billion worth of energy per year.

You are saying then that you look upon other advances that you feel this country may have vis-a-vis other countries and you believe overall that we will come into a situation where we will have a favorable balance of payments, as well as a favorable balance of trade. Is that the thrust of your statement?

Mr. DAANE. That is clearly the thrust of my statement, Senator. I think with respect to the area you are dealing with, this is an area that is of concern but I don't think we should exaggerate the impact in terms of our payments position or in terms of our trade position. I think it does underscore the need to look as the funds get larger in size over time, that we need to look and work with our foreign friends in those countries to see where they place those funds and in what form specifically, because it makes a considerable difference whether those go into one area or another.

Senator HANSEN. I would agree with you. I don't think we need to exaggerate it. It occurs to me that the Arabs will do plenty to bring it to our full awareness. I think there is no doubt about that. I would like to associate myself, Mr. Chairman, with your incisive questions about a balanced budget. If I could say so, I am just a little bit disappointed that there seems to be a reluctance by our people in Government to face up, honestly and forthrightly, to the question of what effect a balanced budget would have on this country. I don't speak exclusively of you, Mr. Daane, but I just think that, basically, many of the things that have happened would not have come about if we had faced up to this and I am willing to assume my share of the responsibility. But as long as we are printing money and making payments through the various Government programs that greatly exceed the tax revenues that come into the Treasury, I think we have laid the basic groundwork for an inflationary situation.

And if there is one single thing that might be done, I would say that a balanced budget has to be of primary importance. In that regard, I compliment you, Mr. Chairman, for your leadership in trying to drive that back home. I think it is a real fact.

Mr. DAANE. Senator, I am not trying to resist this, I am saying, I think, the same thing that if I look back—and I have been a part of this effort going way back—and if I go back to 1965, I would say that our very bad performance at the present time is directly attributable to our weakness in terms of our fiscal policy and our budgetary policy in that subsequent period. I think whenever you get into an excess demand situation, it points quite clearly to making a real and meaningful effort on the fiscal policy side, as well as on the monetary policy side. So I don't think there is any disagreement or any unwillingness on my part to be forthright. I appreciate what you are saying and I think we do have a double-barreled problem when we come to inflation. I would say, again, in retrospect—but we felt it at the time, actually—we felt at the Federal Reserve that our fiscal policy was inadequate to the demands that emerged so clearly as we moved through 1965 into 1966, and so on, and we are reaping the costs of that now.

Senator HANSEN. I appreciate your clarification, Mr. Daane. Thank you very much.

Senator BYRD. Thank you, Senator Hansen.

I want to call now on Senator Fannin, who has one question and then we will go to the next distinguished witness.

Before calling on Senator Fannin, let me say you mentioned, Governor, 1965 and 1966, but our fiscal situation now is far worse than it was then.

Senator Fannin?

Senator FANNIN. Thank you, Mr. Chairman. I regret Mr. Daane, I was called out on a meeting and did not have an opportunity to hear your full testimony. Isn't it true, Governor, we cannot compete in consumer goods on the world markets unless we increase our productivity per dollar of wages? Each year we are adding an added cost much more than the other countries of the world.

Mr. DAANE. Senator, I would agree our productivity is very relevant to the question but we do have an improved position rather than the other way around, as I indicated in my statement. On this point our unit labor costs have performed better than other countries.

Senator FANNIN. I realize we have improved but if we take the last 5 years, we have increased perhaps about 14 percent whereas the Japanese have had over a 100 percent increase in their productivity.

Just as an illustration of the problem we have, when the last steel wage negotiation went through, the wage rate increase for the 3-year period was within 10 cents of the total wage paid the Japanese worker so it will take a long, long time to catch up, won't it?

Mr. DAANE. Well, the data I have is a little out of date on the unit labor costs here, but if you look across the spectrum of the average annual percentage changes in unit labor costs, we have quite a good performance. I have here 1960–72. If you take 1970–, for example, our percentage change in unit labor cost was something like less than 3 perecnt. In the other leading industrial countries, it ranged from 5 to 10 percent.

Senator FANNIN. Of course, with the tremendous differential of the Japanese rate, it is pretty difficult to take it on a percentage basis.

Mr. DAANE. Yes, it is. I think all of the international comparisons, you are quite right, are a bit suspect but we had productivity this past year, 1972, which shows that the percentage increase in our unit labor costs in manufacturing was less in the United States than it was in Canada, Japan, or Western Europe. We had about a 4-percent rise in productivity, a 6-percent increase in hourly compensation and a 2.1 percent rise in unit labor costs last year, whereas the other countries again were well above that. The figure for Japan here is something a little under 5 percent. Again, admittedly, these don't resolve everything but they are indicative that the productivity growth in Japan has declined since 1967. So you had an increase in their unit labor costs.

Senator FANNIN. That is correct.

Mr. DAANE. I don't mean to say——

Senator FANNIN. I understand.

Governor Daane, I think my time is up. I appreciate very much that information. Just one more question:

An article on the financial page of the New York Times quote Dr. Franz Pickenly, an expert in this field, as predicting the price of gold to reach $420 within 3 years. Would you comment on that statement?

Mr. DAANE. That is a self-serving statement on his part. What the price of gold can get to is something I wouldn't forecast. I think you can exaggerate the importance of the price of gold exceedingly. And as we increasingly diminish the role of gold in our monetary system, our international monetary system over time, maybe we will get to where we couldn't care what that price is.

Senator FANNIN. Thank you very much.

Thank you, Mr. Chairman.

Senator BYRD. Thank you very much, Governor Daane. The committee appreciates you and your associates appearing before the committee today.

The next witness will be Dr. Pierre Rinfret who has a well-deserved reputation for candid and perceptive insights on economic issues. The committee is glad to welcome you at this point, Dr. Rinfret.

Before calling on Dr. Rinfret, I would without objection, insert into the record, three tables that I have prepared showing U.S. gold holdings, total reserve assets, and liquid liabilities to foreigners over specified periods: secondly, dealing with deficits in Federal funds, interest on national debt, 1955 through 1974 inclusive: third, receipts and expenditures of the Federal Government, 1968 through 1974.

Without objection, that will be inserted in the record at this point.

[The tables referred to by Senator Byrd follow:]

U.S. GOLD HOLDINGS, TOTAL RESERVE ASSET AND LIQUID LIABILITIES TO FOREIGNERS

[Selected periods in billions of dollars]

	Gold holdings	Total assets	Liquid liabilities
End of World War II	20.1	20.1	6.9
Dec. 31, 1957	22.8	24.8	15.8
Dec. 31, 1970	10.7	14.5	43.3
Dec. 31, 1971	10.2	12.2	64.2
Dec. 31, 1972	10.5	13.2	79.0
Mar. 31, 1973	10.5	12.9	90.9

Source: U.S. Treasury Department (except Mar. 31, 1973, figures are from Federal Reserve Board).

Prepared by Senator Harry F. Byrd, Jr., of Virginia.

	Fiscal year—						
	1968	1969	1970	1971	1972	1973	1974
Receipts in billions:							
Individual income taxes	$69.0	$87.0	$90.0	$86.0	$95.0	$99.0	$112.0
Corporate income taxes	29.0	37.0	33.0	27.0	32.0	34.0	37.0
Total	98.0	124.0	123.0	113.0	126.0	133.0	149.0
Excise taxes (excluding highway)	10.0	11.0	10.3	10.5	9.1	9.4	9.6
Estate and gift	3.0	3.5	3.6	3.7	5.2	4.6	5.0
Customs	2.0	2.3	2.4	2.6	3.2	3.0	3.3
Miscellaneous	2.5	3.0	3.4	3.9	3.5	4.0	4.1
Total, Federal fund receipts	116.0	143.0	143.0	134.0	149.0	154.0	171.0
Trust funds (Social Security Retirement, highway)	38.0	44.0	51.0	54.0	60.0	71.0	85.0
Total	154.0	188.0	194.0	188.0	209.0	225.0	256.0
Expenditures in billions:							
Federal funds	143.0	149.0	156.0	164.0	178.0	188.0	199.0
Trust funds	36.0	36.0	40.0	48.0	54.0	62.0	70.0
Total	179.0	185.0	196.0	212.0	232.0	250.0	269.0
Unified budget[1], surplus (+) or deficit (−)	−25.0	+3.1	−2.0	−24.0	−23.0	−25.0	−13.0
Federal funds deficit	27.0	6.0	13.0	30.0	29.0	34.0	28.0

[1] Estimated figures.

Prepared by Sen. Harry F. Byrd, Jr., of Virginia.

DEFICITS IN FEDERAL FUNDS AND INTEREST ON THE NATIONAL DEBT, 1955–74 INCLUSIVE

[Billions of dollars]

	Receipts	Outlays	Surplus (+) or deficit (−)	Debt interest
1955	$58.1	$62.3	−$4.2	$6.4
1956	65.4	63.8	+1.6	6.8
1957	68.8	67.1	+1.7	7.3
1958	66.6	69.7	−3.1	7.8
1959	65.8	77.0	−11.2	7.8
1960	75.7	74.9	+0.8	9.5
1961	75.2	79.3	−4.1	9.3
1962	79.7	86.6	−6.9	9.5
1963	83.6	90.1	−6.5	10.3
1964	87.2	95.8	−8.6	10.7
1965	90.9	94.8	−3.9	10.3
1966	101.4	106.5	−5.1	12.0
1967	111.8	126.8	−15.0	13.4
1968	114.7	143.1	−28.4	14.6
1969	143.3	148.8	−5.5	16.6
1970	143.2	156.3	−13.1	19.3
1971	133.7	163.7	−30.0	21.0
1972	148.8	178.0	−29.2	21.8
1973[1]	154.3	188.4	−34.1	24.2
1974[1]	171.3	199.1	−27.8	26.1
20-year total	2,039.5	2,272.1	232.6	264.7

[1] Estimated figures.

Source: Office of Management and Budget and Treasury Department.

Prepared by Sen. Harry F. Byrd, Jr., of Virginia.

Senator BYRD. Dr. Rinfret is the president and chief executive of Rinfret-Boston Associates, Inc., an international economic and financial accounting firm, whose clients include leading organizations in business, industry, and finance.

The committee is pleased to welcome you, Dr. Rinfret.

STATEMENT OF DR. PIERRE RINFRET, PRESIDENT, RINFRET-BOSTON ASSOCIATES

Dr. RINFRET. Thank you, Mr. Chairman.

Mr. Chairman and members of the Subcommittee on International Finance and Economics, let me say that I have been waiting 10 years for this occasion. It is about time somebody began to look at our international financial monetary problems.

When I received your invitation to testify, my curiosity led me to go back and read my own work and to attempt to discover when I first became very concerned about the balance of payments positions of the United States. In fact, the first time that I studied and wrote in detail about our deteriorating balance of payments positions was in 1963, 10 years ago. I must say that what I am about to tell you are things I have been saying to my own clients and to both domestic and foreign governments for approximately 10 years. I mean no disrespect to Mr. Daane, but his presentation of cautious optimism can be matched only by my pessimistic caution.

I consider optimism Panglossian in view of our payments situation and symbolic of this administration. This administration always sees the silver lining in the cloud, but unfortunately the clouds remain and the silver lining never appears.

We have had a dollar problem and a balance-of-payments problem since 1963. We have, in my judgment, a long-term problem. This is not a short-term problem. This is a basic problem. We economists call it a fundamental disequilibrium.

I would like to read you a very brief one-paragraph summary of what I said recently to my own clients. This was said just after the second devaluation, which, in my judgment, will be succeeded by a third, fourth and possible a fifth devaluation. This is what I said in one paragraph:

> The Common Market, GATT and the Last Kennedy Round were the political and economic out-maneuvering of the United States by Europe and by Japan. This out-maneuvering included the creation of capital inflow insensitivity by Europe and capital outflow insensitivity by the United States. The simultaneous export of the American technology by the United States while it pursued a huge defense program and the execution of two wars has resulted in an acceleration of foreign productivity and a relatively inferior productivity trend in the United States. The United States is believed, therefore, to have a long-term balance of payments problem even after recent devaluations.

Now, I would like to trace for you how we got where we are. I am not going to do it with numbers because I would like to say something about the numbers. Most of them are not worth a damn. Most of the statistics we have on our balance of payments problems do not reconcile with those of other countries. For example, we claim that we had 2 $2.5 billion deficit with the Common Market last year, and the Common Market claims we have $400 million surplus. You cannot reconcile the figures for trade exports from the United States to France or the figures for imports from France into the United States. No reconciliation is possible. It is impossible to reconcile the gold movements. It is impossible to reconcile currency movements. Our statistical information is pitiful. We do not know what our balance of payments actually is.

If you will look at the little category in the balance of payments accounts that is called "errors and omissions" you will note that it is getting bigger and bigger and, in fact, now represents more than some of the major categories. So I am not going to trace it in terms of statistics. I am going to trace it in terms of commonsense and logic.

I want to start with the postwar period. I want to start with the year 1946. Everyone forgets that we are where we are because of a series of events which has occurred in both the short and the long run, and those events ultimately culminated in something. In 1946, this country was, by and large, the economic power of the world. Through bombings and massive artillery fire we had totally destroyed the German and Japanese economies. As a soldier in World War II, walking through Germany I never ceased, as I saw one village after another, one city after another, to be amazed at the extent to which we had levelled that country. We knew that we had to rebuild the world and we knew that we had to take a very long-run view and help rebuild France, Germany, the United Kingdom and Japan.

I would remind you, for example, of something which virtually everyone has forgotten. The first grant we gave in 1945 was to Britain. $3.75 billion, which you might call the first postwar aid loan. It was rather interesting that within a few weeks the British Government bought the British railway system for $3.5 billion and we gave them $3.75 billion, but that is an ironic footnote to history.

As a part of the reconstruction of world economies, we embarked on massive economic and military aid programs. For example, we never took money from any of the countries for the grants which we gave them. As a perfect illustration, I was a Fulbright scholar and I am proud to say I was one of the first Fulbright scholars to France. The money I received came from the counterpart funds deposited by the French Government against American money received in economic and military aid, spent in France and kept in France. As a Fulbright scholar, I received the money, I spent it there and it benefitted the French economy.

The second thing we did was to decide that the world would reconstruct itself if we would give them access to the American markets. In order to provide access to the American markets, we had to start dismantling certain protections for Americans in their own markets. We realized that in order to overcome the dollar shortage in the world, the Europeans, the Japanese, and all the rest of the world had to be able to get into the American market, they had to be able to accumulate dollar reserves by selling in the United States, but if we penetrated their markets as rapidly, they could never overcome the dollar shortage. So we started up a one-way street of opening American markets to the rest of the world faster than the rest of the world opened their markets to us.

The irony is that, looking at it from a strictly economic point of view, from the viewpoint of productivity and modern capital investment, the way you win a war is, in fact, by losing it. You lose the war, you destroy your industrial base. You then get the United States to begin subsidizing that base and you rebuild that base with modern productivity, modern equipment, and you end up with an industrial base which is more modern than the United States'. For example, there is no question that Japanese technology in steel exceeds surpasses the United States' technology. There is no question that the German technology surpasses that of the United States. If you look at the percentage of our plants which are more than 25 years old, you will find it is amongst the highest in the world.

The rest of the world has more modern equipment and has made much larger capital investment relative to total production than the United States has.

Now, very candidly, I have never been able to figure out exactly how much money the United States has granted in economic and military aid. If I may, I will quote Governor Connally, who claims that we have given the rest of the world $180 billion net income and military aid in the entire postwar period.

We arrived at a point in 1963 where, it is fair to say, the world was rebuilt and we had, in fact, gone back to the prewar relationships. Germany was rebuilt, France was rebuilt, the United Kingdom was beginning to come back, and Japan was rebuilt. The United States was the only country in the world which didn't know that. The United States has continued to follow a policy of believing that it must continue to subsidize the rest of the world.

If I may put it this way, one of the fundamental problems we have in this country today is our vanity and ego. We still think we are the foremost economic power in the world. We are no longer the foremost economic power in the world. We have failed to realize that the rest of the world is as powerful as we are and, in some ways, smarter.

The creation of the European Economic Community was the creation of a United States of Europe, and I remind you that was what it was called originally. The population of that market now exceeds the population of the United States. Its productivity appears to be higher than that of the United States. Its rates of inflation are now lower than the United States'. Normally, the EEC grows about 6 percent a year in real terms, whereas, I would remind you, our record of economic growth since 1968 is an incredible 2.5 percent a year in real terms. So the European Economic Community is a full-fledged competitor of the United States in world markets. And heaven help us if they should ever join with Japan. If they do, then you will have two major trading blocs in the free world, with the United States as the second and inferior block.

We have a cavalier attitude about our economic supremacy. We think, and we were brought up to think, that we are the nation of plenty; that we are a nation of opportunity, and we are the nation which has all the economic muscle. In my judgment, that supremacy came to an end many years ago.

We have a cavalier attitude about gold. I must warn you that I am of French background. I got my doctorate in France, and I am very proud of that, so it may well be that I have some European ideas about gold, ideas which are vehemently anti-American. I was at a private meeting about 2 weeks ago with two gentlemen: one was Stillman

Rockefeller and the other was Langbourne Williams, Jr., who is chairman of the executive committee of the Freeport Minerals Co. We were discussing the role of gold in the world and he said: "Do you know what I did from 1946 to 1948?" And I said, "No, Mr. Williams, I do not."

Parenthetically, I might add that he has been a client of mine for 20 years but I still call him Mr. Williams, as one does if one knows him.

He said:

> My role for 3 years was to make sure that the United States could get rid of its gold supply. The function I shared with Mr. Rockefeller was to make sure that we pumped our gold reserves into the world. We followed an intentional policy of attempting to deplete our reserves and attempting, if you will, to spread our reserves.

So when we went into the war in Vietnam in 1963 or 1964 or 1965—and one is never quite sure when we went into that war—it was obvious then that we had begun to lose our economic supremacy. That war was the crowning blow to our balance of payments deterioration. I will tell you a personal story about that. In early 1966 I toured this country and Europe. I went to France, Italy, Germany, Holland, Belgium, the United Kingdom, and I took the position that the United States was going to war, that we would get our defense spending up to $90 billion a year, that at its peak we would commit, if you included the Air Force, the Coast Guard, the Navy and the ground troops, one million troops to that war. My European friends, particularly the French, said: "You are crazy." They said: "Didn't you learn anything from Algeria?"

When I went to England, I met a young man named Gilbert Bouveret, with whom I took my doctorate at the University of Dijon in France, and I asked him: "Tell me something, where is France getting her gold? Her balance of payments figures are not that good. She seems to have an inexhaustible supply of American dollars and she is converting those dollars into gold. Where is the gold coming from?" He looked at me and he started to laugh and he said, "You must be kidding." I said: "No, I am not." He said: "I am a manager of which bank in London?" And I said: "Now I understand." He was a manager of the French Bank of Indo-China.

In 1966, the only bank of consequence in Indo-China was the Bank of Indo-China. All the American dollars we were pouring into the Vietnam war were ending up in the French central bank. And the French in their wisdom, and I say this in a complimentary way, immediately proceeded to turn as many of those dollars into gold as they could.

If you will look at the statistics, from what we are able to tell, our capital outflow from the U.S. Government to fight that war in Indo-China was apparently somewhere between $4 billion and $5 billion a year in 1966 and 1967, and foreign central banks immediately converted that into gold. Very frankly, in their place, I would have done the same thing.

That was point No. 1.

Point No. 2: If you look at the statistics which your own committee has put together, your own research staff has put together, you will notice an acceleration in Government spending on the international side during the years 1965, 1966, 1967 and 1968. We went from $2.8

billion in 1965 to $4.5 billion in 1968. The war caused us trouble with our balance of payments.

Point No. 3: We pursued the most inane set of economic policies I have ever seen a country pursue. They can be described only as "stop-go." The parallel is England. Every 2 years England decides to "get religion" and they stop the economy. They stop it for 18 months. The economy runs into trouble and they speed it up. They let things run for about 18 months and then they have to stop it again. It is rather amazing to me that in the past 4 years the United States has followed the most disastrous set of economic policies any country could follow. I admit that I am a registered Republican, but I say the facts speak for themselves nevertheless. Look at our record. In 1969 this country decided to stop inflation by restrictive fiscal and monetary policies. In 1970, this country was on the verge of a financial collapse.

I hold no special brief for the U.S. stock market. But the Dow-Jones index was at 1000 in 1966 and it got down to 631 on May 26, 1970. That is an index of the people's confidence, of their willingness to buy securities of American industry and, more importantly, to finance the American economy.

If you read the stories about the Morgan Guaranty Trust, you will find that they ran out of funds in 1970.

The President of the United States held an emergency meeting on April 30, 1970, at which he finally decided to reverse the almost disastrous monetary and economic policies which had been followed, and finally, we did turn the American economy around. It barely recovered in 1970 and 1971. It is rather amazing to me that when you look at your figures on capital outflows, you will discover a rather shocking fact. The capital outflow of private industry goes up when the American economy slows down. It is that simple. If you were a businessman and you were looking for opportunities in the world and the American Government had stopped this economy cold for 3 years, which is what we did, where would you make your investments? Would you make them in the United States or in the rest of the world? While the rest of the world was moving ahead, we were at a virtual standstill. So the money left the United States. Just look at your numbers.

We had a further deterioration in our balance-of-payments position. In 1971, we had one of the worst balance-of-payments positions ever seen in this country, a large part of it due to the capital outflow from the United States. In 1972, as you well know, we began to get this country under economic control. The record began to look good. Then we got into that disaster known as phase 3.

And, as I mentioned, Senator Byrd, I would not agree with Mr. Daane on the balanced budget. I would say we need a big surplus with tax increases now.

This country is out of economic control. Our inflation rate on consumer-prices alone is now running 9 percent a year. Herbert Stein takes great pleasure in the fact that it dropped to only 8 percent in April. Forgive me for putting it this way, but that is like the difference between being in a fire up to your eyeballs and being in a fire only up to your neck; it feels that much better.

He takes pride in the fact that the disaster is less disastrous. In the first 4 months of 1973 our rate of wholesale price inflation was in excess of 20 percent. Recently I asked my staff to look at our wholesale price inflation rate and compare it with those in the rest of the world. We compared the U.S. rate with rates of 17 countries for which we think the statistics are reasonably accurate. We came to a shocking conclusion. We had the fourth highest rate of inflation among those countries today. The countries whose rate of inflation exceeds ours are Argentina, Chile and Uruguay.

The French rate of inflation in the first quarter was 5.7 percent officially, and it is estimated that they understate their inflation by 2 percentage points, so let's say it was 7.2 percent. We had 9. Germany in the first quarter had an inflation rate of 6.2 percent. We ran 9. You go on down the line. You find that we have one of the highest rates of inflation in the world.

Now how Governor Daane—and here I am objecting to his official views—can talk about improvement in our international position is beyond me. I think you are going to see more capital outflow from this country, and you are going to see more private capital outflow as our inflation rates continue to exceed those of the rest of the world, particularly in view of the fact that this administration refuses to act.

And I want to say something bluntly: the American people are running away from their own currency. They are hiding money all over the world. If you don't believe that, go to Switzerland, as I have, go to France and go to Germany. People are walking into banks with dollars in their hands, converting them into European currencies and Japanese currencies, selling the dollar at whatever price it takes to get a stronger currency. We are debauching our currency. How can you talk about stable money with 9 percent inflation in a year?

And don't blame American companies for speculating in currencies. Why shouldn't they? It is their money. As an American citizen, if my money is going down the drain, I think I have the right and the obligation to sell it and to buy better money if it is available in the rest of the world. There is no law that prohibits me from doing that, and if I have most of my assets in the United States and I see what I think is coming in this country, then, frankly, I am a fool not to do it.

I don't blame the multinational companies for protecting themselves either. I don't blame the American people. But I do blame the American people for permitting the kind of inflation we have now. I blame the American Congress for overspending and the administration for refusing to act. To put it very simply, we are all guilty and the irony is that this is why we have a balance-of-payments problem.

There is a law in economics called Gresham's law and it was first formulated in 1554 as far as we know, and it says: "The bad money drives out the good." It is that simple. You get rid of what is bad and you convert it into good.

Next, I want to talk about the flight of American capital for a few moments. Let me say a few things with which you may disagree vehemently:

No. 1: I think there is antagonism in this country toward American capital. I think we have a Congress which is, in fact, antagonistic to American private enterprise and businessmen know it. When I testify before the House Ways and Means Committee, some Congressmen tell me that an investment tax credit is a tax loophole. My rejoinder is, why don't you look at what the rest of the world grants in the form of tax incentives? When you have a Presidential campaign whose chief economic issue is the ability of people to evade taxes, you are scaring American capitalists. And if you scare them, they run for cover. They hide. Gentlemen, American capital is hiding now and I can prove that to you with these statistics.

In spite of the slaps America gets in France, the official position of the French Government every year—and I say this with a name like Pierre Rinfret—is to barely complain about the inflow of American capital. The French Government does its damnedest to get our capital to come there. In southern France, the French Government provides American industry with tax incentives, tax freedom, trained workers, and free factory buildings if they will invest in the Marseilles area. If you put your capital investment where it will help reduce French unemployment, the French Government welcomes you.

The investment tax credit in the United Kingdom is 42 percent. In the United States we fight about a 7-percent credit. In Belgium, they will provide you with your working capital, a trained labor force, and tax freedom for 10 years on any profits you may make in your venture.

American businessmen look around the world and they ask a very simple question, "Where am I safe? Where am I welcome?" And I think we have arrived at a paradoxical stage of life where American businessmen are more welcomed abroad in many ways than they are in the United States.

We are antagonistic toward American capital. You want to close the loopholes? Well, the other day Herbert Stein once again brought forward the ridiculous idea of rescinding the investment tax credit. I know for a fact that this administration has formally asked for the rescission of the investment tax credit. I hope only that it will never happen. How can American industry do any planning when it cannot count on any domestic support? So it goes abroad.

In addition to that, let's look at one fact: This is a country which has gone to war three times in 30 years. We've had World War II, Korea, and Vietnam. Parenthetically, I might mention the greatest irony that I have heard recently. On Memorial Day, this was called a country at peace. I found that a little disquieting. If we are still bombing and if that means this is a country at peace, then I have to redefine "peace."

Does anybody want to stay in a country which is constantly at war? Look at the record in the Depression. Why did we get a gold inflow? We got a gold inflow because the Europeans were running from war and putting their money where they thought there would be no war; namely, in the United States. I venture to suggest to you that it would not be silly to state that Americans are also running from war with their capital.

The irony is that since General DeGaulle ended the Algerian war, peace and prosperity has been characteristic of Europe but not of the United States. And that will always attract capital.

Just look at what the Europeans are doing. They have created continued economic expansion. Their record of economic growth in the last 10 years is superior to that of the United States. Their inflation record until 1965 was inferior. We did much better. But since 1965, we have had an inflation rate about equal to that of Europe and in 1973 we have exceeded it.

If you look at it another way: When Europeans grant an investment tax credit to American industry, they maintain the credit permanently. In the United States we do nothing but argue about retaining and/or revoking the incentives to industry.

Finally, the greatest irony of all, the European Economic Community is getting bigger and bigger, and the greatest defeat which the United States suffered was the multiple float of foreign currencies. It had been predicted that by 1980 the European Economic Community might have a single currency which would be termed the European Monetary Unit.

The United States, by its second dollar devaluation, in effect, advanced the creation of a European Monetary Unit 7 years. We are forcing the European central banks to work together, to harmonize their policies. In effect, we are forcing them to float one currency which is the European currency, against the dollar.

Gentlemen, let me refer you to the record to two wonderful books about this subject. One is "Benjamin Strong: Central Banker." It's about the twenties. The other book is "Memoirs of a Governor of the Bank of France," by a man who was Governor from 1925 to 1939.

I want to tell you a story which I have repeated frequently about my father. My father was an international speculator. Today they would call him an investment banker. He speculated in Russian furs, in foreign currencies, American currencies, American goods, Canadian goods. When I was with him in 1936 in Paris, he told me something which I will never forget as long as I live. He said: "Whatever you give the Europeans, they will take."

Gentlemen, all I can say to you is that we have been giving and they have been taking, and they have been right to do so because, after all, if you are on the receiving end, why not? We have now forced them into a single currency and they will use it against us and not for us.

Notice the hardening line on the trade negotiations coming up in September. They are not going to give us anything. We are going to have to fight. Why should they give us anything? We gave everything and they took it, now they have it and they are going to keep it. And in their place, I would do exactly the same thing. If we have made one mistake, it is that we have given away our natural resources.

Look at the balance of payments. I will ask you a question and I mean no disrespect, but why didn't you convene these hearings 10 years ago? Why not 5 years ago? Why only now? Why did it take us 10 years to realize that we have a problem? You know why? Americans think the balance of payments is unimportant. It is something which is studied by a few obscure economic theorists hidden away in some universities. After all, it amounts to only 5 percent of our total GNP. Other countries understand the importance of the balance of payments. When they have, as Canada does, approximately 28 percent of their employment engaged in export industries, they will very well watch it. We have been so insulated by our domestic markets that we have ignored it completely.

I want to make five recommendations to you, if I may. I want to be very honest with you. I don't think any one of these things will be done. I gave up hoping years ago. I will say this to you: My advice to my clients in the past 10 years have been very simple and I am on record as saying this all over the world. I say that we will lurch from one dollar crisis to another, ad nauseam. We will take action only when we are faced with the inevitable collapse of the world monetary system, and by that I mean a depression. That is on the record. I don't think we are going to do anything. I think we have phobias, I think we have egos, I think we have vanity, and I think we are just plain ignorant. It is a boring subject.

Let me give you my recommendations, but before that I want to tell you some of my assumptions. First, the United States suffers from arrogance. I might say that here in Washington you see it around you every day of the week. We suffer from arrogance. We think we are the No. 1 economy in the world. I don't think that's true anymore. I think we were entitled to that rank once. Senator Fannin talks about productivity. If I remember correctly, Senator, if you look at the differential between our wages and those of the rest of the world since 1946, you will find we have the worst differential on record. Unfortunately, we hear a lot of guff about productivity and unit labor costs.

Well, let me tell you this: the foreigners are outstripping us left, right, backward and forward. You can't export American technology, give them the benefits of our technology with labor costs that are one-fourth to one-half to two-thirds of ours, and then expect us to beat them. We can't. So we suffer from arrogance. We still think we are the No. 1 economic power in the world.

I suggest to you that the No. 1 economic power in the world today is the European Economic Community. If it isn't the European Economic Community, Japan is certainly giving them a close run.

My second assumption is that we suffer from the strangest arrogance possible in that we think we 210 million Americans can dictate to the rest of the world what they should think, feel, and do about gold. I have a tabulation in my briefcase which you may find interesting. I added up the populations of the countries of the world where people are allowed to buy gold. According to my staff there are over 1.5 billion people in the world who are allowed to own gold and we, 210 million Americans say to them: "You are wrong and we are right." We think we can tell them what to do, but we can't. Governor Daane says he would like to see gold wither away. I will take exactly the opposite position. Gold will become ever more prominent in the world as inflation rages, as economies stay out of control because I remind you of one fact: the debate about whether or not gold is a commodity is nonsense. If someone had taken any known material and dropped it into the ocean 4,000 years ago, it would most likely have dissolved and disappeared by now. But if they had taken a piece of gold and dropped it into the ocean and taken it out today it would be in as good condition as it was when it was dropped in. Why has gold remained valuable for 4,000 to 5,000 years? For a very simple reason: people believe in it. I don't know whether they are right or wrong, but if they believe in it they are going to act on that belief. And if they believe in it strongly enough, they are going to continue accumulating it.

Let me remind you of something else. The U.S. Treasury takes the attitude that if the Europeans have dollars and they don't like the dollars, well then, they can sell them by buying American goods. They have forgotten one fact; money is a storehouse of value. I have the right to just keep money as money. You can laugh all you want at the gold speculators, but let me remind you that the price of gold in the world today is equal to the amount of all the increases due to inflation since 1933. At $100 an ounce for gold in the free market, all the effects of inflation have been included. And so the person who put his faith in gold in the past 20 years has been proved to be right and not wrong, right because at least he has the same purchasing power he had 20 years ago. That is a fact and I have looked at those numbers in great detail. Gold has indeed proved to be a storehouse of value.

My third assumption is that after two devaluations and a first-quarter balance-of-payments deficit whose adjusted annual rate was $40 billion, the United States still thinks it doesn't have a balance-of-payments problem. You heard it said today. We don't have a problem. We are going to ride it out. I have been hearing that for 10 years. We are going to muddle through. That is the British term for it.

My fourth assumption is that we have forgotten how to trade. I am a consultant to industry, but I feel our entrepreneurs are no longer entrepreneurs. Where are the Yankee traders? Where are they? Where are the people who used to take risks in the world? Where are the people who used to penetrate markets? They are gone. We have gotten ourselves into a corporate environment where the way you stay alive is to make sure that you never stick your neck out. I am dead serious about that. While the rest of the world is venturesome and daring and entrepreneurial, we have withdrawn into our shells.

Mr. Denny of RCA is sitting in the audience I think. At least, he was sitting there when I came up. He will remind you that when I was a consultant to RCA in the early 1960's, I took the position that the Japanese would steal the entire radio market of the United States. Mr. Denny, if I remember correctly, shared that view but nobody else did. The Japanese, according to the figures we have, now hold 80 percent of the radio market in the United States. Eighty percent of the radios we buy are imported. They have stolen one market after another. We reacted late.

Look at automobile imports. I could tell you stories about that. American Motors came on the market with a small car and they got banged out of the market in 1960 and 1961. American industry worked as long as it could to avoid producing a small car. Only when American manufacturers were faced with the fact that the Europeans and the Japanese were stealing that market did they finally react. We are losing our entrepreneurial drive.

This, Senator Hansen, you asked this question about oil. Senator, there is another problem which nobody has looked at and that is the minerals problem. It is worse than the oil problem. The oil problem is just for openers. We have worked on the minerals problem to a certain extent. The estimate is that if we continue current trends, by 1985 we will have a balance-of-payments deficit in oil alone of $50 billion a year.

Senator HANSEN. What?

Dr. RINFRET. $50 billion a year in oil alone by 1985. It may be that we will have the same balance-of-payments problem in minerals.

We are running out of resources, and all I would say to you, very simply, is this: No economy has ever functioned without energy, and there is a direct correlation between supplies of energy and standards of living.

As for the last of my assumptions, let me put it this way: As a somewhat battered policeman of the world, we still pour out our capital to the rest of the world. We still give foreign aid; we still give military aid. Finally, in my judgment, the world monetary system is sick.

Now, let me give you five recommendations. Some of them may surprise you, but I will say this to you. Each one of them has historic precedents. No. 1, call in all American currency, call in all of the money in the United States and all over the world. Issue new currency. There is more than adequate precedent for doing this. We did it with gold. The results which this might accomplish may be listed as:

First, the elimination of counterfeit currency, which could be substantial. Estimates are as high as $5 billion to $10 billion floating in the world.

Second, the location and identification of large pools of illegal bank deposits and cash hoards. Let me clarify that. You have heard about the troubles of IOS. I don't know if you gentlemen realize that the fundamental reason for IOS' existence was that it was basically a depository for illegal money, money which could not be traced and would not be traced. Isn't it amazing that after all of its troubles, IOS still has assets of $500 million?

Third, we could tax the hoards of cash whose origins cannot be traced.

My second recommendation is to raise the price of gold to $200 an ounce, on the basis of the inflation which has taken place since 1933 in the United States alone; I am using American inflation only, not European inflation. We set gold at $35 an ounce in 1933; if the price of gold today were to equal the inflation we've had since 1933, it would be about $105 an ounce, or where it is. I would double the price, and once and for all, I would put to rest any idea that there are going to be further increases in the price of gold. It is self-defeating nonsense to raise the price of gold 10 percent at a time when inflation is 9 percent in the United States and between 6 and 7 percent in the rest of the world. If you raise the price of gold 10 percent, using the slice of salami technique, and inflation is 6 to 8 percent, then all you are doing is buying 14 months until you have to devalue again. It is interesting to note that the second devaluation came 14 months after the first. Incidentally, Mr. Chairman, let me comment that the second devaluation was not expected by the administration. They reacted late. They were forced to do it. They knew it had to come but they did nothing for 5 days while the crisis went on.

I would raise the price of gold to $200 an ounce and then the United States should stand ready to sell gold at that price to foreign central banks.

My third recommendation is to create incentives to American capital to stay here and create more incentives to attract foreign capital here. There is very little real foreign investment in the United States. Most of it is equity investment. In the past 25 years, the rest of the world has created incentives to American capital to leave the United States. They have done this by various techniques and methods, including investment tax incentives, special grants, forgiveness of income taxes, and so on. This has helped attract American capital abroad.

We need to do two things; First, we have to make it attractive for American capital to stay in the United States by giving our businessmen the same kind of treatment they get in the rest of the world; second, we have to give incentives to the rest of the world to come here, especially incentives to foreign capital.

My fourth recommendation is to treat the rest of the world as it treats us. Let me be frank: Get tough. The Europeans will respect us for taking a hard line. I happen to think they respect Governor Connally. I don't think they like him, but they respect him. They complain about him because he is tough. I am told by Lee Iacocca, president of the Ford Motor Co., that when he exports a Mustang into Japan, he pays $1,000 in duty, but when the Japanese import a Toyota into the United States, the duty is $100. If the rest of the world will not give us equal treatment, we ought to take unilateral action to get equal treatment.

I don't think we are going to have a trade war. I think no one can afford it. The rest of the world could afford it less than we could.

My fifth recommendation may sound silly, but let's face facts. We are internationally bankrupt. There is no other way to put it. We have $83 billion worth of short-term liabilities. We have $13 billion in reserves. We have closed the gold window but we won't face up to the fact that we are broke.

I want to give you a perfect illustration of how that influences Government policy. I will cite names.

On April 26, Mr. Carstens, who is very high in the Christian Democratic Union of the West German Government, came to this country and wanted to negotiate for payments to the United States for the stationing of American troops in Germany. As you know, there is some quid pro quo. Mr. Carstens, I know, was prepared to pay $1 billion for the maintenance of American troops in West Germany. He told me that the U.S. Treasury or the Department of State—I am not sure which—asked for and accepted only $500 million although Carstens was ready, willing and able to pay $1 billion. I communicated this to the proper authorities, and the payment was still $500 million.

We suffer from the idea that we can still afford to be the chief policeman of the world. We gave away $500 million in that one fell swoop. It was not important enough; we didn't negotiate; we didn't bargain.

And so, I would end with one very simple thought: I don't think the balance of payments situation is going to improve. I don't think the U.S. Government is going to do anything to improve it. I think we are going to continue to lurch from one crisis to another. We seem to lack the courage, the drive, the incentives to change the situation.

If you make certain proposals, you are considered extreme, flamboyant, crazy. One of the leading economists in the United States 4 weeks ago suggested that gold is good only for filling teeth. There are over 1.5 billion people in the world who think it is good for other things besides filling teeth. Let's face up to one fact; we are in trouble. We are in trouble economically, financially, monetarily, and we are slipping. I said the other day, before the Senate Subcommittee on Antitrust and Monopoly Legislation, that we are on the way to becoming a second-rate industrial power.

I would give you two priorities: No. 1, stop the inflation in the United States, and No. 2, solve our balance-of-payments problem. I think we have the means, the techniques and the know-how, but we won't use them.

Mr. Chairman, that is the end of my presentation.

Senator BYRD. Well, doctor, I must say I had not expected anyone at these hearings to share the pessimism of the Senator from Virginia. I have been saying it in the Senate for several years. I have thought much of what you have said this morning. I, too, have pessimistic caution. I do not share Governor Daane's cautious optimism. I think, as you said, we have a basic long-term problem and I think the number 1 problem is to get inflation under control here. And it seems to me that is not going to be done until the Government gets its own financial problems under control. I don't see how it is logical to keep on with these huge Government deficits which have gotten worse in recent years. By the end of the next fiscal year, 1974, 24 to 25 percent of the total national debt will have been accumulated in the period of 4 years. As I view it, the rest of the world sees the American problem far better than we see it right here. I think we have been living in a fool's paradise, and I think the Congress is even more living in a fool's paradise.

What disturbs me is that I don't see that any real—well, I was going to say, effort is being made toward a solution to our problems. Certainly, I see no results from any efforts that might have been made. As a matter of fact, it appears to me that conditions are steadily deteriorating. I had not realized until you brought it out today—and I am assuming your figures are correct—that the United States has the fourth highest rate of inflation in the world. That is a very astonishing fact, it seems to me, but I agree with your assertion, too, when you said that our spending is out of control. I think it is. I think we face a very, very serious problem, but in talking with most of my 535 colleagues in the Congress of the United States, I find that very few share my pessimism.

And for that reason I am sorry to know that you not only share it, but are perhaps even a little more pessimistic than I am. I hope I am wrong about this thing. I hope you are wrong and I hope I am wrong. I don't think we are, though. I don't think we are.

Senator Roth?

Senator ROTH. Earlier, you recommended that we should not only balance the budget but also provide for a large surplus. I wonder if you could be a little more specific. There has been a lot of talk recently in the Congress, supporting the need for a legislative budget in which we set priorities. Are you in a position to talk figures for this year in addition to discussing more general concepts?

Dr. RINFRET. Let's start, Senator, with the concept that Congress will accept its responsibility, which I think you will agree it has long avoided, to add up the figures and find out how much it is authorized to spend, then you set a budget, and you rank your priorities. Right now this country, in my judgment, desperately needs a tax increase. I would like to see both a personal and corporate tax increase, but the personal tax increase should not be imposed on those in income brackets below $7,500 a year, because I think these people are overtaxed now. I would hope we would tax to such an extent that we would pick up about $8 billion in revenues for fiscal 1974 over and above present projections.

The U.S. Treasury's most recent estimate for fiscal 1974 shows that the budget will be in the red by about $4 to $6 billion. That is their most recent estimate.

Senator BYRD. What budget?

Dr. RINFRET. That is for expenditures versus receipts, not the full-employment budget but the straight expenditure budget. Now, that is not the official figure. The official figure, as you know, is much higher than that. You must remember that they have raised their GNP estimates by a substantial amount. They have raised their corporate profits figures by a substantial amount. And they are coming up with much higher revenue figures than they had before.

The latest inside estimate for the fiscal year 1974 deficit is that it will be $4 billion to $6 billion; in other words we will have a cash deficiency of that amount, and our spending will be in the red. I would like to see a cash receipts increase of at least $8 billion. That would give us a surplus of $2 billion to $4 billion. I think that would have some obvious impact: (1) it would take spending power away from the people; and (2) of course, it would permit some very moderate, but nevertheless some, reduction in Government debt.

If this Government cannot balance its budget in the biggest boom we have had in maybe 20 years, then heaven knows when we are going to do it. Now, the problem with a tax increase, of course, is whom you hit and how. I myself would prefer a different kind of tax increase, which I have talked about. I would prefer a surcharge on American corporations and on the individual American taxpayer, this surcharge would go into escrow; that money would not be available to the Federal Government and would be kept separate from Federal expenditures. The surcharge could be turned over to corporations and individuals at a later date if it is necessary to stimulate the economy. Incidentally, this is not an economic innovation. This has been done in West Germany with a great deal of success.

Specifically, I would say this to you. We should have enough of a tax increase to get our budget into a surplus position in fiscal year 1974 because we sure can't do it for fiscal 1973. We should move for a tax increase now.

I don't know if that is specific enough for you, Senator.

Senator ROTH. Would your escrow proposal involve borrowing temporarily from the public and paying it back at a later date, when the economy needs a stimulant? Or are you suggesting that there would be no obligation but rather some form of tax?

Dr. RINFRET. It would not be available to the Federal Government.

Senator ROTH. As you know, there are many people both in and out of Government who feel that we are not spending enough to solve our social problems. Some people feel if we increase taxes we will increase spending. Would you recommend increasing taxes and increasing spending? Would that make any difference or would we just be spinning our wheels?

Dr. RINFRET. Well, I would answer you this way: I am no judge of what our social objectives are or how adequate or inadequate they are. But as a consultant to companies in the construction industry, I have heard them scream about the impounded funds for pollution control.

It is amazing how they are for fiscal discipline until it affects their own businesses, then they are for pollution control and not for fiscal discipline.

Senator ROTH. That is a problem we are often faced with, of course.

Dr. RINFRET. I would say this to you. I think there is a very simple answer to the problem. I don't care how you slice it, but if the American people want these social programs and Congress, as a representative of the people, votes for those programs, then I say let Congress tax the people to pay for those programs. That is all. If you want it, pay for it. Why do we persist with the ridiculous notion that there is such a thing as a free lunch in economics? You see, you are taxing the people anyway.

Sure, you don't hit their pocketbooks with a direct tax increase, but when you make them pay 9 percent a year more for the same goods or services as a result of inflation, you are taxing them. Government policies right now are highly inflationary. There is no question that the Government is an engine of inflation right now. Incidentally, so is the Federal Reserve.

This statement about a slowdown in the Federal Reserve allowed growth of the money supply is nonsense. Incidentally, I will make you this prediction and you can check it out: The money supply figures in April, May and June are going to be shocking. Do you know why? Because the Treasury is now unwinding its deposits into the private system and, as they unwind, the money supply is going to go through the roof. Then you are going to see the Federal Reserve faced with another surge in the money supply and another attempt to hold down on credit.

Our fiscal and monetary policies have been creating inflation in this country. Our Government is the engine of inflation. We won't pay the taxes which are necessary to pay for these programs. You can go back, if you will, to the "Great Society" which wanted war and welfare simultaneously. No country in the world can provide both unless the people pay for it, and we didn't.

I don't care how you do it. If people want clean air and clean rivers and everything else which goes with that, then let them pay for it.

Senator ROTH. Many people argue that the public sector is spending too much—some 33 percent of our current GNP. Do you thing that there is any maximum that the Government can spend without placing a serious drag on the growth of the economy? Are we there now or do you think we will reach it soon?

Dr. RINFRET. I would have to give you an honest answer I think that concept is silly in view of what is happening in the rest of the world. It is estimated that the French Government directly controls 50 percent of all of the output of France, for example, and that country is going to be the leading country in Europe in 5 years. They have one of the highest standards of living in the world. It is growing at an incredible rate. Their GNP is growing 6 percent per year in real terms.

Senator ROTH. When you say they control 50 percent, does that mean they control the means of production?

Dr. RINFRET. Yes.

Senator ROTH. So, right now it is not complete?

Dr. RINFRET. It is not quite total control. If you look at it from the viewpoint, however, of Government revenues, they are taking in those revenues and disbursing them.

Senator ROTH. As you know, we have a trade bill before us. I guess this is a little bit out of our immediate jurisdiction in the subcommittee, but I would like to hear your comments on the administration's proposals. How can we write into this legislation the need to bargain, as you put it? Can that be done? Are there any techniques there beyond the administration's people who are selected?

Dr. RINFRET. I just don't know how you do that. I think you have to create a mental attitude and the right personalities have to be involved.

Much of what you heard about the first devaluation was inaccurate. Much of what you heard about the second devaluation was also inaccurate. The first devaluation, for example, was really ~~two~~ two men making a decision. They made a decision about how much and how far they would go and when, and they did it. You know the two men I am talking about; one was the President of the United States and the other was Governor Connally. Now, Connally was ready, I am told, to go in with a 15 percent change in the price of gold. The British said they wanted a change of 8 to 9 percent. Connally went in and bargained. The French wanted 15 percent. Connally bargained. He shocked them when he threw that on the table.

How do you tell the American people that we are no longer rich, that we are financially bankrupt, that we are broke, that we must get tough? People will still tell you that the U.S. function is to provide for the rest of the world.

Now you either change the cast of characters or you are going to have exactly the same thing happening again. I might add that I have been intimately involved in this area on an unofficial basis for a long time, and the problem I have always seen is in attitudes. There is a philosophy in economics which is, unfortunately, sometimes so out of touch with the real world that it gives rise to statements like this: "If foreigners don't like dollars, let them buy American goods." You try to explain that foreigners don't have to buy American goods, but how do you beat that kind of attitude? You beat it with personalities.

When a corporation is in trouble, it gets a new chief executive officer. When the chief executive officer finds that his executives are no good, he gets new executives.

People run trade. When Mr. Eberle goes to Japan, I am told he is tough, and the Japanese scream and the other Government departments scream that he is too tough, he should be pulled off trade negotiations because he is tough. When Mr. Connally goes to Europe and he is tough, everybody screams that he is a bull in a china shop. We get worried whenever we have a tough man negotiating for us and we run for cover. We are simply not protecting our own interests in our trade negotiations.

I endorse the trade bill 100 percent. The President has to have the right to negotiate tariffs up or down. If I may, I'd like to make a few comments about that point. As you will recall, the first point the Secretary of the Treasury made was that the United States was asking for the right to lower tax barriers, and the second point was the right to raise them. I said, "It should be the other way around."

But his attitude was such that he was thinking first of lowering, not raising.

Now, how do you change that kind of attitude? You change the people in charge.

Senator ROTH. Is it your view that through tough negotiations we should try to increase international trade or do you feel that protectionism doesn't have a significant role? Do you feel we are going to have to move more in the direction of protectionism?

Dr. RINFRET. I think there is an answer to that. I have talked to the Europeans about this. I don't think the Japanese or the Europeans want a trade war. I don't think they want the United States to go protectionist. But the impression I get, particularly from talking to people at the top level of the French Government, is that they still don't think we are serious. They still don't think we really want to get our balance of payments in equilibrium. I met with the economic adviser to the French Minister of Finance, and he said a very simple thing to me: "Why don't we stop quibbling and get on with it?"

Senator BYRD. Would you repeat that?

Dr. RINFRET. This was the economic adviser to the Finance Minister of France, and he said: "Why don't we stop quibbling and get on with it?" He was saying, in effect, "We don't want to quibble with you any more."

But they still haven't gotten into their heads the fact that we are serious.

Senator ROTH. Should we put our defense problems together with our trade problems as one bargaining package?

Dr. RINFRET. Absolutely. I gave you one answer to that. What did the Germans say? Mr. Carstens told me that West Germany would be willing to give the United States $1 billion to keep our troops stationed there. We settled for $500 million. I asked him "Why don't we pull the troops out so we can force you to pay us $2 billion, which is what you really should be paying us?" And he said: "Oh, you will never pull out your troops, you can't pull your troops out of West Germany."

This is one of the toughest men in the CDU, and he said: "You can never pull your troops out." I said "Then we should, because if you are scared enough, maybe you will pay us $2 billion instead of $1 billion."

So all I am saying is that we need a total approach using every weapon we have. Ask Mr. Denny what methods he uses in corporate negotiations. What do you use in Congress? You use every tool at your command. Why do we divorce international trade from polictics? Why do we say that the monetary system is not related to political objectives? That is nonsense.

Now, one of the reasons why we have a balance-of-payments problem is because we are spending $5 billion a year for defense all over the world. And don't tell me those points are not related. Part of our getting tough is saying, "OK you want the troops in West Germany? You want all the troops, all the equipment? Fine. Now pay us $2 billion, or you get nothing."

Of course, I have a hypothesis about that, Senator. It is very simple: our troops are there to protect us and not the Germans.

Senator ROTH. My time is up. I would just like to ask you: You made some reference to our country's backward position in attempting to develop incentives. Have you accumulated any information on this type of incentive?

Dr. RINFRET. Yes, sir; I introduced this in testimony on investment tax credits and other investment incentives before the House Ways and Means Committee and, if you like, I will send it to you. It is a detailed analysis of the incentives in most of the Common Market countries and Canada compared with those of the United States.

Senator ROTH. Thank you. I share your desire for this country to get tough, for this is important. We have to learn economically, as well as militarily, that we are no longer the biggest power.

Dr. RINFRET. Yes, sir.

Senator BYRD. Senator Haskell?

Senator HASKELL. Just one question:

You mentioned we lost the Yankee trader instinct. Based upon my limited observation of our major corporate enterprises, I happen to agree with you. You are the first person who has made such a statement though. I would like to hear from you any suggestions you feel might be helpful in inducing us to get back some of these instincts.

Dr. RINFRET. Well, I would have to begin by saying that it is fairly complicated, to say the least.

Senator HASKELL. Oh, yes.

Dr. RINFRET. Let me give you an illustration. When President Kennedy reacted to the steel price increase and sent the Internal Revenue Service to investigate the tax returns of Mr. Roger Blough, then chairman of the United States Steel Corp., that was the beginning of the end of the American industrialists' willingness to talk it out. It really was. If you go back and study the record, you will be amazed to find to what an extent that was the turning point.

You have to recognize that the American businessman is terrified by the U.S. Government. He is absolutely terrified. He doesn't want anything to do with it. He wants to stay as far away as he knows how, and the less involvement he has, the better off he is. He is subject to harassment, he is subject to investigation, he is subject to criticism, he is subject to insults. Most businessmen, in my experience—and I am not carrying their flag because I don't carry anybody's flag—most of them are pretty responsible human beings. Some of them are crooks. Some of them are thieves. But the proportion of crooks and thieves in business is no different from the proportion of crooks and thieves in the rest of the population. Businessmen come up against the U.S. Government and they are accused of everything in sight, so they say, "Well, maybe the best thing is never to testify." They are subject to a taxation system—and this is something I didn't get into with Senator Roth and I would like to make one comment which I should have made earlier. For example, this is the greatest capitalist economy in the world, this is the country which has been the epitome of free enterprise, and free enterprise means, after all, the information of capital. But, if I were to ask you how we rank in terms of capital gains tax rate, what would your response be? Most people would say we rank 8th, 10th, or 15th. The shocking answer is that we rank highest in the world. Our capital gains tax rate is the highest in the world.

Do you know what the capital gains tax rate is in France? Zero. Do you know what it is in Italy? Zero. In England, it is 12 percent. So the entrepreneur says, "Why should I risk my money in the United States?" If I risk my money here, they tax me 37½ percent. If I lose my money, I get a $1,000 deduction. It's a one-way street. The Government shares one-third of my profits and none of my losses.

So you have made him a little less of an entrepreneur. As an individual, I am proud of the fact that my income is a very high six figures. But I will be honest with you; today I wouldn't take the business risks I took 10 years ago. It is not worth it any more. The odds are against me now. I would not take the risk of losing with no compensation because the taxes I pay are too high.

Senator HASKELL. You are advocating increasing taxes?

Dr. RINFRET. I advocate increasing taxes to balance the budget because I think we've got to have fiscal discipline, but that doesn't mean we cannot make other changes to induce capital investment. For example, you talk about the entrepreneur. Let me tell you who is going to maintain free enterprise in this country: the little entrepreneur. You spend all of your time working for the big man and no time working for the little man. You could do thousands of things for the little businessman you don't even think about. You have a subcommittee on small business which, I am told, never gets anywhere.

You tax the income from interest on savings of $5,000. Who saves the $5,000? Mom and Pop. And you tax their income, you tax the interest on their $5,000 savings.

A little man goes into business. He has a shop with 10 employees. Now you take away his $25,000 tax exemption. You are killing him, and so he says, "The devil with operating here, it is not worth the risk."

So where does he go? He looks all over the world. And such businesses are not so big, incidentally. I can tell you stories about people leaving this country with $10,000. They go to the rest of the world and they see that their capital investment is fostered, aided and abetted abroad. So they say, "I am not going to take the risk of investing in the United States. It is not worth the risk anymore. If I invest in other countries, I don't get taxed to death. If I invest here, I get taxed, I am attacked."

You know, Government, the media and, everybody are on the industrialists' backs.

Let me ask you another question just for the fun of it. Name me the industrial leader of this country today. Who is he, sir? Where is he? I don't know who he is, I haven't heard from him in 10 years. Ten years ago I would have said it was Roger Blough. Now who is it? Have you noticed how quiet the leading businessmen have become? They are keeping their mouths shut because the best way to keep from getting burned is to keep your mouth shut.

For example, there are class action law suits. This is a killer. The courts permit one guy to file a suit. I know and most of you people in Congress who are lawyers know that any individual can file a lawsuit and then it is joined by 500,000 stockholders. So all of a sudden a corporation has 500,000 stockholders on its back.

So you play it safe, you play it safer and safer and safer and take fewer and fewer risks. You don't want to be criticized, and so you hide. More and more, you hide.

That is what you see happening in this country. You can't name the industrial leader anymore. I can't. Isn't it strange that the country which is the industrial leader of the world doesn't have an industrialist spokesman? Even the Chamber of Commerce has become quieter.

What is the NAM stand on anything? You hear less and less from them.

What is happening is sad. I will give you my favorite example. I have said this before in testimony and I will repeat it. The Securities and Exchange Commission is the bulwark of the American investor against the financial community. If it were not for the SEC, I am convinced that the financial community would rape most American investors. But I will turn it around. The SEC is destroying competition in the financial community. It is killing it. In 10 years we are going to end up with Merrill Lynch, E. F. Hutton, Bache & Co., and a half-dozen other big fellows and all of the little guys will be gone. The little guys can't stay alive any more. There are too many reporting forms, too many legal and accounting requirements, too many regulations, including limits on fees. Their freedom is being stripped from them.

Do you know what I am doing? I am going out of the mutual fund business. In our small fund we have to spend too much time filling out forms for Government agencies. I am getting out. Let the big ones have it. You're killing us. This country is killing the entrepreneurial drive. If Government wants to share in the profits, it should also share in the losses.

I don't know whether I have answered your questions directly, because it gets more complex.

There is something comfortable in being part of a big, quiet crowd. You can get hurt if you speak out. Forgive me, Senator, for using myself as an example, but when I speak out, I am called flamboyant. I may be 100-percent correct, but I am called loud, extreme, and a headline hunter. That is the reaction you get when you tell the truth. These are some of the problems, and after a while you get tired of them. In 1970, I said, "There ain't going to be no recession" and that has been quoted back to me two million times. Frankly, I am getting tired. One of these days I just might stop making public appearances because you can take only so much. This is part of the problem.

Senator BYRD. Senator Fannin?

Senator FANNIN. Thank you, Mr. Chairman. I certainly commend you, Mr. Rinfret, for an excellent statement and the answers you have given. I am tremendously impressed. I am just sorry that every Member of Congress could not have had the opportunity of being here today to question you because I think you could change the minds of many people regarding the antibusiness attitude that is held by this Congress. We do have an antibusiness Congress.

Dr. RINFRET. Yes, sir.

Senator FANNIN. And it is certainly devastating to this country. When we talk about the tremendous increase in imports, for the future, I am wondering if we aren't just dreaming because to even stay in a balanced import position it will be very difficult.

Do you think that we can work on the side of increasing imports, if we also work on the side of increased exports? In other words, is it possible for us to pay for these increased imports unless we do find a way to compete better in the world market and have increased exports?

Dr. RINFRET. No, Senator Fannin, you are obviously absolutely right. You can't talk about a $50 billion deficit in oil or a $50 billion deficit in minerals without the dollar constantly depreciating so that, say, one French franc might equal one U.S. dollar.

Senator FANNIN. What I am suggesting, is that what we are going to have to do for the next 10 years if we continue on our current course?

I understand this is a tremendous problem for us. We do have somewhat of an answer, though, if we were to be realistic about it. We do have large surpluses of coal, for example, in this country, but we won't bite the bullet and say we are going to use coal in place of our natural gas and in place of petroleum products that we are importing. Other countries in the world, as I understand it, utilize what is available to them.

Dr. RINFRET. There is also a problem, Senator, with this coal. In the early 1960's I worked on this subject for 1 solid year for the Louisville and Nashville Railroad Co., which is a coal-hauling rail line. In 1965 we took a look at the coal versus oil versus natural gas versus atomic energy equation. Let me remind you that it was the stated policy of the U.S. Government at that time to expand atomic energy installations. The U.S. Government took the position that coal would not be needed in the energy mix of the future. Now what happened in 1965 and 1966? I would suggest that you check this, particularly with the Island Creek Coal Co., which can tell you about this in great detail——

Senator FANNIN. Who?

Dr. RINFRET. Island Creek Coal. Check what they did in 1965 and 1966—we were working with them at that time. As a result of the U.S. Government's projections of the demand for oil, atomic energy, gas, and coal. Island Creek Coal entered into a 20-year contract to sell its coal to Japan because the U.S. Government was then taking the position that coal would not be needed in the energy mix of the future. So this is the problem you have today, much of our coal is being exported to Japan. Incidentally, it is our best coal.

And then, of course, you have the ecology problem, of which you are aware. You also have situations where atomic energy installations are so far behind schedule as to be unbelievable. There again we get into the ecology problem, which is holding up construction of the installations with the required double safeguard system and everything that goes with it.

You are right about coal. When we looked at it in 1965, we didn't come to the Government's conclusion. We came to the opposite conclusion. We came to the conclusion that by 1990 coal demand would grow at a compounded rate of growth of 7 percent a year versus 4 percent a year in 1965.

Senator FANNIN. Well, to survive, we must reverse that position, that is my point, regardless of what we have done in the past. We must reverse our position and realize we are now up against almost an impossible situation if we fail to do so.

We do have vast reserves of coal buried in the ground. Large quantities are going to the Japanese, but we do have vast quantities we can use but are being held up now because of the environmental objections, but I think we must realize there is a balance here. We can still protect the environment reasonably but yet go forward with that development.

We also have vast reserves in geothermal energy. We had a breakthrough in that in just the last few months that I hope that you will get information about because I think it has tremendous potential.

But with the problems we have, I fully believe that the Japanese have outentrepeneured us and they have also outworked us. I think that is an important fact; they have outworked us.

But don't you think that the European Economic Community perhaps fears the Japanese more than we do from the standpoint of imports into their countries? We are importing 35 to 40 percent of all of their exports, and the European Economic Community probably is somewhere between 5 or 10. Do you expect that to change?

Dr. RINFRET. No, sir, because the Europeans have told the Japanese, "There is no way that you'll do to us what you did to the United States. No way. If you think you are coming into this market like you went into the U.S. market, you are out of your minds." I know, because I was there when the French Minister of Finance told that to the Japanese. He told them right to their faces "Do you think you are going to do to us what you did to the United States? No way."

To put it another way, the Europeans are not going to be "Uncle Sucker." They are smarter than we are. They recognize the situation for what it really is.

Senator FANNIN. We have this GATT meeting coming up. I share your pessimism on the results of GATT. What do you think will happen? I wonder, do you think we should have bilateral agreements and deal with Japan on a quid pro quo basis? A basis of you ship something into our country and we are going to ship something into your country?

Dr. RINFRET. I think multilateralism is finished. I think we should go to bilateralism. If I may put it this way, I think we should set the Japanese against the Europeans and force the Japanese to go into the European market and let them fight it out there. I think it is about time this country legitimately protected its own interests. I don't care what techniques we use as long as we do it.

I am a little tired of seeing one American market after another disappear. If the Europeans and Japanese were still in deficit, if they had no gold reserves, if they had no dollar reserves, it would be one story. But these are wealthy, prosperous countries with huge productivity, tremendous rates of growth, and huge reserves. Out of the $153 billion total reserves in the world, we have $13 billion. The Japanese have $18 billion. The Germans have $23 billion. They have more reserves than we do and we are giving them help. We are the ones who need help.

Senator FANNIN. I agree with that. We need it and we need it now.

Dr. RINFRET. Of course, very frankly, on the other hand, let me say that I don't blame them. If we gave it, they were smart to take it. I mean I don't blame them for that.

Senator FANNIN. No, they outmaneuvered us. That is right.

Our trade with the Persian Gulf countries will be practically a one-way street. We are bringing our petroleum products in from them and there isn't a consumer market over there.

Dr. RINFRET. There is another answer to that, Senator. In 1957 this country drilled approximately 70,000 wells a year. We are now down to 12,000. In our zeal to get rid of tax loopholes we eliminated the flat 27½ percent depletion allowance and also eliminated many of the wells. Now we are reinstating a measly 5-percent special-investment tax credit. One of the things my firm does is to survey industry on its response to legislative and political action.

We have asked companies what they would do about oil well drilling in 1973 and 1974 if there is such an investment credit.

Now I will say that so far we have only a 15-percent response to the survey. But all the respondents to date say the same thing, we will do nothing. Why? When you analyze it, you find that this credit would be less than what they are getting in the rest of the world. Now, again, you say we will have to bite that bullet.

Again, we have this mental fixation that we are giving away something. We are not giving away something, we are losing something. Do you know what we are losing? We are losing our independence of oil supply. We are losing jobs created in the United States. We are exporting jobs by our tax policy.

Senator FANNIN. I agree wholeheartedly with you.

Dr. RINFRET. And I say the oil problem will not be solved by what we bring in from the Arab countries but by what we do in the United States.

Take the North Slope. The problem there is unbelievable. Take the Arctic Islands. There is commercial gas in the Arctic Islands. We know that four major drillings have been made there and the gas is spilling over like crazy.

Senator FANNIN. I might say we are looking at that, certain members of the Interior Committee are looking at that problem and are very anxious to be bringing in the Alaskan oil and are doing everything within our power to have the recovery you are talking about there.

Is my time up, Mr. Chairman?

Senator BYRD. Yes.

Senator HARTKE. Can I say one thing? Mr. Rinfret is an old personal friend of mine. I have to go to the dining room and meet Bernie Seigel who is over there now. I would invite him to lunch if he could make it.

He is a competent witness. I can guarantee you that. I have the highest respect for him.

Senator FANNIN. Well, we will never have another one, that is for sure.

Senator HARTKE. Goodby, Dr. Rinfret.

Senator FANNIN. Is my time up?

Senator BYRD. It is up. But go ahead.

Senator FANNIN. Well, the problem as I see it, if we are going to trade with other countries, for instance on the petroleum issue, then we have a problem of having them being able to purchase our products if it is going to be successful over the years. Do you feel that we have a potential in Russia in that respect, because they do have the people there. I know they don't have a consumer market yet to any great extent, but they have the natural resources and they have the people. Do you look toward that market for consumer goods, also as a supplier for capital goods and consumer goods?

Dr. RINFRET. I would say this to you, Senator. I think the potential proportions of the Russian and the Chinese markets may be the one thing that will pull us out of our balance-of-payments dilemma.

Senator FANNIN. Well, I say Russia, but I mean the Soviet Union.

Dr. RINFRET. Yes, sir. We have studied this extensively and in tremendous detail. Let me give you an illustration. Let me give you a very strange concept, and I want to quote the numbers. It is estimated by the CIA that the Russians have 57.9 million ounces of gold and the Chinese have 17.4 million ounces of gold. That is point No. 1.

Point No. 2: Did you know that the Russians are reported to be selling gold in Europe at $57 an ounce for the account of the United States? I would like that fact surfaced and checked out. That statement has been made by the Bank of France. The Russians are selling gold for our account at the midpoint between the free market and the official market prices. Then, of course, they are using the proceeds to buy our agricultural products and our agricultural equipment.

Now this may sound very strange, but if we were to change the price of gold to $200 an ounce, for example, the purchasing power of the Russians would go from $4.6 billion to approximately $12 billion in reserves alone. The Chinese reserves would go from $1 billion to approximately $3.5 billion. In other words, a change in the price of gold will benefit this country more than anybody else, because the two countries which need our agricultural products and our agricultural equipment most are the Chinese and the Russians.

Now, if you look at Russia, you will find a shocking thing. According to the best statistics we have, from 1913 to 1968 the Russian population increased faster than its agricultural production. Russia is in a constant state of agricultural turmoil. I remind you of the rumors that Khrushchev was ousted because of the failure to produce wheat in Siberia. We have what the Russians want; namely, agricultural products and agricultural equipment. They cannot produce the size of equipment we produce.

The Chinese market is even bigger. Now, people say the Chinese don't have anything to pay with. Well, the reason why that April trade gain figure is phony is because we are paying for those exports to China ourselves by giving them credits. It shows up as a favorable balance-of-payments but our credits are paying for those exports. Now, this may be our salvation. Maybe in the long run, our salvation will be what we can sell to these people.

Did you read Brezhnev's statement the other day that the cold war is finished? It is over. The Russians and the Chinese are desperate for food and if you like, I can give you lots of memorandums on this.

Senator FANNIN. Yes; I just returned from there this past week.

Dr. RINFRET. Do you disagree with me? I would be interested to know.

Senator FANNIN. Absolutely not. I would like to have more information.

Dr. RINFRET. When Mr. Allen Dulles was alive, I had the pleasure of writing his speeches on the Russian economy. I did that as a private citizen and that is when I first became knowledgeable about the Russian agricultural situation. That is their Achilles' heel and it is our great opportunity.

Senator FANNIN. Well, thank you very much.

Dr. RINFRET. I will give you copies of all of these, Senator, if you like.

Senator BYRD. Senator Hansen?

Senator HANSEN. Mr. Chairman, the candor and the knowlege of the witness is certainly most refreshing. I have been stimulated by his presentation. Thank you very much.

Senator BYRD. Dr. Rinfret, that has been a very stimulating presentation. The committee appreciates your being here today. Let me ask you this on behalf of the average American, how can the average guy, the average man and woman of our country protect himself and herself against this raging inflation?

Dr. RINFRET. Senator, I have been studying this ad nauseam and I have come to a very disturbing and discouraging conclusion, there are no inflation hedges.

There is one unfailing protection, it has been used for centuries, and will continue to be used and will destroy us if our inflation is allowed to continue unchecked. I will say to you what I have said publicly about inflation—the only protective method the rest of the world has used against it is cheating. People become dishonest, they become crooked, they do things under the table. They take money for services in cash instead of in checks. They cheat on their income tax. If you have ever wondered why the rest of the world seems to cheat more than we do, maybe it is because they have had more inflation to contend with than we have.

Senator, if I may, I would like to submit to your four reports which I did on this very subject in 1968. I came to one conclusion; there are no inflation hedges. The only inflation hedge is work.

Senator BYRD. That is disturbing and we would be interested in those reports. I have been trying to compare the two situations between Germany and America. I have been interested in the German inflation in the early 1920's. I never understood it. I read two or three books on it and I don't have much more knowledge now than I had before.

No. 1, are there any books that you would recommend in regard to that German inflation in the early 1920's, and, No. 2, could you briefly indicate the main reasons for that severe inflation?

Dr. RINFRET. Well, the answer to No. 1 is that I cannot, off the top of my head, recommend any books to you. Concerning No. 2, we economists have examined that period in detail to see what happens with inflation. I can tell you it was caused by two elements: lack of production and tremendous Government debt. The Government debt poured money into the system and there was no production to absorb the money. So they got galloping inflation. I will tell you this story, which I think epitomizes the period.

I had an economics professor by the name of Sipa—not Walter—Heller. He told us a story about the German inflation. He was living in Germany at that time. He said he had an uncle who had spent 20 years investing in an annuity. Every 3 months, he made his payment to the insurance company. The annuity came due during the period of hyperinflation and when he received it, the postage stamp on the envelope was worth more than the annuity it contained.

That is what inflation does to you. How do you protect yourself? You can't. I have studied every stock market in the world. Since 1966 the Consumer Price Index has increased by an average 5 percent a year in this country. Figure that out. Seven years at 5 percent, that makes 35 percent inflation.

Now where is the American stock market? The Dow Jones index is now at 900 versus 1,000 in 1966. It is down, and so is everything you look at.

You do find one hedge though. Maybe a person's own home is his best inflation hedge. But you will find, Senator, throughout the world it always comes down to cheating. People become crooks. They cannot live legally with these rates of inflation, and this is the sad fact. We know this historically. I want to quote one number. If you will look at the GNP statistics for 1966, you will see that the GNP and income almost matched, there was only a slight discrepancy. But now we have the biggest discrepancy we've ever had between income and production. We can't trace enough income apparently. All of a sudden the income is going somewhere but we don't know where. I know where it is going; people aren't reporting it or they are taking cash for their services instead of checks. That is how they protect themselves. That is what you do to meet the reality of the situation.

Just study the rest of the world. Let me give you the example of France in 1945. I was there as a soldier. Morality was nonexistent among the people. They had no morality. I am not insulting the French. I would have done everything they did just to live. Whether it is good or bad, you sell anything just to stay alive. That is what you do. And when inflation rages, the only thing you think about is how you can exist.

If we let inflation rage in this country—and apparently we are going to do that—if we let go on, then I will make you this prediction: just watch what will happen to Government revenues.

Senator BYRD. To what?

Dr. RINFRET. You just watch what will happen to Government revenues. All of a sudden they won't be getting the revenues they should.

Senator BYRD. Well, I think that we should get Government spending under control, too, because I think that is a major cause of this inflation you have.

Thank you very much for being here. Dr. Rinfret.

[Whereupon, at 1:45 p.m., the subcommittee recessed, to reconvene at 9:30 a.m., Friday, June 1, 1973.]

THE INTERNATIONAL FINANCIAL CRISIS

FRIDAY, JUNE 1, 1973

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND
RESOURCES OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:50 a.m., in room 2221, Dirksen Senate Office Building, Senator Harry F. Byrd (chairman of the subcommittee) presiding.

Present: Senators Byrd, Jr., of Virginia, Hartke, Gravel, Dole, and Roth, Jr.

Senator BYRD. Today we begin our second day of hearings on the International Monetary Crisis. We have two distinguished witnesses, the Honorable William McChesney Martin, former chairman of the Board of the Federal Reserve System, and Mr. Eliot Janeway, the prominent financial writer and analyst.

Mr. Martin served with distinction for 19 years as Chairman of the Federal Reserve Board. Before that, he served as Chairman of the Export-Import Bank and president of the New York Stock Exchange. What a record.

Mr. Martin, we welcome you to the subcommittee. You may be aware that on Tuesday of this week, Governor Daane testified and expressed optimism over the U.S. balance-of-payments prospects, while Dr. Pierre Rinfret took a more pessimistic view. Yours is the tie-breaking vote and we look forward to hearing how you cast it. You may begin your testimony.

STATEMENT OF HON. WILLIAM McCHESNEY MARTIN, FORMER CHAIRMAN OF THE BOARD, FEDERAL RESERVE SYSTEM

Mr. MARTIN. Well, I would like to preface my remarks by saying I have been retired now for nearly 3½ years from the Federal Reserve and I have not consulted with anybody from the Federal Reserve or the Treasury, my former associates, about my testimony today. This has been a fireman returning to duty and I think it is good that your committee is taking a look at this international financial crisis, because I think in this instance, crisis is the right word.

I have a very brief statement which I would like to read. Let me make clear at the outset that I am basically optimistic about the American economy. My only reservations are in the matter of speed. We are growing too fast; too much of tomorrow is occurring today. We have not yet scratched the surface of our potential but, like our modern automobile, the economy requires safe drivers, and one who advocates safe driving is not an opponent of growth nor is he one who urges more unemployment to restrain inflation.

Inflation is the root cause of the current international financial crisis. Events since 1965 clearly demonstrate how inflation produces feverish activity, impairs sound growth—witness the ups and downs of our security markets during this period—undermines balance of payments—look at the statement of our balance of payments today—and distorts the savings and investment process.

Money is a medium of exchange, a standard of value, and a store of value. The American dollar in the postwar world has been the principal bulwark of the international payments system as well as the best currency in the world in which to save. This is no longer true and now no one has complete confidence in saving in any currency. This accounts for the speculation in gold and this at a time when the world needs capital formation desperately.

When the Germans decided to let their currency float and we embarked on our new economic policy, we set sail on an uncharted sea where, despite assurances to the contrary, liberal trade policy is going to be buffeted by severe storms and, in my judgment, our economic, our monetary, and our diplomatic position has been definitely weakened.

I think the President acted boldly and courageously in reversing his stand against wage and price controls and taking direct action against inflation. Phase 1 was definitely a success and Phase 2 did moderately well. We had a good year in 1972 and business has been unusually strong in 1973, so strong in fact that inflation has already raised its ugly head once again. Now, I do not mean that strong business always means inflation, but in this instance, I think it does, because in order to bring this about, we have engaged in fiscal stimulus so far in excess of any reasonable requirement that in my judgment, it borders on the irresponsible. As a counterpart, monetary policy had to be easy.

I seriously question whether the full employment budget concept is an adequate answer. I welcome the efforts the administration is currently making to limit spending. We must not only have limits on spending but limits on the rate at which we consume those resources which we now realize are not inexhaustible—oil is good example of it; we now talk about allocations of gasoline—and which as a matter of simple prudence, must not be squandered.

In other words, our resources are not limitless. In the absence of such limits it is hard to see how anyone can be confident that we are not heading into another inflationary spiral which will have as its aftermath the inevitable recession.

The boom which we have produced by a combination of fiscal stimulus and easy money is now running into shortages of capacity and unforeseen problems to produce a flood of business froth which is now cresting the way the Mississippi River has been cresting as it and the Missouri comes together in this terrific flood we have, and will, I think, result in at least a moderate recession by the end of this year or the middle of the next.

But my view of inflation is clear. To those who believe that full employment requires inflation, my conviction is that unless inflation is restrained full employment is impossible. I happen to believe that at least relatively full employment on a sustainable basis is not only desirable but feasible and can be achieved with high levels of business activity if we can find some way of containing inflation and maintaining reasonable stability. The nations of the free world have become remarkable successful at priming the pump and forcing growth but none of us has yet learned how to apply the brakes and sustain growth and employment. We have now turned back to the view that each country can stimulate its domestic economy without regard to its balance of payments and without regard to its impact on others. In short, this marks the end of an era of international economic and monetary cooperation envisaged in the Bretton Woods Agreement Act.

Now I want to say a few things about the dollar. I am distressed when people say, "Thank goodness we have devalued the dollar." That it became necessary and even desirable to do so cannot obscure the fact that it represents a failure of U.S. economic policy—a failure to restrain inflation and failure to improve our balance of payments. I approved of the first devaluation, however, reluctantly, and accepted it as both necessary and essential to give us a new start. And I was not inclined to dispute the President's statement that the Smithsonian Agreement was the most significant in the history of the world, assuming we were going to build on it promptly and effectively. However, we became suspended in an euphoria of belief that the realinement of currencies on that occasion settled all our troubles. This was certainly not the case, as was demonstrated by the second devaluation of the dollar in February of this year.

I do not think this second devaluation was necessary; in this area, there is no way of measuring precisely how you determine the value of the currency and a lot of psychological and other factors go into that. When I say I do not think it was necessary, I think we had nearly 14 months to rebuild our confidence in our currency and our intervening to protect it and we let that time pass. The dollar is now, in my judgment, with the second devaluation, undervalued and it is going to take considerable time to persuade people that we are not going to do it again. On a recent trip in Europe I was asked repeatedly, "How soon will the dollar be devalued again?" and was unable to persuade anyone that we had seen the end. I think it is now imperative that we defend the value of the dollar by intervening actively to support its value whenever threatened. It is not yet believed that we are prepared to go all out to make the dollar a currency in which it is useful to save. I am appalled by those in this country who think that convertibility of the dollar is of no importance and who believe we can concentrate all of our attention on stimulating the domestic economy without regard to our deteriorating balance of payments. Unless nations are willing to have fiscal and monetary responsibility, there is no way we can deal effectively with unemployment and produce lasting prosperity. I might interject here that I have over the years heard constant talk of reforming the international monetary system. I think it can stand some reform. I do not mean to completely discount it, but I say a lot of people that are talking about reform are people who do not want fiscal and monetary responsibility and want to find some means of evading paying their bills and getting all the credit that they need. This is their idea of reform. That sort of reform just is not in the cards, in my judgment.

I am sure it will take time, as we are presently learning, to reconstitute our international monetary system but it is essential. I believe that the International Monetary Fund should be covered as rapidly as possible into some form of a world central bank. Secretary Shultz, in his splendid speech at the meeting on September 26, 1972, stated, and I quote:

"Several times today, I have stressed the need for a comprehensive new set of monetary rules. Those rules will need to be placed under guardianship of the IMF, which must be prepared to assume an even more critical role in the world economy.

"Given the interrelationships between trade and payments, that role will not be effectively discharged without harmonizing the rules of the IMF and the GATT and achieving a close working relationship."

I would go further than he does. I think we must have a Federal Reserve System in Europe and an International Monetary Fund in which nations will pool some portion of their sovereignty in their own interest. We do indeed need a new balance between "flexibility and stability * * * between unity of purpose and diversity of execution." I have taken those from Secretary Shultz' speech. Nevertheless, I am convinced that we should sacrifice some individuality and some small measure of sovereignty in what would constitute a world central bank. Unless we can work out something of this sort we are going to have a lower standard of living in the world than would otherwise be achieved and we will have frictions that will make keeping peace more difficult.

Now, I am well aware of the fact, Senator, that this will be considered to be visionary by some people and that the trend in the world today is away from this type of thing. And I am not suggesting that anybody ought to do it for idealistic motives. But I say that the confluence with multinational currencies and with the flow of currencies that there is around the world and with the growing activities of our Arab friends through our need for oil and the accretions of dollars that they will get from that require us to have some central body that will at least collect all the statistics and do a little bit better than the BIS and the IMF have done in the past. While we may give up the par value system and the specific technicalities of the International Monetary Fund, I feel that it is very vital that we revitalize it or something like it in order to have a forum where the nations of the world will sit down and discuss these things.

Now, when you get into a crisis, there is very little discussion that goes on. And I want to say that I was terrifically impressed—I just got back last night—with the staff report here of your subcommittee. I think the material that is brought together there is really splendid and I read it, I must say, only hastily, but I think it covers everything. One of the things it says is "What are our alternatives? Gold sales by the United States and monetary conference?"

I think a monetary conference is very necessary. I do not think it has to be a Bretton Woods Conference, but I think it is vital that we get together the material that is involved here and see if we cannot form some means of dealing with the massive overhang of Eurodollars that there are in the world. When I was abroad 2 weeks ago, I talked with one well-informed individual who was convinced that there were $90 billion of Eurodollars in Europe. I think he may be high on that, but he is a fellow who follows it very carefully. And this type of thing is all over Europe today and inflation in Europe is out of control. This is a worldwide phenomenon, this problem of inflation, at the moment, and we have to find some way of bringing this under control or we will find that we all, at the same time, have a recession and that can become a very serious thing to us.

Senator BYRD. I certainly agree with your assertion with regard to the need to bring this inflation under control. I want to say, too, that I greatly appreciate and the committee greatly appreciates your, as you expressed it, return to duty, Mr. Martin. This is a tremendously interesting paper which you have presented to the committee, provocative. There are so many questions that I want to put to you that I am not sure exactly where to start. I think I will start with your comment a moment ago on the need for a monetary conference.

Do you feel that the United States should take the lead in seeking such a conference?

Mr. MARTIN. I think at the present time, we should. I was not so confident of that before the first devaluation because I thought it might be misconstrued, our taking the lead. But I think now we are in, I think this is one of the most important things that we have. I think that we cannot just sit by and see the dollar declining every other day without making some effort to get our partners in the world to share in our grief, if you want to put it that way.

Senator BYRD. I note in your statement you mention that the International Monetary Fund should be converted as rapidly as possible into some form of World Central Bank. In that connection, I note that you made an address on this subject on September 14, 1970. Where was that address given, here in Washington?

Mr. MARTIN. No, that was given in Basel, Switzerland. It was under the auspices of the Per Jacobsen Foundation. Per Jacobsen was the head of the Monetary Fund for some years and they have a foundation now that is in his memory and this was the seventh lecture since he died. I chose that as my topic. As I say, some of the people at that meeting and some since have said that I was a bit visionary, but I think it is a good thing to have a goal out in front of you.

But what I am talking about as a world central bank is the central bank of an individual country as a lender of last resort and also a provider of reserves, a creator of reserves. I think the world needs a central body that will be a lender of last resort, when we have speculative excesses of one sort or another. I am not attacking speculators. They are frequently right. If we did not have speculators, maybe we would not find out how bad some of these things are at times. But it is able to deal with it on a rational basis, and also that can create, as was done by the SDR mechanism, which I may say Secretary Fowler did Herculean work to succeed in negotiating that into the International Monetary Fund and I think eventually that special drawing rights or something like that are going to be a type of world asset that can be used by everybody.

Senator BYRD. Without objection, your lecture on this subject delivered in Switzerland will be inserted at the conclusion of your discussion this morning.

Mr. MARTIN. Fine.

Senator BYRD. Mr. Martin, you state that inflation is the root cause of the current international crisis. My question is what is the root cause of inflation?

Mr. MARTIN. I think the root cause of the inflation is excessive spending in budgetary imbalance. That is the best way that I can put it. If you spend more than you are going to take in for any period of time, you have to finance it. Now, I do not like to sound like an alarmist and I do not feel that I am, but if you look at the loan-deposit ratios of the banks of this country today, you find that what used to be a 60-percent level is now up to 80 percent and debt has become a way of life. I am, I am afraid, and old-fashioned individual on this, but I think that the way I was brought up was that it is like a rubberband. You can use your credit, you can stretch it, but if you stretch it too far, it snaps. I think we have been stretching our credit very far. I think that what went on, what has gone on since 1965—the reason I point up 1965 is that in the 1960–65 period, we had a reasonable prosperity in this country. We had stable growth. But in 1965, the shades of the Vietnam war were on us and we were dealing with guns and butter and it was a very, very difficult thing to get anybody to see that this could not go on indefinitely without causing us trouble.

I remember in the Federal Reserve that it was Senator Russell who first told me that the spending in the Pentagon building was, in his judgment, considerably more than appeared in the figures that I was dealing with. He also told that to the Chairman of the Federal Reserve Bank of Atlanta at the time, who told me this, and I am sorry that Senator Russell is gone. I do not like to talk about a man who is no longer alive, but he was one of the first who alerted me to this problem, because with the figures we in the Federal Reserve and the Treasury were using, it did not look quite that bad.

President Johnson, who I am sure was sincere, really believed that this was just a little war and that we could afford to do all things. I am sure he was sincere in that belief. But as it worked out, we were starting then a train of events that has gotten us in deeper and deeper.

Senator BYRD. Would you say that a major cause or perhaps the major cause of the inflation in the United States is the continued and huge Government deficits?

Mr. MARTIN. I would.

Senator BYRD. Would you put it as the major cause?

Mr. MARTIN. Well, I think along with that goes the cost-price-wage thing, that if you consistently have wage increases far in excess of productivity, that also is a contributing factor. But I still think that the No. 1 is the budget deficit.

Senator BYRD. Eight years ago, you made a speech suggesting that there were disquieting similarities between the then existing international monetary situation an dthat of the 1920's and 1930's. Do you feel that there are even greater disquieting similarities today?

Mr. MARTIN. Well, in that speech, I also pointed to some encouraging dissimilarities. Most of the disquieting similarities were played up to the exclusion of the encouraging dissimilarities. I think there are disquieting similarities today along the same lines as what I was outlining in that talk, but I think the world has progressed a good deal and grown a good deal since then. But we have not yet come to grips with this problem of debt. To this extent, I think that the disquieting similarities are just as bad today as they were then, and I think the only problem on the management side, which is the encouraging side, the encouraging dissimilarities, is the fact that our managers have not been doing as well as I think they might. And this is why I have used the phrase in the opening, "safe drivers." We have an economy here that I think is really remarkable in every respect. But we also have automobiles that are the same way. But if you step on the throttle of an automobile in traffic here, you will be going at 90 or 100 miles an hour; perhaps you just cannot do that. You are just going too fast.

Now, this is a contributing factor to inflation, too. Everybody is forcing growth. And that is really what I was trying to point up here in a brief thing. I used this phrase that I picked up some place which I like, that too much of tomorrow is occurring today. Now, whenever you do that, people think you are against growth. I am not against growth at all. I just do not think that you can do it all by debt.

I am worried about the banking system today. I am not talking about people losing money in deposits, but I am worried about the constant growth of debt, the constant growth of consumer-installment debt. You will get all sorts of figures that will show you in relation to this period or the other period. It is not disastrous. I am not suggesting that it is disastrous. I am simply saying that if we keep on going this course long enough, it will become disastrous. That is what I mean by safe driving.

Senator BYRD. Well, the disquieting similarities that exist to those of the 1920's and early 1930's, what are the major disquieting similarities?

Mr. MARTIN. Well, I think the major one is the failure to get our spending under control. I am not talking about what the spending ought to be for or the priorities of spending, but I have been under the impression in the last couple of years that there was not any real control here in the Congress on spending.

Senator BYRD. You are certainly correct in that impression.

Mr. MARTIN. And this, I think, is the most disquieting thing of all.

The world looks to us as the leader, and I do not mean to wave the flag here, but the American dollar has been something of great importance to me. I am not suggesting that we should never devalue the dollar, but we went from the start of our country up to the present time without devaluing our dollar and there was a time when we said that the dollar was as good as gold. Well, I am one who thinks that gold has to be phased out over a period of time.

I do not think there is going to be enough gold or gold production in the world to supply the needs of world commerce as I see it. But nevertheless, I am rather distressed that we now have had to suspend our convertibility and we have not put anything in its place. This, to me, is a very disquieting problem.

Senator BYRD. Gold—would this be correct, that the value of gold, a major value of gold has been that it has exerted a form of discipline on the Government in the past in regard to its fiscal policies?

Mr. MARTIN. Well, gold has unquestionably had some impact on it, but the discipline has been largely on the wrong groups in the society. That is why I gave up my faith in the gold standard as discipline, because in a society such as ours, the central bank can always offset the gold by printing money if you want to use the phrase loosely. When I first went on the Federal Reserve, I found out we had the power there to offset an inflow of gold or to compensate for an outflow of gold. With due respect to George Bernard Shaw, who is quoted many times on this and whom I always enjoyed, who said he would rather trust gold to the management of any government that he knows, I still happen to think we have to trust governments basically. And I do not think money should be our master; it must be our servant. But a good servant, if you are using money in that sense, is not one who has no discipline at all. It can just float all over. We have to get the concept of money which we had in the Special Drawing Rights where a group of countries are willing to agree that they will exchange assets and when there is an inflow or an outflow of an excessive nature, as occurs in every central bank in the world, there will be someone to offset it. And that is what a good central banker is trying to do.

Now, I feel very sad, if I may say so, that we came to the point that we had not been able to keep our own inflation under control and we had not been able to keep our balance of payments in anywhere near equilibrium, so we had to devalue the dollar. Well, devaluation works two ways. Devaluation helps your trade surplus, and I think we are on the way at the present time to having an improvement in our trade surplus. But it harms the credibility of your currency and it impairs the faith of people in your currency. So it works two ways, you see. Trade surplus good, payments bad.

Senator BYRD. It is no basic solution to the problem, is it?

Mr. MARTIN. No basic solution whatever.

Senator BYRD. And as I understand your feeling, the first devaluation was necessary and probably good, and that is the way I look at it, but the second devaluation has raised considerable doubt in the minds of European financial interests, business interests, that the second devaluation may be followed by a third or more devaluation.

Mr. MARTIN. This doubt has been raised not only in Europe, it is actually raised in this country. I run into people from time to time who say, when is the next devaluation? This is something that can be done as a last resort once and maybe twice—I am not going to put any limit on it. But it is a very dangerous weapon to play with.

Senator BYRD. It is a very dangerous weapon, and to do it twice in a short period of 14 months, I assume, adds to the danger?

Mr. MARTIN. That is right.

Senator BYRD. Senator Dole?

Senator DOLE. Let me yield to Senator Roth.

Senator BYRD. Senator Roth?

Senator ROTH. I am sorry I could not be here from the beginning. Unfortunately, the Metroliner was late today. So if I am asking you to repeat questions, please bear with me.

Two days ago we heard Mr. Daane of the Board of Governors of the Federal Reserve. He took a pretty optimistic point of view, the balance of payments. He was followed by Dr. Rinfret, who took just the opposite point of view. He even predicted several more devaluations. As a noneconomist, I am confused.

What do you think?

Mr. MARTIN. No, I think we are improving. Our trade position is improving. This last month figure which has been widely publicized was a step in the right direction and I would expect that it would improve more. But the problem, I think, is deeper than just the trade surplus. As I was indicating earlier, we have a problem now with the credibility of our currency on the payments side and our job is to restore and rebuild confidence in the American dollar as the symbol and more than the symbol, as the strength in the United States.

You know, you can destroy confidence very quickly, but it takes a long time to rebuild it. And I think our job now is to try to restore and rebuild that. But I think in the course of events that I was trying to emphasize in this statement, we have got to revitalize some organization like the International Monetary Fund—I think the International Monetary Fund is here and can do the job—into having the power to do a last resort thing, a sort of reserve in an emergency. We have multinational companies today and I think multinational companies on the whole are doing a good job. But we have a new flow of currencies in the world, as emphasized most by the fact of our possible shortage of oil and the amount of money that we will have to pay to the Arab nations in order to pay for that.

Now, that amount of money ought to be in some way brought into a central place, where ways to invest it, ways to handle it, will be done on a multilateral basis rather than an individual basis.

I do not want to quarrel—I did not hear Governor Daane's testimony and I did not hear what Mr. Rinfret said, but I believe in this, that our principal problem is restoring confidence. I think confidence is badly shaken today.

Now, you can argue about whether the first devaluation was too much or to little. I personally think this is in the realm of technical legerdemain, but we did it. And it certainly was a step in the right direction as improving our trade. But we did not take the intervening time. Once having done that, we had this realinement of currencies, we sat by and we said, well, everything is going to be all right and we did not use this time to show that we are going to get in here and intervene, we are going to have the Federal Reserve and the Treasury whenever there is any large inflow of Treasuries get in and, let us put it bluntly, fight for the dollar.

Let me point out that when the Germans revalued the deutsche mark, they paid out $2.5 billion to defend it in a period of a couple of days. Well, that is what I call fighting for currency.

Senator ROTH. As to the problem of confidence, I think there were two significant statements made in the Congress yesterday, one by the chairman of the House Ways and Means Committee, Mr. Mills, and the other by our majority leader, Mr. Mansfield. I do not know whether you have had a chance to read either of these statements, but Mr. Mills spent considerable time on the need for confidence in this country. He proposed that the President should establish a total price and wage freeze for 90 days—to give as a period of time in which other policies could be developed.

Mr. Mansfield did not go quite as far but he did urge that we turn to something like phase 2 and have sterner measures. I wonder if you would care to comment on that.

Mr. MARTIN. Well, I am always very sympathetic with people who have to administer this type of thing. I am not a wage and price control man. It is not part of my basic philosophy. But I have a strong conviction that you cannot be both. You have to have more freedom than we have permitted or you have to have more control than we have tended to have. You canot be both at the same time.

Now, I think when we reached the August 1971 period and we had not been willing to carry fiscal and monetary policy further than we did because we were afraid that it would create more unemployment than we were willing to take—and that is a matter of judgment—and we decided we were going to do something on the wage-price front, which was out of control, I think it was a very bold and courageous move that the President took. And as I say in my statement, I think phase 1 was a success.

If I may have an aside here, I had an operation in the Mayo Clinic in the summer and the day it happened, and when I got out and could walk around the halls there, I talked to all the nurses and they were all saying to me, well, we voted for Hubert Humphrey, but we think what Mr. Nixon did was just right here, because they were feeling prices and wages, you see, and they were willing at that time to give up a portion of their wages so that this was the right thing politically at that point, no question about it. That is a very small sector, but it interested me.

Now, phase 2, I think, if I were doing it, I would have liked phase 1 to be a little longer than it was—30 days longer, say. But phase 2 came along and it did moderately well.

Now, when you come to phase 3, I have real question about it, and you see, I ducked it in my statement. I talked about phase 1 and phase 2, and after all, I am in private activities now. And I am not following this very carefully. But I ducked it. But if I had been doing it on my own, and it is very easy, you see, to sit on the sidelines where you have no responsibility, which I do not have today, to do this, I not only would not have given up phase 2 at the time they gave it up, but I would have been disposed at that time to put what I call the coup de grace on the thing by having some wage and price freeze for some limited period of time. I think that would have been a psychological advantage and it would have capped what had been a fairly successful operation up to that point.

My observation is that phase 3 has not been much of a success. You have talked about returning to the free market but you have not really returned to the free market, because you have the threat of the Government over you and in the case of dividends and interest, why, you have a set of standards here.

Now, I am not criticizing the administration of this. I happened to say and I am glad to mention it, that I think my successor at the Federal Reserve Board, Arthur Burns, is a far abler man than I ever was in the field and I take off my hat to him. He is one of the great economists that this country has turned out, and I realize the difficulties that he is dealing with. But you asked me a question and I just volunteer it. Phase 3, as you see I ducked in my statement, but I am not happy with what has been going on here and I do not think prices and wages have been properly handled here.

Senator ROTH. I think that most people would agree that both the current chairman and his immediate predecessor have been outstanding men and served the country well, and fortunately have been able to enjoy support on both sides of the aisle. I compliment both of you for that.

I believe you have predicted or foresee the danger of a recession coming later this year. What steps do you recommend we take now to try to avoid that, or is it too late?

Mr. MARTIN. I am sorry to say I think it is too late on that. I think that what we can do now is to keep it, if it should occur, to moderate proportions. In other words, I do not think at this juncture you can just reverse the course of events.

Now, we have had a lot of unforeseen things such as the weather conditions in this country. Nobody could forecast that that had come along here. But I think the movement has been so rapid and in some instances so dramatic and the supply-demand relationship has been so imperfect that we have a head of steam on here, some of which is only going to be moderated by just rolling over the dam and moving down.

That is not going to be a disaster. I am not suggesting I am courting this and I hope it will not happen at all. But I thought I ought to put it in this paper, since I was trying to give you what I honestly thought or what I think is the likelihood for the balance of this year and the first part of next year.

Now, you say to me, well, there ought to be some way that we can just turn it off at this juncture. I do not think there is.

Senator ROTH. I am interested in the problem of capital formation. One of our witnesses yesterday dwelt on our inability to help new business with various types of incentives. Of course, you are well aware that many people feel that we go too far in this area, that the tax laws are tax loopholes that benefit the large corporations and the rich. But would you care to comment on the importance of capital formation and what, if anything, you think we should do from a legislative viewpoint.

Mr. MARTIN. Well, I think saving is at the heart of capital formation and the thing that has distressed me the most, as I am trying to point up in this paper here, is that at one time, we had gold, dollars, and pounds. Then the pound went by the board and it became only gold and the dollar. Then gold went by the board in 1968 and it was only the dollar as the kingpin. Now, again, as I say, I am not trying to wave the American flag on this, but I happen to be very proud of the American dollar and very proud of this country and I think it is too bad that it is not still the kingpin and it is stronger, still, than the other currencies in the world. But by default, not by virtue of really intrinsic value. The inflation abroad has been worse than the inflation here, but both of us are having inflation. So that on a relative basis, or to use another phraseology, we have been less drunk than our European friends have been in the last year.

Well, saving is not nurtured in that sort of environment and you are not going to have permanent capital formation unless you again are making it of some value to people to save. And there is a quality to saving as well as a quantity. Your professional economists will tell you frequently, well, now, the savings here are not showing too badly in our figures, but what they forget about is that savings have now gotten around the world so that you have many foreign elements that are buying up real estate in this country and other places as a hedge against inflation. Now, on another matter, I have been working on some real estate projects in New York City. I have enjoyed it very much. But the values are really astounding today. One of the things that is keeping the values up is that there are foreigners and others who come in and say, well, here is a vacancy or here is something, I will be glad to buy that as a hedge against inflation.

That is the best way I can put the whole problem of capital formation. We are not going to get sound capital formation unless we get back to a saving environment.

Senator ROTH. Do you think there is anything that we in Congress can do to provide a greater incentive to capital formation?

Mr. MARTIN. No, I think there is a lot that can be done in the area of taxation, but I do not think we ought to get into that. I think taxation as an incentive can be very helpful.

Senator ROTH. Mr. Chairman, I have a few more questions, but I think I have taken my first 10 minutes.

Senator BYRD. I only want to ask one question, then I will yield to Senator Dole.

Dr. Martin, in your statement, you say, "I think it is now imperative that we defend the value of the dollar by intervening actively to support its value whenever threatened."

Now, in view of the fact that we have only $13 billion in reserves and $92 billion in short-term liabilities, what is the procedure or what are the mechanics for defending the dollar?

Mr. MARTIN. That is why I wish we had a revitalized monetary fund to help us on this. But my old associate, Charlie Coombs at the Federal Reserve Bank in New York has been very good in intervening in currency activities from time to time and the Treasury stabilization fund has been very good. It does not take a whole lot of money to intervene in short-term movements of these currencies. Now, I do not pose as an authority on foreign exchange, but I have worked in it quite a bit over the last few years and I simply say that with due respect to my colleagues at the Treasury and the Federal Reserve, that there is not a conviction today in the foreign exchange markets that we are willing to put our money on the line to defend this dollar at this level.

Now, I do not know whether this is the right level, but I say I think that is imperative. If we really believe that this is—and I understand the President has taken this position, Secretary Shultz has taken the position that this is the right level for the dollar—I have said I think it is undervalued. That is a judgment I am making. But I say if that is what we believe, whether we have $13 billion or not, we ought to be prepared to get in there and make it clear to everybody that if need be, we are going to go to the wall to defend it.

Senator BYRD. Thank you.

Senator Dole?

Senator DOLE. I was going to ask you about the initial phase 3, but you covered that.

Mr. MARTIN. And that, mind you, Senator, is just a judgment I am making. It is relatively superficial. I think the only thing I would emphasize on that, which I think may be of some help to you—and this is just purely one man's judgment—but I think the big problem in international monetary control here is fish, flesh, and fowl. You try to be both. We get people making speeches about let the free market do it, then you have people saying, we are going to control this, that, and the other thing. We have the problems of interest rates and all these other problems, but the thing that has bothered me on the phase 1, 2, and 3 is that I do not think we carried through; having decided to have wage and price controls, it does not seem to me we carried it through far enough.

Now, that is a judgment.

Senator DOLE. I find it difficult—we talk about confidence and we hear the flood of criticism—I use that word advisedly—with reference to inflation and the run on the dollar and this morning, on the "Today Show," the new high for the price of gold. Many people around can always find fault, of course, with anything that is done by the Government or by any administration. I understand that confidence may be, in Europe or somewhere else in the dollar may not be the same as confidence in this country. But it is difficult for me, at least, to try to project to the American people, or any single individual American, how these complex things really affect the average American. How do you make the American people understand the real problems? They understand it when prices go up, but inflation escapes them.

You mentioned spending limits, which I think are necessary. I am not sure Congress will ever accept that responsibility. We talk about the power and responsibility, but we want the administration to have the responsibility and we want the power. Do you have any suggestions on how we can, how the American people can more easily understand the basic problems?

Mr. MARTIN. As you say, I earlier mentioned the reaction I got when I had an operation, on the price side. I think that does get through. I think the American people will understand the role of the dollar better as they travel more. And we are going to have a big travel year.

Senator DOLE. They are going to understand it more as they buy more energy, apparently.

Mr. MARTIN. Yes, they will get some inkling of it. I have been fortunate in being detached, more or less in semiretirement—let us put it that way—that I have been able to travel a lot. I never expected in my lifetime to be wandering around to find out whether I could get $10 more on $100 in a given currency from one hotel to another as I did last fall in several places. There is a traffic in foreign exchange going on today and always will under this type of condition. And our European friends, start with our Germans, that were all against inflation for a long time, and they have gotten to where they accept this doctrine that they will just stimulate their domestic economy and to heck with their balance of payments. Now you find over there the same thing going on and you can get your currency under the table from any number of places.

Now, I know I am not overstating that because I have been wandering around recently. Now, that will bring it home to the American public as time goes on.

Senator DOLE. But of course, only a very small portion of Americans travel. The point I am making is it has an impact because the pressures come to the American people. to those of us who have some role in leadership, and sometimes we react based on those pressures—proper pressures, of course—or at least we feel them, and maybe the judgment we make is not the correct one. But there are all kinds of things floating around now in the Congress on what we should do and spending limits and we continue to spend more than we have and add more to each bill that comes along.

Mr. MARTIN. Right.

Senator DOLE. How are we going to have realistic spending limits? Can you suggest an answer to that question?

Mr. MARTIN. Well, on this, you see, it takes a long time to come home. But I do not believe in boom and bust. I think we have the ability, if we manage things well, to prevent that day. That is a principal dissimilarity between this and the period of the 1920's. I think we have the power and the capacity if we manage properly to prevent a boom and a bust. But I do not believe we have yet found any way to avoid the fact that if you stretch your credit too far, to use my rubber band illustration, it will snap. And in a good many places around this country today, it has snapped. It is not only the Penn Central case and a few defalcations that you hear about, but a lot of this has occurred because of imprudence and because of the high loan deposit ratios of banks, and because we have just been floating in a sea of debt. That is the only way I can describe it.

Now, I hope that we can find some way of educating people and educating bankers and educating businessmen. I was very pleased that my successor, Arthur Burns, recently called on the banks to be more careful in their lending. I think you can talk all you want about general controls, but if the bankers are going to be imprudent in the way they advance credit, we are going to have a lot of IOS's. I saw IOS from its start and it was just an unbelievable pyramiding of credit. The story has not yet been told. You just had dollar on dollar that was progressively put out. I know a little bit about this, because they tried to make me the chairman of it at one time. Of course, I laughed at them. This was right after I retired, you see.

But this is something you can sell people, you see. It is like a land boom. You can keep on selling people just up to the point that it breaks. And I think it is our job to see that it does not break.

There is a lot of commonsense in this country. I am a great believer in the American people basically.

Senator DOLE. Thank you, Mr. Chairman.

Senator BYRD. Before calling on Senator Hartke, let me ask you, or let me comment on your statement that we are floating in a sea of debt. Most certainly, the Federal Government is floating in a sea of debt. The figures show, to use the administration's own figures, and allowing for some improvements in 1973, fiscal 1973, some improvement in these figures for 1974, even allowing for that improvement, the accumulated Federal funds deficit for the 4 years, fiscal 1971 through fiscal 1974, will exceed $100 billion. That will represent better than 20 percent of the total national debt. In other words, 20 percent of the total national debt will have been incurred during a 4-year period, while it has taken 150 years or whatever it was, 125 years, including the Civil War and the Spanish-American War and World War I and World War II, the Korean war, and much of the Vietnam war, for the other 80 percent of the national debt to have been incurred. It seems to me we have never been on a more unsound basis financially than our Federal Government is today. I do not know whether you would want to comment on that or not.

Mr. MARTIN. Well, I think that you have to make a lot of comparisons. You know, I have had a good many years of jousting with our good friend, Wright Patman, and you would think that the Federal Reserve had created all the debt since the Revolutionary War. But I do think that the proportion of debt, what is taken out of our gross national product today, has become a very, very serious problem. If it goes on too long, why, you are not going to have any free enterprise of any sort in the country. This is where you get back to the tax problem and the other aspects of it. I do not think you have overstated that basically, but I think there are a lot of comparisons that have to be made on it.

Senator BYRD. Senator Hartke?

Senator HARTKE. Hi, Mr. Martin.

Mr. MARTIN. Hello.

Senator HARTKE. I did read your statement and you are optimistic in your statement but pessimistic in your viewpoint. Is that correct?

Mr. MARTIN. I think what I am saying here is that unless we have safe drivers——

Senator HARTKE. Unless we have what?

Mr. MARTIN. Safe drivers. I am using that comparison with an automobile.

Senator HARTKE. That is right.

Mr. MARTIN. Unless we have safe drivers, I am pessimistic and I do not think we have been driving safely recently.

Senator HARTKE. You know, that is just like saying you can reduce the death toll if not as many people die.

Mr. MARTIN. I do not believe it is quite the same thing.

Senator HARTKE. Why, sure it is, unless you say you want to get rid of the administration or the Congress. I do not know which one you want to get rid of.

Mr. MARTIN. I do not want to get rid of anybody.

Senator HARTKE. You do not approve of their policies, so there must be something other than just going out and saying, change the man who is driving the machine. A. J. Foyt did that in Indianapolis and lost with both cars.

Mr. MARTIN. He certainly did. What I am suggesting here is not that you change the Congress but that we have the power to keep this under control and spending is one of the critical items.

Senator HARTKE. To keep what?

Mr. MARTIN. Keep spending under control. I think we have the power to keep spending under control. I do not know whether you agree with me or not.

Senator HARTKE. We have the power, but again, what does that mean? If you have the power to keep spending under control—we have always had that. I mean, we have had this continuing dialog between every administration and the Congress, that the administration contends that the Congress spends too much and the Congress always contends that we spend less than the President asks for. But that is just so much mumbo-jumbo. It does not mean anything. It is like the debt limit. That does not mean anything, because if you spend more than you take in, somebody has to pay the bill.

What I am asking is, Where is the concrete solution that you offer to continued inflation? You are an expert in this field. Where is the solution? You know, to go on out and say, stop inflation, that is like telling my wife not to spend money. It is good advice, but not generally speaking. Most husbands do not have that much control over their wives.

Mr. MARTIN. Well, you can stop inflation if you apply fiscal and monetary discipline to the economy. It may create more unemployment than you wish.

Senator HARTKE. Those are words, Mr. Martin. Monetary discipline—what is monetary discipline? What is that? Do you think that the dollar went up today because of the fact that somebody over here did not exercise discipline? Is that what you are telling me?

Mr. MARTIN. No, I am not telling you that.

Senator HARTKE. Now, the dollar is going up again today—I mean gold has gone up again today.

Mr. MARTIN. I do not know.

Senator HARTKE. There is no question that at this moment, there is definite insecurity in the field, by your own statement, about a third devaluation. And you say you cannot convince them that there is not going to be a third devaluation. You could not convince me, let alone the Europeans.

Mr. MARTIN. Well, I hope——

Senator HARTKE. Well, I read your statement and I appreciate what you said, OK?

Thank you.

Senator BYRD. Mr. Martin, how does the average citizen, how can the average American citizen protect himself against this very severe inflation which the country is experiencing and probably will continue to experience?

Mr. MARTIN. Well, he is almost helpless in protecting himself against it. I think a good many people buy real estate or buy securities because they think this will be some protection against it. Most of our institutions have accepted the total return concept today and many of them are spending a portion of the increase in capital gains that they have when they take them for income. This has all been a byproduct of the inflationary period. a side product. I think the average citizen today is up against a very, very difficult problem, because he does not know where to save money.

In our South American countries, where they have been faced with this problem, real estate has been their principal hedge. I do not think we are going to come to the South American state at an early date, but I think that we have been moving in that direction.

Now, we are very fortunate at the present time in this country that business is stronger than I have ever seen it. We have a very strong business picture. This has been brought about by exaggerated fiscal stimulus and also by the fact of the ingenuity and the competence and the capacity of American businessmen. But we have so many imbalances. We have tried to do so much in the way of combining free enterprise and controls that we have an unbalanced situation and I think it is very dangerous.

Senator BYRD. Would it be accurate to say that one of the best ways the average citizen could protect himself, his future, would be for him, the voter, to demand of both the Congress and the administration that the Government puts its financial house in order? Because unless that is done, it seems to me we are not going to get inflation under control.

Mr. MARTIN. That is right at the heart of what I am trying to say. I agree with that completely.

Senator BYRD. Thank you, sir.

Senator Gravel?

Senator GRAVEL. You make the statement that you did not think the devaluation was necessary after the Smithsonian Agreement. Then why did our administration devalue the dollar if you do not think it was necessary?

Mr. MARTIN. Well, this is a judgment that I am making and I was not in on it. I simply say that we had 14 months after the first one in which to rebuild our position, in the International Monetary Fund and in the world. I think the second one—I do not know whether it was forced by speculators, but certainly there was terrific pressure put on the dollar, just as Senator Hartke said there was today. I have not seen what happened today. It goes up and down.

Senator HARTKE. Gold went up.

Mr. MARTIN. And we have had more of that. Now, it is necessary—and its very easy when you sit on the sidelines and tell the players what they should do, and I was not there, but my own judgment is that when we devalued the first time, which I was not happy about—I do not like ever to see the American dollar devalued, so I was not happy about it but I thought it was necessary; I thought it would give us a start. I thought it was essential that we rebuild as rapidly as we could and I think we let the time pass in the interim to the point where the world was losing confidence in whether we had a grip on our economy and the world was beginning to doubt us and then there was a flow. Whether it came from the Arab nations or where, we do not know. We have a lot of Eurodollars floating around today, a great many more than I wish were there, and I think we are going to have to find some means of consolidating them and knowing where they are and how they are going to be funded. But they were floating all over Europe and then all of a sudden, there is another run.

Now, you are right up against it. Maybe that is all they could do at that particular time. My personal judgment is that the dollar is now undervalued. It will not continue to be undervalued if we do not make good on handling our own economy.

Now, we have been hiding behind the statement that, well, we are relatively better than some of our European friends. That is not a strong position, in my judgment, to justify your conduct. I think what we have to do is to be a leader and have a currency based on the resources and capacity and will of this country, which is likely——

Senator GRAVEL. What should the Government do if there is a run on the dollar? The run on the dollar, as I understand it, is occasioned by the hedge that there is going to be a devaluation. In other words, they anticipate that there is going to be a devaluation and people are going to start running on the dollar and that precipitates the actual devaluation.

Mr. MARTIN. I am convinced, Senator, that what we need is a revitalized International Monetary Fund where, if this run develops, there will be others that will be in a position to be helpful on it.

Senator GRAVEL. In the light of the rhetoric that we have received about the Smithsonian Agreement being the most significant development in international finance, I do not know if there is anything left for us to do to reorganize the monetary fund.

Mr. MARTIN. Well, I think that it could be assumed that having devalued, we were going to actively proceed to reestablish our currency.

Senator GRAVEL. But was it not a point of fact that the rest of the world essentially did not accept the price at which we pegged the dollar and, thus feeling that our devaluation was not sufficient, they felt additional devaluation should take place. Therefore, people started moving out of the dollar which caused a run on the dollar, and which occasioned the quantity of dollars that we have abroad, as you pointed out about $80 billion.

Mr. MARTIN. Some people think more than that. We do not know.

Senator GRAVEL. Is there any way we can measure that?

Mr. MARTIN. That is what we are trying to do, but we have a Bank for International Settlements, we have an International Monetary Fund, and this thing has grown in recent years faster than we can deal with it.

Senator GRAVEL. Well, I think that if the energy crisis continues, and particularly if we continue importing large quantities of oil to meet our domestic needs, we will be moving more money abroad in 2½ years than we presently have abroad today.

Mr. MARTIN. Well, I think that can happen.

Senator GRAVEL. Would that in your mind jeopardize our last devaluation and make a third devaluation necessary? It seems to me that our second devaluation has demonstrated that we do not control our economy, that anybody who controls enough dollars abroad and who wants to work up a speculation can force us to do things.

Mr. MARTIN. I am not in a position to judge that. You will have to talk to the Treasury people and the Federal Reserve. I am not in any position to judge that. I think the first devaluation was essential in order to give us a new start. It represented a failure of U.S. economic policy, which we brush aside, but nevertheless, it was necessary. Now, I do not think it is necessary for us to devalue a third time.

Senator GRAVEL. You disagree the need for the second devaluation. The thesis I am advancing is that we lost control of our economy, the monetary side of it, because of the sums of money, American dollars, that were abroad. Do you agree or disagree with that?

Mr. MARTIN. No. I say yes, we did lose control, but I say we could have kept it in control if we had been more active in the intervening period and had a positive program. Supposing we had made an effort in the 6 months afterward to fund the Eurodollars that were abroad to give short-term Treasury certificates or longer term Treasury certificates for them, to mop up, as the Federal Reserve does, through its swap activities.

Senator GRAVEL. That is an interesting proposal. What you are talking about, then, is if we can work out an accommodation with foreign governments, we can go into the same type of financing we were doing domestically. Is that what you advocate? Do you think this is a possibility to solve our problem?

Mr. MARTIN. Well, I certainly do.

Senator GRAVEL. Would that not even then give the Bundestag, give the Parliament of France, more control? In other words, there is no point in your coming to testify to us. You go testify to them 5 years from now and you tell them your problems, because they will have control of our economy.

Would it not be more germane to say that if we are producing x and sending it abroad and we are importing y, that basically we must keep the dollar value of these in balance. When they are not in balance and we are sending an increasing amount of our currency abroad, we have lost control of our economy. In such a case, as indeed we have today, what you advocate is working out some agreement where we can roll over our debt with them?

Mr. MARTIN. I am saying that the nature of the problem today, particularly with the problem of the oil that we are all faced with today, is that we have to have some wider group that is going to negotiate how we deal with these problems of currency swings and what criteria we have for the use and creation of reserves. The special drawing rights and the monetary fund can do a lot for that.

Senator GRAVEL. Sure, but I think that even if we send somebody out to negotiate something, we ourselves as policymakers can see the parameters that exist within those negotiations. Now, we can go talk, but if it comes down to a simple thing that we are going to send our wealth abroad, we have no way to chase it back if there is no return consumption—if we buy oil from somebody, they take our dollars and then buy our machinery, then we have a little trade. But the little country of Abha Dabba and the country of Saudi Arabia, their consumptive ability is so low that there is nothing they can do with that money on a consumptive basis except invest it. We can either then develop a national policy to go chase those dollars to get it back to the United States and cause them to invest it here, or they are going to take that money, take those American dollars, and try to invest them in Europe, which in my mind would decrease the solidity of the dollar in Europe or increase the flood of dollars. This could have a reverberating effect on our economy which I think could be of panic proportions or of depression proportions.

Have I exaggerated? I do not want to be a prophet of doom or sell fear. But I am highly concerned about what that flow will be because I am watching very closely what is happening with the energy picture and I assume the administration does not understand what is going on.

We had a gentleman that came before this committee and I asked what kind of game plan they had and they have no game plan. All you are telling me is maybe we ought to send somebody off to negotiate. Well, negotiate what? What are our goals to be?

Mr. MARTIN. You and I are on exactly the same wavelengths here, because I agree with everything you say, that we do not have a game plan and we have to have a game plan. I think many of these things—you have a splendid little booklet here that the staff has prepared, that puts out the oil companies, what we may pay for them over the next few years. Well, this happens all the time between California and Texas and various parts of this country, that somebody has to follow that and has to decide how or by what means we can deal with it. I say that if we do not have some internatioanl body, and I think a revitalized International Monetary Fund would be the ideal way to approach it here, if we do not have somebody like that wrestling with this problem that you are stating very well, it will be only on a crisis basis that we will make all of our concessions. And I think we have just got to, over the next few years, realize that this is a changing world and that we need this.

I know some people think I am a visionary on this, but I really think we have to see the European Common Market develop a Federal Reserve System in Europe, as I say in my statement. They are on the verge of doing it now. After all, it is no harder to put them together, outside of language and a few things, than it was to put California and Texas and New York together. But if we do not do that——

Senator GRAVEL. I do not disagree. I think that certainly is a goal and I would support that type of public policy. But I do not see where that would solve the thesis that you now apparently agree with me on. That is that we can set up a Federal Reserve System for Europe, but if our problem is that we have a hemorrhaging of American dollars, then we literally lose control of our monetary system. It becomes based upon the fickleness of the international market. We can be driven, as I think was the case in the last devaluation, into a panic situation.

Unless significant changes are made in the future we can expect to be bouncing on the waves of what international speculators or other governments may choose to do with our currency? They may act with altruistic motives, but they could act irresponsibly and trigger a panic in this country that would trigger a depression in this country and the world. I think the matter is very, very serious because I believe that by the mid-1980's the energy crisis will have become a financial crisis as well.

Mr. MARTIN. I could not agree with you more. I think it is very serious and that is why I say you and I are on the same wavelength.

Senator GRAVEL. Maybe I could get an endorsement of the value of the Alaska pipeline because I think that would contribute to some——

Mr. MARTIN. Well, it would.

Senator GRAVEL. Let me ask you as an addendum to that. If you send something out, you have to get something back. We have to find a way to produce energy domestically or we have no solution to our monetary problem, which is going to become considerably more aggravated than it is today.

Mr. MARTIN. Absolutely.

Senator GRAVEL. So we can talk of monetary funds, we can talk of a Federal Reserve System for Europe, which I think would be good, but all of those will not solve the fundamental problem, which is that the outflow must be kept in balance with the inflow.

Mr. MARTIN. I agree with you, that they won't solve them, but I think if we have a body that was composed of a variety of countries discussing this, we would get better solutions than we are likely to get on a haphazard basis.

Senator GRAVEL. I am just talking about the fundamental operations of the American economy. We can solve these other problems as well. But if we have considerably more money going out than coming in, then regardless of what organization is going to work on our problem over there, they will be controlling our problem. They may be working on it, but they will also have the control of our economy. Am I wrong in that?

Mr. MARTIN. No, you are not wrong in that, but it is up to us to try to work it out.

Senator GRAVEL. We will try to find ways

Mr. MARTIN. Thank you.

Senator Byrd. I think Senator Roth has one or two questions.

Senator ROTH. I believe you said that you felt the business community was doing a pretty good job. There is a theory that these multinational corporations are partly responsible for some of our international problems. Do you feel that we should attempt to promote more investment abroad, or do you think we should try to bring corporations home and move them more in the direction of protectionism.

Mr. MARTIN. No, I would not want to move them in the direction of protectionism and I want them to make the investment where it is the most profitable for them. Now, they have to weigh that and if there is a governmental problems, it comes in taxation on that. I think the multinationals have, on the whole, done a good job.

Senator ROTH. Do you think we should make them bring profits home, for example?

Mr. MARTIN. Yes. I think they would be glad to bring them home. It depends on the tax situation there. You have your taxes in France and you have your taxes here. I think that has to be weighed. But I would like to see as much foreign investment as we can possibly have. I wish we could put more investment into the Arab countries, but they do not have the capacity to take them.

Senator ROTH. Well, it is my understanding that the present tax situation is such that, at least under certain circumstances, if you do not bring money home, you are not taxed for it. The corporations are not taxed, though the profits are actually brought back here. Taxing overseas earnings more heavily might be an incentive to bring the funds home, would it not?

Mr. MARTIN. Well, I think you have to look at each individual case on that. I think taxes can be used as a lever to do just that, in fact. But in the foreign country, you have to work it out with the foreign country, you see. This is where this whole thing has to be a matter of negotiation today. If you have a company that is operating in six or eight different countries, you will find that their tax department is one of their major departments. If you want to give them an incentive to bring money back—most of them would like to bring it back. It is just a case of whether they have a tax advantage by retaining it. It is a little bit like going to Puerto Rico, you know. Puerto Rico has given, I think it is 10 or 20 years, to companies before they do it. So you have a lot of American investment in Puerto Rico. That has been their way to have investment come in. But that is a very real problem.

Senator ROTH. Yes, I agree with you.

Now a number of people outside of the Government, and even some inside, seem to be saying that a surtax or some kind of tax should be enacted now to cool the economy. What are your opinions?

Mr. MARTIN. Well, I was rather pleased to see Secretary Shultz suggesting an increase in taxes on gasoline as a way of perhaps getting more revenue and restraining the purchase of gasoline. But this is on the whole broad question of taxation, you see. Here I would like to go along with the administration that we do not want to see any increase in taxes. We are already overly taxed.

Senator ROTH. That was the next question I was going to ask you.

Mr. MARTIN. But the counterpart of that is what Senator Byrd has put out on the volume of debt that we currently have. If you are going to continue to spend, there has to be some way of paying for it.

Senator ROTH. Even if we tax more, do you not think we will continue deficit spending? Will our rate of spending not just increase that much more? Do you think there is any reason to believe a further tax would be used to balance the budget rather than to be used for new spending?

Mr. MARTIN. I am inclined to share your pessimism on it, but I would hope it would not be so.

Senator ROTH. I was interested that you mentioned Mr. Shultz' proposal on the gasoline tax. Senator Jackson, of Washington, has proposed some monumental steps which appear to me to have considerable merit. But I wonder how we finance it. Should we use part of this increase in cost of gasoline or tax as a trust fund to make an energy breakthrough. Would that make any sense to you?

Mr. MARTIN. Yes; it makes some sense to me. I think it is an administrative problem.

Sentor ROTH. It is a what?

Mr. MARTIN. It is an administrative problem, how you do it and how effective it would be. But we certainly have to produce more energy than we are likely to have in the near future in this country.

Senator ROTH. His proposal is particularly directed at research.

Mr. MARTIN. Well, it makes some sense.

Senator ROTH. In the 1960's, when we put a surtax on, I was on the other side and I was intrigued at the possibility that if you did put a surtax, you could set that aside at some point and possibly repay it at another time. Mr. Rinfret yesterday suggested something similar to that. It was his recommendation that there be some increase in tax during the present economic problems, and that this be set aside to be used, I guess, to help when the economy is in a slump. I think he said some countries are doing this. Do you have any comment on this approach?

Mr. MARTIN. Well, I think your earlier pessimism would be warranted in the use of this.

Senator ROTH. Well, I could not disagree with that.

Thank you, Mr. Martin.

Senator BYRD. Senator Hartke, do you have further questions?

Senator HARTKE. No.

Senator BYRD. Senator Gravel?

Senator GRAVEL. No; thank you.

Senator BYRD. Two very brief questions; then the committee will call on Mr. Eliot Janeway.

Mr. Martin, do you feel that a third devaluation is a reasonable assumption?

Mr. MARTIN. I would certainly hope not. I think we have devalued enough already and I understand that the Treasury and the White House have agreed that we do not want another devaluation. Therefore, I do not think it is a reasonable assumption, assuming we put our shoulder to the wheel now.

Senator BYRD. You think it would be, would have considerable adverse impact should there be another devaluation?

Mr. MARTIN. I think it would. I think it would be a return, a tendency for us to return to competitive devaluations as a way of handling our balance of payments.

Senator BYRD. One final question. As longtime tennis buff, is it your intention to follow Bobby Riggs' example and challenge Margaret Court?

Mr. MARTIN. I would not last one game.

Senator BYRD. Thank you so much, Mr. Martin. Your return to duty, so to speak, in bringing your expertise to this committee has been tremendously helpful to the committee. We are very greatful to you. Thank you so much.

Mr. MARTIN. I wish you well in your undertaking.

Senator BYRD. The committee will now call on Mr. Eliot Janeway, the noted, able economist, one who has wide contacts in the financial field, one who is the author of an outstanding newspaper column which appears in many, several hundred newspapers throughout the United States. I think the committee is fortunate to have Mr. Janeway here today.

We welcome you at this time, Mr. Janeway.

STATEMENT OF ELIOT JANEWAY, FINANCIAL WRITER AND ANALYST

Mr. JANEWAY. Thank you, Mr. Chairman.

Senator HARTKE. I would like to say I also would like to welcome an old friend of mine, Mr. Janeway, here today, and say his fame may be in his own right, but also may be due to the fact that he has a distinguished author as a wife and two outstanding sons who are well known in their own right. I feel that, being an economist, his son Bill, who used to be an associate in my office, is going to rival his father in this area.

Mr. JANEWAY. He has me beat already, Senator Hartke.

Mr. Chairman, I appreciate your invitation to appear before this subcommittee and I congratulate Chairman Long on the practicality and timeliness of his judgment in authorizing the creation of this Subcommittee on International Finance and Resources. I have every confidence that you, Chairman Byrd, and your colleagues will activate it into the task force which the crisis calls for. In appearing today, I unreservedly endorse the realism of your call for these hearings—specifically, your repudiation of our repeated and apparently endless dollar devaluations as a solution to the crisis, or even an expedient for living with it; also, for your warning of the interrelated budget and payments deficits at the root of the trouble; but, above all, for the sense of urgency which animates your assumption of responsibility.

The five questions you have posed call for concrete steps that can be taken, either unilaterally by America or in concert with other major trading nations. My response is to stipulate that any hope of constructive international cooperation is fated to remain merely academic until unilateral American action can again set the stage for international cooperation. My premise is that, given unilateral American initiatives that work, international cooperation will follow automatically and almost effortlessly. Contrariwise, no efforts to revive international cooperation are to be expected in the absence of pragmatic American initiatives calculated to activate them.

Mr. Chairman, I would not like to see America crawl on its knees to any new monetary conference. I interject this into my statement in response to the previous discussion. We are now so weak, we are in such disarray and disgrace that to call for a conference would be to invite a financial Pearl Harbor. Our action is what is needed.

Your call prompts me to emphasize another distinction. Your formulation of the problem calls for positive action to restore confidence in the international dollar. But your definition of the problem created by our interrelated budget and payments deficits—and, I may add, the trade deficit built into our payments deficit as well—makes the problem of confidence insoluble until we have put our house in order. It is all too clear that we are not about to do so.

My answer to your five questions assumes the feasibility of a distinction between the restoration of strength to the international dollar and the restoration of confidence in it. It is my judgment that initiatives within the power of this subcommittee to suggest to the Congress can quickly and effectively restore ongoing strength to the international dollar in the markets of the world as they are constituted today. I regard this objective as no less realistic than recognizing that confidence in the dollar will not be restored in anybody's mind short of the executive branch putting its budgetary house in order and reversing its permissiveness toward inflation.

Market confidence is not an indispensable prerequisite of market strength. Quite the contrary. Taking the experience of the last generation in the great expansive thrust of the American stock market, sustained demonstrations of market strength repeatedly asserted themselves in the face of failures in market confidence in it and, indeed, fed on the failure of nerve in the popular attitude toward it. I urge the relevance of this distinction upon you as a combined expression of my lack of confidence in the practicality and resolution of the present administration's approach to the crisis; but also as an expression of my confidence in how readily soluble the problem of restoring strength to the international dollar is, and how readily feasible congressional initiatives can bring it to the point of solution.

In particularizing my support for your repudiation of devaluation as even an expedient of American policy, much less a preference, I feel obliged to recall that these repeated devaluations have been hailed with official claims that they were winning advantages for America—specifically, that they were winning relief from familiar squeeze for Americans in their dual capacity as income earners on notice to be competitive and as consumers. If the premise that dollar devaluation can be to our advantage is realistic—and in view of the admitted fact that we are on the defensive—why ever stop?

No doubt, most economists will continue to insist that cheaper dollars add up to future advantages for America. But most Americans are fast finding out for themselves that falling market prices for the dollar are forcing every family in the country to pay even higher prices for food and gas and oil: Mr. Chairman, in terms of the question Senator Dole put about the difficulty of winning intelligibility for the meaning of inflation, the dollar since Smithsonian has come down 40 percent. The family's food bill since Smithsonian has gone up 40 percent. Cent for cent, down for the dollar means up for the tab at the supermarket cash register.

In the interest of time, I am going to skip some pages. You have my view on devaluation. This administration's inclination to deal from financial weakness has heaped indignity on the American dollar. But America can recoup her financial losses and overcome her financial weakness by dealing from her economic strength. Dealing from economic strength for American today is providentially within America's ready reach. The strategic economic strength which America commands and, moreover, which every other country on the other side of the market from the international dollar recognizes that America commands, is rooted in her unique farm economy.

I would like to take a minute to note the great change in the world situation which has blessed the American farm economy. It is axiomatic that, for better or worse, the American farm economy is structured into the world economy. Until America endowed the countries which were her anxious clients—which are her successful competitors, and which have become her harsh creditors—with the means and momentum of affluence, agriculture was the orphan of the American economy. It is emerging as the benefactor.

As the world is structured today—all the way from Japan through the Communist world over into the Middle Eastern oil countries, and on across Free Europe—no country can manage, no government can survive, no economy can stabilize itself without massive and continuous access to American agricultural products—but especially American feed crops. Animals and meat products are a luxury symptomatically in increasing demand. But feed crops are a necessity. The world protein revolution is the reason.

Despite America's defensive posture, thrust upon her by the indignities perpetrated upon the international dollar, it is significant to note that the watchword in every single country in the throes of the world protein revolution is: Americanized living standards.

Put in the broad historical perspective of the decline and fall of America's world role since the proud, postwar pretentiousness of the Pax Americana, I urge your consideration of my premise that American agriculture is arming American policy with unique and unprecedented strength. This agripower immeasurably outweighs the strength claimed during America's brief enjoyment of her postwar monopoly over nuclear weaponship. Then, her naivete led America into the illusion that any industrial technological lead can be anything but a headstart. It can never be a monopoly. Any foreign policy presumption that a military technological lead can provide the basis for bargaining from strength over any period of time is bound to build a Maginot. America's pretentions to nuclear power did, as the comeuppance subsequently suffered by American power has long since proved. But America's distinctive agricultural plant is spotting her a trustworthy monopoly.

With all due respect for the impressive progress modern chemistry and animal husbandry are making toward the reduction of lead times in the cattle cycle, the world protein revolution can be guesstimated as good for the better part of the decade; and America's new chase to keep up with the demand for full farm production can be trusted to last every bit as long.

Taking inventory of every other candidate for competitive status, Japan and Europe are rich in nothing but money and money-good demand: they are fresh out of space and have no chance of getting into the productivity race. Canada and Australia have the space, but lack the capital and the manpower. Argentina has the space and the manpower, but lacks the capital and is increasingly running out of export availability. Russia and China have the space and the manpower, but are hopelessly lacking in the productive wherewithal.

As Senator Hartke is authoritatively able to confirm from the rich first-hand evidence accumulated during his recent visit there with a group of distinguished colleagues of yours from the Commerce Committee, Russia is making rapid strides toward negative progress. She is today more dependent upon American farm supplies than she was when Hitler was ravaging her countryside on America's military supplies. China is a good decade away from accumulating the capital resources which are a "must" for modern agrobusiness productivity.

Altogether, America's farm productivity is unique in its massiveness, in the fit it makes with the world protein revolution and in the handle it offers this Government on the retrieval of financial strength. If the executive branch cannot see it and will not seize it, I have no doubt that the legislative branch, its wisdom leavened by its traditional orientation to the strength of America that is rooted in her farms and her rural communities, will.

The disaster of dollar devaluation has combined with the miraculous, but as yet unexploited, export premium on American farm products to produce a violent one-way tilt. This is reversing the normal commercial buyer-seller relationship. The normal incentive of the commercial buyer is to buy as cheaply as possible. Not so in the case of the foreign buyers of American farm products. They literally have dollars to burn. Not only do they experience daily deterioration in the buying power of the dollars burning holes in their pockets: they have the power to make their dollars worth less. They are also operating on constant notice of their continuous need for more American corn, soybeans, wheat, rye, oats, barley, milo sorghum—and animals as well. Dumping surplus dollars to pay up to stock up on their irreducible future food import needs is by now a well-established two-way bargain—on both sides of the transaction: getting rid of cheapening dollars and getting hold of premium food products.

As fast as foreign buyers dumped their dollars to bid American farm product prices up, they priced these basic raw materials of American food production hopelessly out of the reach of American processors of meat, dairly, bakery, and other food products. The pandemonium on the floor of the Chicago farm futures markets bears irrefutable witness to this self-generating one-way tilt effect of dollar dumping on food inflation. The sky's the limit—that is, just so long as we permit dollar dumping to play deuces wild by running hog wild across our speculative futures markets.

I come now to my modest proposal. I hope that you will find it a five-purpose answer to your fivefold question. In formulating it, my thinking has been influenced by my daily observation of the ready and, indeed, greedy disposition of foreign dumpers of depreciating dollars to latch onto every last bushel and pound of American farm production their dollars will buy—not merely regardless of cost, but with dollar cost no consideration whatever. What's more, the predict-able and consistent lesson driven home by the impact of dollar devaluation on farm price inflation has been providing a daily demonstration: That the more depreciated dollars are dumped on the farm futures markets they inflate, the hungrier foreign food product buyers become for the American farm products whose prices they are inflating with the dollars they are depreciating.

The thrust of my proposal is to invite each and every one of America's farm food buyers to do more of the same. The effect of this proposal of mine would be to transfer the burden of coping with food inflation onto the countries with currencies stronger than the dollar, and to ease the burden of coping with it on us. It would also show our people that our Government is protecting them against the consequencies of food cost inflation instead of continuing to join in the attack. Mr. Chairman, we are now subsidizing a cheaper diet through dollar devaluation in countries which are our competitors—and taxing our own people with a more expensive diet. Little wonder we have lost our competitiveness.

My proposal is indeed modest: To employ the formal device of the trust fund, which Congress has created to finance various domestic objectives. The add-on to be paid into the trust fund would be borne by the foreign buyer. And only the foreign buyer would bear this burden. The amount would, of course, be fixed by congressional discretion. My horseback opinion suggests 20 percent.

Assuming a $20 billion level of farm exports, a 20 percent add-on paid into a trust fund would generate $4 billion of inflow. No danger would be run of these exports following the familiar pattern of American industrial exports and being priced out of the world markets. On the contrary, demand would be protected by the familiar established process of marked-up American farm export prices whetting the appetite of foreign buyers armed with surplus dollars and anxious to dump them for the privilege of inventorying their future necessities.

The proceeds to the trust fund would immediately become available to the Secretary of the Treasury—at his discretion, with the advice of the Chairman of the Federal Reserve Board and subject to the supervisory scrutiny of the appropriate committees of Congress—to buy dollars or alternatively, to restock American's inventory of stronger currencies and/or of gold. This would free the Secretary of the Treasury to sell gold unilaterally or in conjunction with cooperating countries along the lines canvassed by Chairman Mills. If the Secretary had $4 billion at his disposal as the result of unilateral action, he would then be in a position to seek cooperative action and putting together a pool on the basis of our $4 billion or $20 or $30 billion through international negotiation would be no trick whatever and that would break the back of any gold speculation against the dollar.

A $4 billion plus for the dollar would make a beginning of a first-year answer to your first question about immediate steps to strengthen the dollar. A minimum $4 billion annual cut in the U.S. balance-of-payments deficit would make a respectable contribution to answering your second question, what can be done to cut the deficit and the payments balance. Hard evidence that higher American export selling prices for American's proprietary export products were not hurting America's trade balance while, at the same time, arming the U.S.

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Treasury with gold and strong currencies, would scatter speculators overnight—thus answering your third question.

An alternative variation to my trust fund proposal, or a supplement to it—which, in my judgment, the traffic would bear—could explicitly require foreign bidders for American proprietary farm exports to take nonnegotiable, noninterest-bearing, long-term U.S. securities in exchange for their present holdings of short-term, interest-bearing liabilities. I have no hesitation in recommneding this as the answer to your fourth question.

Answering your fifth and final question, I submit that my proposal would answer any frustrations over our continuing failure to mount any project so ambitious as a new Bretton Woods. Without an effective American initiative, no new Bretton Woods is thinkable. With it, no new Bretton Woods would be needed. The moment the international dollar began to strengthen, all the other pieces of the puzzle would begin to fall into place.

A byproduct of the ability to stabilize and strengthen the international dollar, which the congressional initiative I am proposing would implement, would be to stop the inflation of America's oil import bill while inhibiting the incentive of America's foreign food customers to continue bidding her farm prices up out of the reach of American food processors and consumers.

A final word as to the urgency of the congressional initiative that is already overdue. All hopes of performance on the promised Government spending limit have already been dashed. The failure of the administration to perform on this promise has coincided with the outbreak of a record business buying and borrowing panic. The interplay of domestic inflation and dollar devaluation has triggered it. Evidence is rapidly accumulatng that this business buying and borrowing panic is fated to repeat the familiar cycle of boom-and-bust before the end of the year.

Meanwhile, it is reminding us of the relevance of Keyne's dictum, "Inflation is a mighty tax gatherer." "Easy come, easy go," tells the story of boom-time surges in revenue. They begin by promising to close the fiscal gap and end by opening it wide again with recessionary aftermaths of revenue collapses. The dismal story being told by the stock market is putting the Congress, the country, and the world on notice of the dire consequences of drifting with the prevailing wisdom relied upon by the executive branch. If the present business buying and borrowing panic is allowed to drift on until it breaks up, with inflation uncurbed and devaluation allowed to Chileanize the American dollar, a tragedy that is still avoidable will engulf us.

In a simpler age, Bismarck remarked that God has a special regard for drunkards, children, and the United States of America. Providentially for Americans today, and for the world today which is more than ever dependent on the ability of America to manage, the American initiatives guaranteed to restore strength to the dollar are simple. Initiatives suggested by the action of modern markets invariably are. I urge you to seize the one America's control of the balance of power in the world protein revolution has put within your grasp. Not least among the byproducts will be to restore and to renew the faith of this country in the ability of at least one arm of the Government to measure up to the challenge of this age of crisis and opportunity.

Senator BYRD. Thank you very much, Mr. Janeway. That is a very interesting statement you have made to the committee. There are certain aspects of it that I would want to get a little additional information on.

First, let me ask you this: Do you feel that a third devaluation of the dollar is a reasonable assumption?

Mr. JANEWAY. Mr. Chairman, without being presumptuous I would like to suggest a reformulation of the question and to note that Secretary Shultz himself is in the position of conceding to my reformulation. Floating is a form of permissiveness. Floating not only makes possible, but even more invites, continuous devaluation. No formal devaluation is needed. It is a form of continuous surrender. The Secretary was quoted directly in the New York Times to this effect the other day. Speaking for myself, I am unreservedly against floating. I am unreservedly against devaluation. The advocates of floating rates have, in the main, been economists not directly responsible for making decisions or finding the money to support decisions. But the reservations beginning to be expressed against floating rates are coming from the managers of industrial concerns in the business of making the long-term decisions on which the structure of prosperity has been built, and which increasingly are being interrupted and impeded by the uncertainty built into the system of floating rates.

I would like to note here for the record an exception to various formulations that were made in the previous discussion. I do not think there has been a second or third devaluation. I think we are suffering a devaluation of the month. Another one is in process right now.

Senator BYRD. Well, a formal devaluation merely officially expresses what actually is taking place in relation to the value of the dollar, is that not it?

Mr. JANEWAY. That is right, but these devaluations are now coming so continuously and so violently that they are not stopping for formalization. This is a continuous crisis moving from spasm to paroxysm.

Senator BYRD. You say the trade deficit built into our payments deficit as well makes the problem of confidence insoluble until we put our house in order.

Now, which aspect of our house are you speaking of in that respect?

Mr. JANEWAY. I am speaking of both aspects, the domestic budgetary and the cost-push, demand-pull aspect. It is my judgment, Mr. Chairman, that it will not be possible to implement wage-price controls—which I favor in this emergency, and I regard it as an emergency—in any purely domestic context. There is no way to implement a domestic freeze until the Government is able to come to labor, business, and commerce and transportation as well, and demonstrate good faith and confidence in the stabilization of farm prices and food costs. And I know of no proposal to impose a domestic wage-price freeze that would extend to farm prices which, as Senator Gravel was suggesting in connection with money and oil, we have allowed to fall into the hands of our creditors.

But I do affirm without reservation the need to bring the budgetary aspect of this runaway inflation back under control; and, when, not if, this business buying panic busts up in the second half of 1973, we are going to see a return to massive Government borrowing operations.

Indeed, the hemorrhage now being suffered by the savings institutions as the result of this latest inflationary surge, and the resultant upsurge in interest rates, is already forcing the Government housing agencies into another active round of massive borrowing in the credit markets.

Senator BYRD. You say that dollar devaluation is penalizing the American consumer of beef, poultry, eggs, and milk. Would you comment a little on that?

Mr. JANEWAY. The American packer, the American poultry grower and so forth are dealing in domestic dollars; and they are operating under marketplace pressure to watch their steps in bidding for supplies. But the foreign buyer is dealing with international dollars, and those dollars are getting cheaper for him. Consequently, there is no market sanction on him not to bid up the futures prices of American commodities he can anticipate paying for with dollars which will be predictably cheaper by the time he takes delivery. In other words, the inflation in the Chicago farm futures markets has become a byproduct of the nonstop run against the dollar. The futures markets in Chicago have ceased to be trading markets. There is an opening bid and that is it. If they were to raise the daily trading limit from 40 cents a day—they have just raised it to that—to 80 cents, the market would go up 80 cents a day. It is the foreign buyer, in every case a government-financed buyer, which is dumping these dollars and bidding up the prices of these supplies. Senator Roth's poultry growers, and your Virginia cattlemen, and Senator Hartke's poultry and cattle feeders cannot compete with this torrent of dollars being dumped back on us, with cost no consideration. Moreover, our domestic bidders for feed crops are working with their own money and on their own credit. But the foreign buyers topping their bids are in the enviable position of being able to draw on endless reserves of unwanted dollars from the central banks with which they are affiliated.

Senator BYRD. You say dealing from economic strength is in America's ready reach today. Are you speaking primarily of our agricultural products as being our economic strength?

Mr. JANEWAY. Primarily, yes. But there are other raw materials—coal, copper, lumber. The situation in lumber in the Northwest is faithfully and frighteningly duplicating that in food. I believe that, while this is not within the purview of your fivefold question which I endeavored to answer with one proposal, we are on the verge of being forced—though this administration is still reluctant to recognize this—to adopt export rationing of our primary products.

Mr. Chairman, I would like to make a general statement about our trade position. I wish here to take unreserved exception to former Chairman Martin's expression of confidence that we are working our way out of our trade difficulty. We have instead engineered and trapped ourselves into the position of being exporters of the primary products of our soil and our subsoil; and we have invited ourselves to become importers of labor, which as we all know is the lowest common denominator of manufactured goods. No other industrial country in the world would permit this.

Senator BYRD. Well, in connection with our agricultural products, what has been the effect of the Russian grain deal on the United States?

Mr. JANEWAY. That triggered the entire chain reaction. And we have subsequently boxed, frozen or, you might say, cheated our American farmer out of the play. And that advertised the shortage to the entire world. That put Japan and Free Europe, the Arab nations, and China on notice, as a great Virginian once said, to get there "fustest with the mostest." It started the competition off, and America's foreign competitors having dollars to burn have run away with it.

Senator BYRD. As you see it, then, the Russian grain deal has had an adverse impact on the United States, generally speaking?

Mr. JANEWAY. Yes, I think that, when it was negotiated, the administration had no idea that it was really giving away, as the saying goes, what was meant to be sold, and that the Russians would have met our terms under any conditions. If we had taken a very hardnosed line with them, we could have solved the dollar problem then. Our Government was confident then that the problem had indeed been solved. But we could have turned to our advantage their desperate need for grain, as well as the confirmatory need which subsequently showed up in every other country in the world—particularly in Japan, our strongest competitor and our most powerful creditor. And we could have then forced international cooperation to support the dollar and avoided the subsequent catastrophe.

Senator BYRD. You mention in your statement that Russia is making rapid strides toward negative progress.

Mr. JANEWAY. My adviser on Russian agricultural problems is Senator Hartke. But Senator Hartke's firsthand report from Russia has been richly and frankly confirmed by the Russian officials dealing with our Government in this country, and also by the evidence of the marketplace. The Russians are desperation buyers.

Senator BYRD. What I am trying to get clear in my mind is the term "rapid strides toward negative progress."

Mr. JANEWAY. The Department of Agriculture issued a statement a month ago expressing confidence that Russia's wheat demands on this country this year would be half what they were last year. It is my judgment that Russia will buy even more this year than last year, not just in wheat but in a broad spectrum of products, and that she will do the same internationally. Russia is suffering the worst of both worlds as to her shortage of feed grains. I think Senator Hartke will bear this out—because she does not know whether to feed any given allotment of grains to animals or to people. If she takes the easy way and feeds her people, her animals will die off. If she goes the hard way and gives feeding priority to her herds and her flocks, she will invite all sorts of social problems.

I think that Brezhnev's regime has something to worry about in that connection—which, of course, gives us a still stronger handle on them. I think they are in the position that we would not contemplate, in spite of our inflation, of feeding wheat to animals, using it as fodder. We may be driven to that. We were in World War II. Russia is now.

Senator BYRD. You expect heavier purchases?

Mr. JANEWAY. Yes, sir.

And not only in this country. I think Russia will also clean out the other producing countries and suffer a weakening of her bargaining power with satellite countries in the Communist world—countries like Hungary, which have some small surplus.

Senator BYRD. If her purchases should equal or exceed last year's purchases, will not that mean higher food prices?

Mr. JANEWAY. Yes, sir, drastically; and despite any recessionary breakup of this domestic business buying and borrowing boom which has been reaching panic proportions. This would mean that the stag-flationary experience of the last recession would be duplicated on a much more acute and intensive scale—with a runaway in the violatile commodity prices underlying the entire structure of the cost of living and doing business, but a simultaneous dropoff in business activity. We were not exposed to this during the last stag-flationary episode which led the President to act in August of 1971. This agricultural phenomenom had not then surfaced. Russia had not yet shown her hand and confessed her weakness, and the other countries had not yet gotten rich enough to become large-scale buyers in our farm futures markets and with dollar cost no object. So the next stag-flation scheduled for the end of this year and the beginning of next year is going to be much more vicious.

Senator BYRD. Senator Hartke?

Senator HARTKE. What you are saying, very simply, is that the Russians are at this moment unable to produce what they need to feed their people. That is a fact of life.

Mr. JANEWAY. That is right. I suggest adding to your formulation, if I may, to feed their animals and their poultry, either. This can and will have a still more devastating effect.

Senator HARTKE. This is not really something new, but with the increasing education and the increasing demands of their people, they have to accommodate them.

Witness what happened in Poland. We sometimes think that these things do not happen in countries, but Gierek came to power because people demanded more in the way of consumer goods. The No. 1 consumer of goods for those people is still food. As indicated, when I talked to Brezhnev, he said they wanted to move over to more consumption of meat. They cannot move over to more consumption of meat without importing feed grains which they have not started yet. Soybeans are getting $10 a bushel now.

Mr. JANEWAY. Soybeans have moved faster than gold, which proves my point. As a measure of this one-way tilt of prices, the inflation in soybean prices has been more violent than the inflation in the price of gold.

Senator BYRD. Will the Senator yield?

Senator HARTKE. Yes.

Senator BYRD. Is that a result of weather conditions?

Mr. JANEWAY. Accentuated in a very minor and temporary way for just about a month. The planting, I understand, is now proceeding at a vigorous catchup rate and the price increase is greater now than it was before. The weather reversal frightened the foreign buyer and—this is my thesis—the foreign buyer is better able to protect himself than the American buyer because he does not care what he pays. The foreign buyer flung more dollars into buying protection against weather-induced shortages than the domestic buyer. Moreover, the inflation in the soybean and related futures markets has been more frenzied since the weather cleared up in the farm belt than it was during the worst of the storms. After all, it is just our dollars that the foreign buyer is throwing away.

In terms of what Senator Hartke was saying about Poland, I suggest that—in terms of what Dr. Kissinger calls realpolitik—any handle or bargaining lever we have on Russia is readily transferable by us into a bargaining handle on the other countries of the free world, which have great respect for Russia. One way of dealing with Japan and with our European creditors is to make a hard deal with Russia. Using our agripower, it is within our reach to do so. And that is one way to solve the gold problem, because while Russia's gold reserves are sometimes exaggerated, Russia has gold to put up. We could make Russia contribute to the support of the dollar.

Senator HARTKE. Mr. Janeway, let me ask you, though. You propose an export tax, in effect.

Mr. JANEWAY. I would never propose a tax in a discussion of first impression on this side of the Capitol. I prefer to call it a fee.

Senator HARTKE. Well, all right, export fee. The thing is that we still at the present time have an export subsidy.

Mr. JANEWAY. It is preposterous. It is indicative of the octopuslike nature of the executive branch. In terms of Chairman Byrd's questioning of Mr. Martin, the waste that is involved in these agencies which are performing counterproductive jobs is preposterous. It is preposterous for us to have one person on the payroll to spend 5 cents of any Government money to administer a farm subsidy for export purposes. We can command a premium: "Come and get it," should be our attitude, "but what will you put up for the privilege of receiving it?" As I indicated, we are in a position to ration the world, and to make provision for the orderly removal of this overhang of surplus dollars by the way we ration our farm exports. And I suggest adding coal and timber to the list.

Senator BYRD. Mr. Janeway, the Senate is voting at the moment. Would you mind waiting a few minutes for us to answer the rollcall?

Mr. JANEWAY. I will be privileged.

[Recess.]

Senator BYRD. Thank you, Mr. Janeway, for permitting us to answer that rollcall vote.

It is a very intriguing proposal that you say is indeed modest.

Mr. JANEWAY. You asked five questions and I tried to come up with one answer to the worry they express about the vehicle known as our economy getting out of control. The only safe and effective way to put brakes on any runaway vehicle is to stick a spoke in the wheel someplace; and this is one weapon we have.

Senator BYRD. Well, now, let us, if we may, explore that a little bit.

"To employ the formal device of the trust fund, which Congress has created to finance various domestic objectives, the add-on to pay into the trust fund would be borne by the foreign buyer."

Now, would you amplify that?

Mr. JANEWAY. Well, assume the Government of Russia or the central bank of Japan, which is really the governmental buyer, wanted to take a vessel out of Seattle or Galveston. The requirement would simply be that, if the cost were, say, a million dollars and if the judgment were for a, say, 20-percent export fee—and I think it is more diplomatic for me to speak in terms of a fee—the buyer would simply write two checks: one check for the million dollars to the selling name or bank, and another check for $200,000 to the trust fund. It would be handled, really, in the same way in which the employer handles his trust fund obligations in issuing each paycheck.

Senator BYRD. Well, just to take a figure, it would be a 20-percent markup, so to speak.

Mr. JANEWAY. Right. But by their actions, by their daily performance, they are showing that markups in the prices of our export farm staples are no deterrent to them. There is no reason, therefore, to suggest that this would bother them, since they are also complaining of an excess of dollars being a burden to them, while admitting that a shortage of feed crops is an even more urgent headache. The add-on I am proposing would relieve them of those dollars. The dollars they were thus relieved of, we would commit to use for nothing but the defense of the international dollar.

Senator BYRD. Well, that would not have the effect of starting a so-called trade war?

Mr. JANEWAY. There is no recourse that anyone could possibly have. When we were discussing this with Senator Hartke, it was on the tip of my tongue to point out that we speak of other countries as names in connection with commodities. But really, the massive preponderance that America enjoys enables her to call the tune. I do not like to speak with swagger, as an oldtime dollar diplomat might have, but their needs can only bring them here on our terms: there is no other place they could go. We are absolutely immune from any sanction. It is an unusual position, and we can thank the contour of our continent and its richness for that; also, the unique combination of people, capital, soil, space, and technology. There is no other place they can go. The numbers available to them in every other source of supply are fractional, marginal.

Senator BYRD. Well, in reading further on in your statement, you would require payment either in gold or in a strong——

Mr. JANEWAY. No, no, they would pay in dollars and then the Secretary, in his discretion, would have the flexibility he would need to use those dollars either, as on a bad day like today, to go into the market and buy more dollars—he would have dollars to do that with—or, if he wanted to, he could replenish our stock of stronger currencies. Those stronger currencies would be usable as an equivalent to the dollar in any confrontation between the dollar and gold. Alternatively, he could replenish our gold stock if he thought that was the thing to do.

When you were questioning Mr. Martin, your question was right to the point. You asked what we could do about owing $80 to $90 billion of hot money and having $13 billion with which to do any talking. My proposal is aimed immediately to make an $8 billion a year change, taking 4 from them and giving 4 to us—that would be 8, right? Then the Secretary, having that 4, would be in the position of really having bargaining power and forcing other countries whose currencies he might drive up—the Germans are very sensitive to this—to put $20 billion together if he started with 4 and wanted to go the other route of international cooperation. But he would have that flexibility, and he would have that buying power. He could support the dollar.

Senator BYRD. To digress just a moment, do you agree with Mr. Martin that the Government should go all-out to support the dollar?

Mr. JANEWAY. Absolutely. The question, though, goes back to your question, and that is no digression, of where you get the wherewithal and where you get the buying power. I am against cutting any customer off and I am against an embargo, but I am for making them fund the dollar balances into nonnegotiable, non-interest-bearing, long-term instruments in consideration of our permitting them to take our food staples out of our ports.

Senator BYRD. But if we did that, would not that provide an opening for the oil-producing countries, for example, to add a 20-percent fee on to their exports to us?

Mr. JANEWAY. Why not put it the other way? In the first place, the oil powers are already doing this. They are making explicit demands for compensation against devaluation. If we do not do something like what I am talking about, we are going to find our oil bill spiraling on us because they, in fact—not having the benefit of our education—are playing oil exactly the way I am suggesting that we wake up to play farm commodities. But if we do what I am talking about, we would then have a defense against their doing this, because we could tell them with a factual basis behind it that the dollars they were getting for their oil would be constant dollars. As a matter of fact, the Arab world, the oil-producing world in the Middle East, is food short, too. I published a newspaper column, which I will be happy to make part of this record——

Senator BYRD. Without objection.

Mr. JANEWAY [reading]. "Oil is America's big new resources problem. America is fresh out of it. But where to buy oil is less a problem than how to shop for it. The producing countries have plenty of oil. The trouble is that they also have plenty-plus of the dollars America is pressing on them for their oil.

"As America has been growing more insecure, the people in the oil-producing countries have been growing richer at her expense. It's little wonder that the oil powers have been growing steadily more formidable in the eyes of Americans. The sharper America's new oil shortage pinches, and the higher America's fuel cost bill is inflated, the drier her gas and oil pumps run; and the weaker Americans assume they are, the stronger they believe their sources of oil are.

"This latter-day American disposition to talk poor invites a weak trading stance. It fails to reckon on the trouble the oil-producing countries would be in without the American market. Their need to move their oil into America is at least as critical as their oil is for the American standard of living.

"But America's need to buy foreign oil accounts for only part of the inclination of the oil-producing countries to play ball with her. Their need to buy the one line of products which America is uniquely able to sell accounts for the willingness of the oil-producing countries to keep the trading friendly and to keep the terms reasonable. America's ability to export basic foodstuffs is her secret weapon.

"Americans of faint heart and strong susceptibility to suggestions of weakness in foreign dealings are inclined to foreshorten the proportions of America's oil problem by measuring it purely in terms of her dollar drain. Admittedly, America is going to need oceans of oil from overseas. Admittedly, too, she has allowed her dollar drain to be inflated to the proportions of a nonstop hemorrhage.

"The pessimism in vogue among market watchers throughout America is asking how America is to find the money to pay her prospective oil import tab. The realism on the rise among marketmakers is discovering that having American foodstuffs to ship is a sure way to magnetize return cargoes of oil.

"Last month, one of America's major oil companies—by definition, one of America's major importers—approached a knowledeable congressional friend from the gulf oil country and the rich farm area just above it. The purpose of their call for help was to latch on to 10,000 tons of top-quality Mississippi Valley rice. And cost was of no concern to this oil company foraging for rice. All that mattered was getting the rice to barter for acceptance of its bids for crude in the Middle East.

"Unlike soybeans or the rest of America's long line of rich feed crops for livestock and poultry, rice is scarcely a top premium crop. To Americans, trading rice for oil is an obvious bargain, at any price. By the primitive nutritional standards still prevailing in the Middle Eastern oil world, getting rice in barter for oil is a fair exchange. It's better business than just taking in still more dollars.

"This telltale incident—by no means isolated—drives home a point I have been at pains to make. America is accepting the disadvantages of financial weakness when the advantages of economic strength are in her grasp. Dealing from her economic strength is America's surest hope of recouping her financial losses and overcoming her financial weakness.

"Nevertheless, the same mentality which presided over America's decline and fall from undisputed world financial leadership is resisting the opportunity to reclaim her leadership. The endemic stupidity dominating Washington still sees American agricultural products as the export giveaways so many of them were until just a short time ago.

"The overeducated ideologues who not only accepted but welcomed the multiple devaluations of the dollar inhabit an academic vacuum insulated from the realities represented by the terms of trade. The dogmatic opportunism of devaluation has hoodwinked America into marking down the export selling prices of her basic foodstuffs to countries poor in their larders and rich in their treasuries. Then, while all America is up in arms over the runaway in domestic food prices, this same institutionalized idiocy is bragging that American farm exports are up—as if they could be down! Adding insult to injury, the dollar devaluation which left America with less to show for the farm exports her creditors need also obliged her to put up more cash to pay for the oil she herself needs.

"The potential hold America's agricultural resources are giving her over her creditors is more than a headstart. It is here to stay. None of her creditors have the soil, the space, the people or the technology to outgrow their dependence on American foodstuffs. More than incidentally, some of these creditors also supply America with the oil she needs. Trading hard to feed them well guarantees a fair trade to fuel America.

"Old-time Yankee trading knew how to harness dollar diplomacy to lead from strength and to deal away from weakness. The opportunity will be around for a long enough time to justify the hope that the mentality in charge of American policymaking will rediscover the technique."

Mr. JANEWAY [continuing]. In which a major oil company told a distinguished colleague of yours on the House side, during the worst of the weather distress, that they wanted his assistance in locating some rice. Rice is not, with all due respect to our friends from Louisiana, of the same order of value as soybeans. It is not a protein commodity. Why did they want rice? Because they are as desperate for food as our major oil companies are to secure crude oil. And, contrary to the popular misimpression, there is nothing contrived about the oil and gas shortage. It's too real for comfort. One proof of it is the fact that the American international oil companies have bid up the price of crude in Rotterdam, which is not a point of production, out of the reach of European competitors. They are finding themselves forced to bid against each other for cargoes on the high seas. This particular oil company told your House colleague that if they could produce 10,000 tons of rice, the Saudi Arabians would favor them in the allocation of crude oil. The Arab world is as food short—in this case, starch-food short—as the Japanese, the Russians, and the Europeans.

This fits. It is so simple that it is workable.

Senator BYRD. What you are saying, then, is this: That for the oil-producing countries of the Middle East, oil is their gold.

Mr. JANEWAY. That is right.

Senator BYRD. And that for the United States, agricultural products are our gold?

Mr. JANEWAY. That is right. And that the Arab countries, not having the benefit of overeducation in economic metaphysics, are dealing from strength in a primitive and rudimentary way to get full value and full exploitation for any of their products that they give away. But we are still treating the products with which your family has such a distinguished association as if they were orphans of the market storm, instead of recognizing that they have turned up as America's saving asset. It is the offset to our loss of industrial supremacy. There is no way in which we can give this away as we have given away our industrial technology because there is no competitor having either the space or the population or the soil or the capital to produce it.

And, incidentally, this is a tribute to our free system, because the Russian and Chinese form of organization is penalizing their ability to get the farm production that our private system is able to get. And this is one way to get on the road forward which you and that great man, your father, before you have consistently fought for in getting the private sector to take over from the public sector. This has been a major drain on the budget ever since the 1920's. This is a 50-year-old running sore on the budget. But, thanks to this world miracle—of which we are the beneficiary, to which we are blind, of which we are not willing to take advantage—it is suddenly turning out to be a potential source of gain to the Treasury, instead of a continued drain on the Treasury. This is one way to stop the fiscal wantonness that you are so militant and consistent in being against.

Senator BYRD. Unfortunately, we have another vote. Are you in a hurry?

Mr. JANEWAY. I have an engagement at 1 o'clock.

Senator BYRD. Let me ask you just one——

Mr. JANEWAY. I will be happy to come back.

Senator BYRD. No, no, that is not necessary. Let me ask you one question, the same question, incidentally, that I asked Mr. Martin.

In your judgment, how can the average American citizen protect himself or herself against this raging inflation?

Mr. JANEWAY. The average American citizen, I regret to say, had better defy the established conventional rule and get all the cash, all the liquidity available and get out of short-term debt. This is the first inflationary crisis in the history of all inflationary crises to be putting a premium on liquidity. I think we are heading into a very severe and acute credit crunch. The increase in cost of living and the crunch of credit argue for the average citizen to reverse the debt pattern by getting liquid and staying liquid. As to the moneyed American, there is no question that the moneyed American is now doing what the moneyed foreign is doing. The saying in business is that the Japanese will buy any American property provided you mark it up. The Arabs are saying that they are willing and able to overpay for anything the Japanese will overpay for. But no government has yet figured out a way to print land; and land is therefore, more than ever, the classic defense of money against inflation.

I would add this, that in view of this agriboom—which has a minimum of a decade to run, and which no government mismanagement can stop—sophisticated and strong money is now moving into food-productive land as well as into forest-productive land.

Senator BYRD. Thank you so much, Mr. Janeway.

I yield to Senator Roth.

Mr. JANEWAY. Thank you, Senator.

Senator ROTH [presiding]. First, Senator Dole asked me to say that he regretted he could not be here during your testimony and have a chance to participate in the questioning.

Mr. JANEWAY. May I say, Senator, that I particularly regret that myself, because so much of the thrust of my thinking is aimed at maximizing the opportunity this country now enjoys to restore its world position, thanks to the great world revolution being centered in Senator Dole's home State.

Senator ROTH. I will relay that message to him.

Mr. JANEWAY. Quit while you are ahead, Senator.

Senator ROTH. I find your proposal very beguiling. I think it is so simple that there must be something wrong with it.

Mr. JANEWAY. It is so simple it can work is the way I prefer to think about it. And if it were not simple, it could not work at this stage of the game.

Senator ROTH. I hope you are right.

Yesterday, a witness stated that he felt that agriculture would not be very promising in the future as an aid to our balance-of-payments problem. As I recall, he said our surplus might continue in the range of $1 billion. But I take it you do not agree at all.

Mr. JANEWAY. I entirely disagree. Senator, I think that both official and academic thinking are so far out of touch with the times, with the new times, that we are still regarding every crop sale made as a great achievement and we are leaning over backward to undercut the prices of exports which would be enjoying premium demand, even if their dollar selling prices were going up. This is part of the rationale of devaluation. I covered this, as a matter of fact, in pages of my statement which, in the interest of time, I did not read. The rationale of devaluation argues that we will get more farm exports if we cut the cost in dollars, in export dollars, to our foreign customers. However, the record shows that, though our export quotations have risen more than the dollar has fallen, every increase in price has caused more foreign demand to come to our markets. What we have done with this insane series of self-defeating devaluations has been to trade against ourselves. We have cut the take-home pay to America of the staples the foreigners would pay up for even if we had been in the fortunate position the Japanese find themselves in. If we had been revaluing our currency upward, they nevertheless would have bought more, too.

Senator ROTH. But if I understand your proposition, it is based upon the fact that trading in the futures markets in Chicago has gone up substantially.

Mr. JANEWAY. Pricing has, more than gold.

Senator ROTH. More than gold, correct. What are these buyers going to do with these futures?

Mr. JANEWAY. Oh, they are short of supplies and they will take delivery.

Senator, countries like Spain and Italy—Spain has no economy, Italy has no government—are throwing distress surplus dollars around like drunken sailors. They are buying dairy cows here. We are going to have a milk shortage—and you have a dairy State. You are familiar with this problem. Your constituents live with it. The American dairyman finds himself unable to bid, as I said in my statement, for American feeds. He finds himself forced to sell his played-out cows for what we call teeth breakers—low-grade hamburger. He sells his rich cows to the foreigners. Every time the foreign importer of American cows, already a necessitous and desperate buyer of American feeds, takes in more cows, that buyer of cows increases its national requirement for American feeds. Do you see? They get their heads still deeper into the lion's mouth we can designate as American agripower. And American agripower has teeth, but we will not use them. It has jawbone, in that sense, in the physical sense, but we will not use it.

The foreign buyers are in our hands and they are getting in deeper all the time as they increase their feed crop requirements.

Senator ROTH. Are you saying that these people who are buying American cattle here and——

Mr. JANEWAY. And cows.

Senator ROTH. Well, don't you see a great market abroad in wheat and grain?

Mr. JANEWAY. Yes; they are hedging. They are buying futures at a scaled-up price to anticipate their requirements, their future requirements. They know they will need more, and the devaluation of the dollar has freed them from any market discipline in the form of a cost sanction.

Mind you, if I had my way—and I have been calling on the President to do this for the better part of a year—I would break this game that is going on that the foreigners are playing at our expense in Chicago. And when I speak this way, I want it clearly understood that I am not a nationalist or an isolationist; but I am against the game of America last that we are financing. I am against it in the interest of our customers as well as ourselves. I have been calling on the administration to introduce an export licensing system for these products. If you did that, then owning a futures contract on next December's soybeans at last month's prices would do you no good, unless the American Government gave you a license. That would destroy an incentive to outbid us in the futures market.

Senator ROTH. Are you saying there is a demand for the product abroad?

Mr. JANEWAY. Yes, sir—limitless.

Senator ROTH. One of the statements we constantly hear is that because of the tariff and trade barriers in, say, the Common Market, it is very difficult to sell agricultural products there.

Mr. JANEWAY. Senator, you could not get your Delaware chickens into the Common Market. But there is no way that Senator Hartke's Indiana corn and soybeans can be kept out of there. It is precisely because they are protecting their chicken flocks against yours that they are in need of Indiana's corn and soybeans. So their protection is selective and studied, and is concentrated on protecting what they have and on freeing their resources for the concentrated purchase of imports to supplement their domestic deficiencies.

Senator ROTH. It is my understanding that the European Community is adopting a common argicultural policy to encourage the production of these grains. You do not see that making any impact?

Mr. JANEWAY. Miniscule. It is like adding up Canada, Australia, the satellite countries and Argentina, and getting nowhere. The only practical, reliable answer for the outside world is acknowledged defense of American agriculture.

Senator ROTH. To what extent do you see Russia and China being important in this picture?

Mr. JANEWAY. Vitally important—already so, and China more so by the year.

Senator ROTH. And this leads me to the question which I think you have partially answered already. Wouldn't it force Russia to use her gold supply as a means of purchasing?

Mr. JANEWAY. Yes, sir. And may I add that China is proud to be a hard-currency, hard-cash buyer. Russia likes to use credit; therefore, China likes to use hard cash. We have heard a great deal about Dr. Kissinger's strategy of real politick in playing Russia and China off against one another politically. If we applied that approach economically to the marketplace, I think you would find Japan—which is now the major buyer of these items I am talking about, and also of live animals—falling in line and playing ball. And I have no criticism of the Japanese. My criticism is of our Government's unwillingness and inability to deal with the Japanese at face value.

The Japanese are not the problem. We are our own problem. I do not mean to go off the point of Russia and China. I am suggesting merely that if we were to play Russia and China in the way I am suggesting, we would find the Japanese falling into line.

Senator ROTH. Are you echoing another committee witness who said that historically we have not negotiated tough enough, that since World War II we are not looking out after U.S. interests sufficiently?

Mr. JANEWAY. Every one of these countries was our client. We sat these countries up in business against us. Not content with inviting and financing them to be our successful competitors, we then set them up in business as our creditors. Now we are inviting them, as Senator

Gravel was saying—and I entirely endorse what he was saying—to run our own domestic markets and run up our own cost of living and our own cost of doing business out of reach of the American family and American business.

Senator ROTH. I know some people have felt that Mr. Connally was like a bull in a china shop. With the future negotiations coming up, the European countries have argued that we should not mix the problems of defense and trade. Do you have any comment on that?

Mr. JANEWAY. Yes, sir, I told Mr. Connally, who is a lifelong friend of mine, that one writer before the public from whom he never got any such criticism was Janeway; and he said he appreciated that. There is an old saying in business, Senator, that when your competitor begins to speak well of you, you fire your sales manager.

Of course, Connally got a bad press. His approach, however—as the old Texas mule story reminds us—caught their attention. Now, that does not mean that I agree with everything he did during his term, but I think that his approach was explicitly aimed at reversing and correcting the American last status that we are right back into.

Senator ROTH. I strongly agree that we ought to be a lot tougher in these negotiations.

Mr. JANEWAY. And answering your other questions, of course the other side is insisting—or claims, or purports to be insistent—on separating the trade and the monetary and the defense aspects of the problem. Do you want them to bargain on our side?

By the same token, it is of the essence for any American policy to connect the economic, the trade, the monetary, and the defense side of the problem.

And may I point out—it is not frequently enough realized—our problem is dual in nature. Our trade problem is essentially with Japan and with Canada. Our problem with Europe is essentially a money problem. That is another reason for joining the two.

When you speak of defense, it is preposterous for the dollar to be the market equivalent of a rug. It is preposterous for America to be paying with the money our creditors claim they do not want to put a defense ceiling over them, while Russia is our new best friend. You remember what Dean Acheson said, with characteristic candor and color, about the British after World War II, that Britain had lost an empire without finding a role. It seems to me, Senator, that the President's famous initiatives toward Russia have put every nickel that we are spending on what is called the defense of Europe in that same category. That part of the budget has lost its justification and there is no new role for it. Whom are we defending Europe against with that kind of expenditure?

I believe that your colleagues in the Armed Services Committee will agree that there is plenty of very hard strength there in case the situation should change, and that these defense subsidies—I call our garrison there, tourists in uniform—will never be used against an enemy in anger. I think that these defense subsidies ought to be cut off right away; and that is part of what I think Chairman Byrd is speaking of when he complains about Government spending on habitual frills and indulgences.

Senator ROTH. Speaking of subsidies, do you think agriculture subsidies should be done away with?

Mr. JANEWAY. Export subsidies? Absolutely.

Senator ROTH. No, I am sorry, all agricultural subsidies.

Mr. JANEWAY. That becomes a social question. In my mind, that is analogous to the antitrust question. I have no doubt that we pay great economic penalties—I do not mean to digress—for our commitment to the antitrust philosophy which no other country is rich enough to indulge. But that is a social preference. If the Congress in its wisdom and the society, including the churches and the schools, want to preserve the family farm, that becomes a social decision and it then becomes the responsibility of the rest of society to finance that inefficiency. I point out, Senator, that I believe that, in States as different as Texas and Nebraska, something like 1 percent of the entries in the cattle-production business already account for over half the production. So as long as we are clear about the social values the various forms of domestic farm subsidy are buying, we are not talking about hardnosed or strong-muscled economic policy aimed at getting our own back.

Fortunately, however, and I do not think I am ducking your question—that is not my nature—we have the wherewithal in that portion of our agriculture which needs no domestic subsidy to get our own and more back internationally.

Senator ROTH. I think you probably heard my earlier question to Mr. Martin in reference to the desirability of a renewed wage-price freeze. I wonder, do you think it would be wise at this time to put a total freeze on?

Mr. JANEWAY. I think it would be fatal not to. We are all on notice to tread very lightly and warily in not taking under very serious advisement judgments in this area by Chairman Mills. Chairman Mills was careful to argue against the practicability of including interest, the reason being that Germany now has a 15-percent rate of interest as her way of going to war against inflation. If we were to freeze interest, as provided for in the original form of the House bill renewing the President's authority, then the run on the dollar you are getting now would be child's play. Also, I see no way of doing rollbacks.

But I am entirely on Mr. Mills' side of that argument, and I am happy that Senator Mansfield has associated himself with it, and I am happy that Senator Mansfield is blasting phase 3 as formalized. For phase 3 formalizes permissiveness to inflation.

But the thrust of my approach, Senator, assumes that a domestic freeze is needed. However, in order to start it, in order to come to grips with any attempt at domestic recontrol of inflation, it behooves us to begin at the root of the inflation, which the devaluation of the dollar is now feeding back into our domestic system by way of the primary Chicago markets for farm futures.

How can this Government come to the unions, the corporations, the transportation companies and the merchants and say we are freezing you—or we are controlling you—when there is a 40-percent annual rate of increase in basic farm prices? So my modest proposal—I call it that with some sense of literary continuity—is aimed at removing the alibi that the Government cannot move. Chairman Mills said in his speech that the President can move, in spite of various embarrassments; and he called on him to move.

I do think that the farm price inflation, that this phenomenon, this pandemonium, this daily panic on the floor at Chicago is an inhibiting complication. I think my proposal clarifies the complication and removes the inhibition, and frees the Government to get back into the inflation-controlling business.

Senator ROTH. What recommendation would you have in the area of trade with respect to manufactured products? How do we move toward a more favorable situation?

Mr. JANEWAY. I think the question suggests a will-o'-the-wisp until we get our costs under control. If the President were armed with the machinery I am talking about, the President—or the Secretary, who is the Deputy President—then could go to the unions, go to corporations under cost pressure, and say, look at what we have done, give us a year, give us a holiday on wage increases. You can give us wage cuts and reckon them as increases in real wages because you got wage increases as offsets to farm price increases. Now we are going to take your food costs down again, and we are going to give you constant dollars that you can count on receiving for your exports.

Many businesses would be delighted to lower their selling prices. But now, with your out-of-hand costs behind you, if you are going to receive less hard money for your exports, it does not pay you to export.

Senator ROTH. On behalf of the committee, I want to thank you, Mr. Janeway, for appearing here. It has been most interesting and your suggestions are most innovative.

At this time, I recess the committee until 10 a.m., Tuesday, June 5th.

Thank you again.

Mr. JANEWAY. I thank you for the opportunity, and I particularly appreciate the penetrating gravity of your questioning.

Senator ROTH. Thank you very much.

[Whereupon at 1 p.m., the subcommittee recessed to reconvene at 10 a.m., Tuesday, June 5, 1973.]

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THE INTERNATIONAL FINANCIAL CRISIS

TUESDAY, JUNE 5, 1973

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL
FINANCE AND RESOURCES OF THE
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2221, Dirksen Senate Office Building, Senator Harry F. Byrd, Jr. (chairman of the subcommittee) presiding.

Present: Senators Harry F. Byrd, Jr., of Virginia, Mondale, Bentsen, Roth, Fannin and Haskell.

Also present: Senator Long (chairman of the full committee).

Senator BYRD. The committee will come to order.

Today is the third and final day of the subcommittee's current set of hearings on International Monetary Crisis.

On Friday we heard from William McChesney Martin, former Chairman of the Board of Governors of the Federal Reserve System. He saw domestic inflation and our balance of payments deficits as the prime causes of monetary instability, and we heard from Elliot Janeway, private economist and journalist, who revealed his own plan for restoring our economic position.

Both witnesses agreed that the present situation merits description as a crisis. Unfortunately, the news from abroad continues to justify the use of the word crisis.

On Friday in European gold markets, the financial siege of the dollar continued, with the price of gold hitting unprecedented levels.

This morning's news indicated the dollar is still under siege. The significance of speculation in London or Paris or Frankfurt is a matter of debate among officials and economists, but it reflects to some extent an erosion of confidence in this country's currency, and that, however, cannot be denied.

Our task is to separate the symptoms of monetary instability from the causes, and then to prescribe appropriate remedies for present comfort and future health.

Now, today we are fortunate to have two distinguished witnesses, each with his own unique perspective of international monetary affairs.

Our first witness is Hon. Jack Bennett, Deputy Under Secretary of the Treasury for Monetary Affairs.

Mr. Bennett is in a position to present the administration's view of the present situation and to tell us what actions, if any, it may be considering.

Our second witness is Edwin L. Dale, Jr., financial writer of the New York Times, who has had many years experience analyzing international economic affairs and presenting the issues with clarity and precision.

Mr. Bennett, you may proceed any way you wish.

STATEMENT OF HON. JACK F. BENNETT, DEPUTY UNDER SECRETARY OF THE U.S. TREASURY

Mr. BENNETT. Mr. Chairman, I am flattered by your invitation for me to present the administration's thinking on current international monetary development. I will present a viewpoint which differs substantially from those of several of the witnesses who appeared before you last week. They spoke—as does the blue briefing book prepared by your staff—of an international monetary crisis. There are changes underway in the world but in my view it is a considerable overstatement to refer to them as a crisis.

Current developments indicate that we have great responsibilities before us in the management of our domestic economic affairs and great opportunities for negotiating further improvements in international monetary arrangements. But, while recognizing these responsibilities and opportunities, we should recognize that existing international monetary arrangements have performed well in recent weeks, far better than would have been likely if earlier arrangements were still in place. It is my judgment that current monetary arrangements are viable and they are capable of—and indeed are—absorbing and diffusing new pressures and speculative influences without impairing domestic economic policies or the fabric of trade.

As you know, the price of gold has moved in large jumps in the private markets in recent days, not only against the dollar but also against all other currencies as well.

This morning it rose by $3.50 to $127 an ounce in London.

That experience has in our view further underlined the unsuitability of gold as the base for a reformed monetary system, but, despite the continuing formal links between gold and the international monetary system, the instability of the private gold price has not brought crisis to the currency markets.

We have been living through a difficult period in terms of an unexpected and unacceptable rate of price inflation and in terms of foreign questions about the reliability of our governmental processes, but the outlook is strong for the basic determinants of our international payments position. There has been no faltering in the economic policy procedures of our Government. Prices will be rising at a lower rate in the coming months. Our trade balance has been moving strongly in the right direction, and foreigners have increasingly recognized the opportunities for attractive investment in the U.S. economy.

Looking backward a few years it may be helpful to recall that the dollar and our balance of payments weakened sharply in the 1950's and 1960's, not because of a poor relative record on inflation—the United States performed better than most countries—but because of abnormally rapid increases in productivity elsewhere as Japan and Europe were catching up with us after World War II. This major structural change in the world economy was not matched by comparable changes in exchange rates—under the Bretton Woods system there was a certain inertia if not rigidity in exchange rates. The result was a progressively growing upward pressure on certain currencies of Europe and Japan and downward pressure on the dollar.

Senator BYRD. May I interrupt you at this point? Are you speaking of the present or of the past?

Are you speaking of the present or of the 1950's and 1960's?

Mr. BENNETT. I am speaking at the moment of the period prior to August of 1971.

Senator BYRD. You mentioned the 1950's and 1960's a few minutes ago, and I am not clear now as to what you are saying. You say, for the moment. Now, does that apply to the 1950's or 1960's, or are you talking about the current situation?

Mr. BENNETT. No, sir.

I was trying to explain the situation that led up to August of 1971 and what has happened since. I am speaking of the past.

Senator BYRD. Thank you.

Mr. BENNETT. By 1971 it was apparent that a fundamental malalinement of exchange rates had been allowed to develop. The actions taken since the President's initiatives in August 1971 have now removed that fundamental malalinement from the system. It took a year and a half to accomplish the necessary changes. In the process a natural resistance to change had to be overcome, and uncertainties arose as established beliefs were broken. But a difficult adjustment needed to be made and now has been made insofar as exchange rates are concerned.

As a result adjustment toward elimination of our payments' deficit is well underway.

The question is sometimes asked, "Why was the United States so anxious to put an end to its payments deficits?" "Since the United States was receiving more goods to import than it was having to export, wasn't this helping us to combat inflation in the United States?" The answer is that the U.S. fight against inflation probably was strengthened in the short run by the import surplus. And the U.S. Government wasn't borrowing any more just because some foreign governments were buying U.S. Treasury bills; in effect some U.S. citizens were finding it more attractive to sell than to hold U.S. Treasury obligations at the prices the foreigners were offering. Yet these factors were more than offset by other considerations. For one thing unreasonable exchange rates were unfair to large segments of our economy forced to compete under a significant handicap with goods produced abroad. The United States could—and was—providing an adequate level of total demand in the United States, but that was not adequate consolation for those whose livelihood was lost or threatened by foreign competitors benefiting from an unfair rate of exchange. Moreover, we could not reasonably expect foreign countries to continue forever to ship more to us than they received. We could not reasonably expect their governments to continue indefinitely accumulating low-interest U.S. Treasury bills. Sooner rather than later—this imbalance was sure to be brought to a halt, probably with great recriminations, probably with new forms of government trade and investment controls abroad, probably with a suddenness which would cause larger economic dislocations the longer the correction was delayed.

It was for these reasons that in December 1971 we entered into the Smithsonian agreement. It was for the same reasons, but on the basis of the further need for change indicated by the experience in 1972, that we entered into another agreement in February of this year. Again, as at the Smithsonian, the United States agreed to propose a change in the par value of the dollar in terms of gold—a change sometimes referred to as a change in the price at which we were not trading in gold. But again, as at the Smithsonian, the real implementation of the agreement took place by the action of other governments moving the points at which they would intervene in the private exchange markets, thus permitting a decline in the value of the dollar relative to other currencies in the market.

In the weeks subsequent to the February agreement the markets effectively expressed their disbelief in the newly declared intervention points. Foreigners continued to acquire assets expressed in the currencies of some of the intervening countries, particularly Germany. And after a few weeks the authorities in these countries abandoned the practice of regular intervention in the market at announced points in the relationship between their currencies and the dollar. In replacement of earlier arrangements, in mid-March an agreement in principle was announced in Paris among the principal countries and the United States that in future official intervention in exchange markets may be useful at appropriate times to facilitate the maintenance of orderly conditions.

Since that time, as you can see in the illustrative chart which I have provided, market rates have varied, but no large-scale intervention has been necessary. The rates are now free to move, but there is a difference from the situation for the year and a half after mid-1971. During that period there was a large accumulated need for rate adjustment—and the signs pointed all in the same direction. Now there may be changes, but they are likely to be largely as a result of any new development which may occur in the future. To the best of our judgment the accumulated need for rate adjustment has been accommodated, and I see no justification for the statement in your bluebook that the present situation is "inherently unstable."

A little later I would like to mention some of the reasons why I suspect the dollar will be worth more on the exchange markets relative to other currencies 3 months and 12 months from now, but, whatever the change, I would expect it to be brought about gradually by changes in the marketplace. I am convinced that when the Congress completes action shortly on the Par Value Modification Act now before it there will not be another occasion when the Congress will be asked to devalue the dollar by lowering its official price in terms of gold.

Many questions have been asked about who were the speculators who brought about the exchange rate changes in February and March. And we are sometimes asked what can be done about such destabilizing speculations. Before commenting on what facts we do have at this time, however, I would like to add to the list of questions. Has there been an irrational degree of emphasis on the word "speculation"? Is there really any point in attempting to delve into an individual's motives to try to determine whether he was hedging or speculating, that is whether his lack of belief in some government's official line was expressed through changing the timing of a foreign exchange transaction which would have been made in any event at some time or was expressed through a transaction which would not have taken place if there had not been the lack of belief? Is there any reason to consider it unpatriotic for an American to doubt that a foreign government would be successful in its effort to hold down the value of its currency relative to the dollar?

These questions should be borne in mind, I think, when studying the chart attached to the statement. Certainly a case can be made that those movements of funds which led to the change in the dollar value of the mark and the Swiss franc from the basic level of early January to the new level of late March were not irrational and destabilizing. They could be considered a final part of the suppressed need for rate adjustment which had built up over quite a few years.

The further changes in the last few weeks are probably different. They are for one thing not the sudden result of breaking through a level of governmental opposition to change. The rates have been free to move on a daily basis since mid-March. I can understand that there have been some developments which private traders and investors might judge to be adverse for the foreign exchange value of the dollar. I wouldn't be surprised, however, if it turns out that the market has given undue weight to these adverse factors. I mention them to help explain a somewhat confusing picture. Probably there have been some irrational elements, but our rate of price inflation in the first quarter was higher than expected, and this was not a favorable development for our future trade balance. Germany did introduce severe anti-inflationary measures and did increase its interest rates. The Senate did approve legislation to permit private U.S. citizens to hold gold for investment and speculative purposes starting at the end of this year, and such permission, if finally enacted into law, could well, not only increase the cost of our substantial level of imports of gold for industrial and artistic purposes, but also lead to a large additional import burden. It is for that reason that it is my hope that the Senate-House Conference Committee on this legislation will adopt the House version, which defers the move to private ownership until such time as the President determines that sufficient reform of the monetary system and sufficient demonstrated improvement of our payments position have been accomplished to permit the change to be made in an orderly fashion.

I mention these considerations in part to explain my belief that the exchange rate changes in recent weeks were not the result simply of some inherent instability in current exchange arrangements. But I do believe, as I shall explain later, that the market may temporarily be overlooking some contrary and more fundamental considerations.

In recent weeks, as you know, the exchange rates rather than the levels of exchange reserves have reflected the market's changing viewpoints on various currencies. One can never be sure, but my own guess is that in present circumstances if we had tried the reverse, if governments had consistently intervened to attempt to hold the exchange rates unchanged while absorbing the currency flows in reserve changes, then we could well have generated greater uncertainty and a crisis atmosphere.

That, of course, was what happened in February and March. During that period the reserve holdings of dollars assets of the foreign countries increased by about $10 billion. From reports which have been made public already, it appears that about a half of the accumulation was reflected in transactions reported by banks in the United States including branches and agencies of foreign banks. Some of the transactions took the form of reductions in privately held deposits in the United States. Some took the form of new loans from the offices in the United States either in the form of newly approved credits or—in most cases probably—drawdowns on already existing lines of credit. What we don't know in any precise numerical way is to what extent the initiative for the transactions came from within the United States and to what extent from instructions received from abroad. In a qualitative way the banks have reported that the preponderance of the initiatives came from abroad.

Apart from the reported bank transactions there were probably about $5 billion of other transactions which increased the dollar asset holding of the foreign central banks in that period. Later this month we'll get our first statistical reports for the first quarter showing a breakdown of this outflow among the current accounts, the direct investment flows of U.S. corporations, the credits of U.S. nonbank corporations, and the errors and omissions. The company reports from which the Government's statistical reports of the investments and credits are prepared were received in recent weeks by the Treasury and the Commerce Departments and are now being compiled and analyzed. To insure the accuracy and comprehensive coverage of these reports to the Government, a joint letter was sent by the Secretary of Commerce and the Secretary of the Treasury to the heads of over 1,400 reporting companies asking these men to give their personal attention to insuring the quality of the reports submitted.

Senator BYRD. Mr. Secretary, may I interrupt just a moment?

I have just been given a copy of your statement. I haven't had it before. Now. I see some changes.

May I ask the staff, was this the submitted statement?

Mr. Secretary, is this the same statement you are reading from?

Mr. BENNETT. In large part, yes.

Senator BYRD. It is a different one?

Mr. BENNETT. I have reduced it, Mr. Chairman. From this point forward I have cut out about one paragraph, and the rest is about the same.

Senator BYRD. You may proceed.

Mr. BENNETT. More recently the two secretaries have sent another letter to about 20 selected companies in various parts of the country requesting the companies to receive a joint Commerce, Federal Reserve, Treasury team of experts which hopes to discuss these companies' transactions in detail to insure that present forms and procedures are not missing any significant types of transactions involving the U.S. companies.

As you can see, there is still a great deal we do not know about the transactions in the first quarter. The lack of the knowledge was not a handicap at the time, since for any operations we might have wished to undertake there was ample prompt knowledge of the magnitude and direction of the flows taking place even though the purpose of the flows was not known. Later this month we will know more, but to the extent that the movements were originated by foreigners, for example by foreign trading companies and foreign central banks, we will never know the full story. As a point of interest to you, however, I should mention that we have had reports from a number of important oil producing countries indicating that they had not originated large movements during the first quarter.

However it was that the new interim monetary arrangements were put in place, they have provided a favorable climate in which the negotiations on longer term international monetary reform can proceed.

I believe that the present monetary arrangements represent a substantial improvement over the recent past, and that, with international cooperation, these arrangements are serviceable and sustainable for the period required to negotiate and introduce needed further reforms. But the present system is far from perfect, and the United States is committed to the effort to build a better permanent system. We helped launch the Committee of Twenty, and last September the President and Secretary Shultz presented a comprehensive outline of U.S. views on reform.

In essence, our proposals are for an open and equitable international economy, free from continual reliance on controls but with effective means to prevent development of large and persistent payments disequilibria whether surplus or deficit.

At this level of generality there is little disagreement, but we have not yet reached agreement on specifics—for example, on the rules and procedures which should be introduced to assure that countries do eliminate their balance-of-payments surpluses and deficits, on the means for determining the amounts and types of reserve assets in the system, on the way in which gold will be phased out of its central position in the system. On that last point there is a wide measure of agreement on the objective, but there is not yet agreement on the most practical route to the objective.

In addition to these questions your subcommittee has asked two other specific questions on the reform; first, should the short-term liabilities of the United States be funded; and second, is a new monetary conference similar to Bretton Woods needed to reshape the international economic order.

The first question, on the possible desirability for funding or consolidating some or all of the $70 billion held by foreign official institutions, has been the subject of much discussion. The large dollar holdings of foreign central banks are the result of past instabilities in the system. For the major holders they are not particularly volatile. Therefore, funding of that balance would not necessarily make an important contribution to short-term monetary stability. Over the longer term our preference is to deal with these balances by earning back a maximum number of the dollars through balance-of-payment surpluses. In a reformed system it would be useless to fund or otherwise tie up these dollar balances without at the same time changing other elements of the system so that instabilities and inadequacies in the system would not simply lead to new accumulations of currency balances replacing those which were funded. With effective adjustment arrangements and other elements of a reformed system, possibilities for funding or exchanging part of existing dollar holdings into SDR obligations warrant careful consideration. I must point out that it would be no mean task to find terms that would be agreeable to both debtors and creditors, but we have stated our willingness to give careful consideration to the possibilities.

The second question, the possible need for a Bretton Woods conference, has been considered more than once. Our feeling is that such a move would not be helpful. At the time of Bretton Woods, conditions were quite different from today—a wartime period, when travel was difficult and communications limited, and a relatively few voices were involved in the major negotiations. Also we did not have, as we now have, annual meetings of the IMF governors, where the financial leaders of 125 member states can regularly convene. It has seemed to us that a better way to proceed was with periodic meetings of the Committee of Twenty, and regular meetings of the IMF, without the fanfare and potential for market disturbances of a special conference like a new Bretton Woods.

Several meetings of the C-20 have been held, at both Ministers and deputies levels, with considerable progress toward understanding of respective positions and definition of critical issues. Another meeting of the deputies is scheduled for early next month. There is the possibility of another meeting of the Ministers before they are scheduled to meet again at the time of the annual meeting of the IMF governors in Nairobi, Kenya in September. We, and others, have expressed the hope that the main outlines of a new monetary system can be agreed upon by the time of the meeting in Nairobi. The United States will do all it can to meet that goal.

Meanwhile, of course, as these reform discussions continue, international business goes on, and you have asked three basic questions about the period just ahead. What steps can be taken to strengthen the dollar? How can the U.S. deficit be cut? And how can speculation be reduced? In practice I suspect those three questions are just three ways of asking the same question. At any rate it seems to me that the right answer and the basic answer is the same to all three questions: Take care of the fundamentals. We must insure that we follow the appropriate budgetary and monetary policies, that we remove impediments to the full productivity of the U.S. economy, and that our businessmen are not handicapped by unfair international conditions of trade.

With respect to the budget, you have, of course, just received the mid-session review indicating that on a full employment basis there will be a surplus of $5 billion in the fiscal year starting at the end of this month. In fact I would guess that the economy has already moved into a posture of surplus. With respect to monetary policy Governor Daane has already reviewed for you in detail the gradual and persistent tightening which the Federal Reserve System has introduced over the past year.

For the release of the full productivity of the U.S. economy you have had reports of the short-run measures which have been taken and those that have been proposed, including the release of nearly 50 million acres of land into production and the planned reduction of the Government's material stockpiles to more appropriate levels. For the long-run you are aware, for example, of the decisions that have been taken to amend the oil import program to make it possible in the future to build oil refineries in this country rather than to have to rely on new construction abroad, and you have received the President's recommendations for the deregulation of newly produced gas to encourage expanded exploration and production in this country.

Such basic measures are the proper response to inflation at home. It is true that since August of 1971 the increase in our cost of living has been less than that of any other one of the 20 members of the OECD. But the performance of our wholesale price index, which is more relevant to our international trade, was not equally good and, of course, we were greatly disappointed by the increases in our price indexes during the first quarter of the year. Yet I think there is justifiable confidence that the basic measures which I have outlined will increasingly be reflected in lower rates of price increase. Moreover, I have seen no evidence of hesitation within the administration to take additional basic measures if it should become clear that they are needed. On the other hand, it is necessary to bear in mind that there is a timelag between decision and results, and there would be no wisdom in overturning the boat in the other direction.

In our international trade the improving trend is apparent to all. Over the first part of this year the improvement was in large part a reflection of our higher level of agricultural sales. It is quite possible these sales will not be at the same high level in the coming quarters. Yet the marked improvement which provided a $196 million trade surplus last month in contrast to the deficit of the previous month depended only in small part on an increase in agricultural sales. It seems to me that as a result of the basic improvement of our competitive position there is a strong likelihood that in the first half of next year our trade balance will be markedly stronger than in the first half of this year, stronger even if agricultural sales are not quite so high, and stronger despite the forecast continuing growth in our oil imports.

The real cost of a barrel of imported oil is rising and will probably continue to rise, and we shall be importing more barrels. The total dollar costs rose from $2.7 billion in 1969 to $5.1 billion last year. And there are many projections that the figure will reach $15 billion per year well before 1980. Yet no confidence can be placed in the precision of such long-range estimates. Necessarily they tend to be based primarily on extrapolation of past trends and cannot yet have taken adequately into account the results to be achieved from the President's new energy program designed to increase production of all forms of energy in the United States and designed to use that energy with greater care and efficiency.

I realize that there have been concerns expressed that the large income of some small producing countries will endanger international monetary stability in the future. On the other hand, I am also aware that these countries will have large needs for imports to meet their developmental and their defense needs. They will be seeking secure and productive investments to replace their assets from the ground. They know that their reserves of oil will not last forever and that an important part of their income must be invested wisely in order that it may provide income for the time when their production is declining and newly developed alternative sources of energy have reduced the dependence of the industrialized world on their supplies. Furthermore, large as their assets may be compared to their holdings today, their combined assets will not comprise any large fraction of the capital assets of the world as a whole.

The large income of these countries will represent a real cost to the importers, but they represent no reason to forecast a weakening of the dollar relative to the currencies of Europe and Japan. These countries taken together will be increasing their imports in absolute terms by far more than the United States. They, too, will be competing with us to provide exports to the oil producers and to offer them attractive investment opportunities. In such competition we expect the United States to be competitive, and the dollar could well come out ahead.

In the short run, of course, we are all familiar with the recent declines in the value of the dollar in the foreign exchange markets. We have watched the decline in the value of shares on the U.S. stock exchanges. Fears have been expressed that these developments will drive away prospective foreign investors, and it is true that at any moment in time, a prospective investor may choose to wait so long as he expects those trends to continue. On the other hand, the prospective buyer must be careful not ot hold out too long when a bargain is available but not guaranteed to last. There are large sums in the hands today of foreigners who are definitely prospective buyers, and I expect they will not fail to notice that the value of the dollar has been increasing in terms of U.S. shares. I do not have any reports on net trading in the last few weeks. There was probably no great inflow. But I do know that in the first quarter of this year the net flow of foreign private portfolio investment into the United States was at an all-time record rate. I would expect it to be at an even higher rate in the coming months.

I do not have the skill—or the temerity—to attempt to predict exchange rates precisely in the coming weeks. My own judgment is, however, that the foreign exchange market has probably misjudged the extent to which basic fundamentals will be reinforcing in the near future the improvement of our trade balance and enhancing the attractiveness of investment in U.S. dollar assets. On balance, therefore, I would expect the dollar to strengthen. Fundamentally, however, I think what is important is not what changes may take place from day to day in the market valuation of the dollar. What is important is that we appear now to have in place a system which can accommodate changes without disrupting the fabric of international trade, investment and cooperation. Meanwhile work on long-term reform continues.

Thank you.

Senator BYRD. Thank you, Mr. Secretary.

I suggest the committee follow the 10-minute rule on the questioning.

First, let me say that I think the President, President Nixon, and Secretary Connally took a very important and desirable step in August of 1971. I agree with you, with what you say in regard to that matter, but now we come to 1973. Let me ask you this, How can you account for the erosion of confidence in the American dollar?

Mr. BENNETT. Mr. Chairman, in the September of 1971 period, Secretary Connally at the Annual International Monetary Fund Conference suggested to the other Governors that they stop intervening to hold up the price of the dollar and that for an interim period they let the market move the dollar to a realistic level. The other governments would not agree. They limited the movement of the dollar. And finally, after hard negotiations, in December of 1971, we struck a deal at the Smithsonian that we would take off our 10-percent import surcharge and that they would make more substantial moves in the points at which they were intervening and allow the dollar to decline.

We argued for a greater change. We thought more was needed, but ultimately we struck a deal to get the changes we did get, and——

Senator BYRD. Mr. Secretary, I don't want to interrupt you, but that was not my question. My question was, How do you account for the erosion of confidence in the American dollar?

Mr. BENNETT. I am attempting to explain that as best I can.

At that time we wanted a larger change but we accepted what we got knowing that no one could be confident as to what was needed. As it turned out, over the following year it appeared that we had been right; that our trade bill did not show a large improvement. In fact, in the latter part of 1972, it was going the wrong way. That was the basic cause for the lack of confidence that led to changes in early 1973.

Senator BYRD. In other words, it was a heavy adverse trade balance and balance of payments that led to the lack of confidence or the deterioration in the confidence of the dollar?

Mr. BENNETT. That was true with respect to the further exchange rate changes early in this year.

To put it more broadly, however, I think you can say that those changes in February completed the elimination of the large backlog of need for a change in the U.S. exchange rate that had built up over the sixties. We finally got that out of the system early this year.

Senator BYRD. Yesterday Secretary Shultz told the Ways and Means Committee that he was somewhat puzzled over the weakness of the dollar. This morning you tell us there is not a crisis. I am somewhat puzzled myself.

How you do reconcile your position with that of Secretary Shultz?

Mr. BENNETT. There are factors that I can understand as to why the changes in more recent days arose. I mentioned several of them. Yet I am somewhat puzzled, Mr. Chairman. I have the feeling that the reaction may have exceeded the justification. In that sense I am also puzzled.

On the other hand, it has led to no crisis in the sense that trading is difficult. It has led to no crisis in the sense that it is difficult to make foreign exchange transactions or to carry out trade. The changes have taken place in the market gradually.

There has been no need for monetary officials to go jetting off to hurriedly called meetings or to close the foreign exchange markets.

Senator BYRD. Do you feel that the United States has a responsibility to defend the dollar or to allow it to be continuously devalued by the so-called free market?

Mr. BENNETT. As you know, I do not expect a continued devaluation. In fact, on balance I expect the dollar will be moving in the other direction in the coming months.

Senator BYRD. Let me phrase my question this way, William McChesney Martin in testifying last week said he felt that the U.S. Government should vigorously defend the dollar. Do you agree with that or not?

Mr. BENNETT. I do not agree with it. I think there is perhaps a basic difference, and I have never had the pleasure of working with the chairman in the relative weight that he puts, and I would put, on the domestic economy and the international exchange rate. There is a difference. To the extent it facilitates international business and we want stability in the international exchange rate, but our primary concern is to insure that we are following the appropriate domestic policies.

Senator BYRD. Well, now, that is the point that concerns me: are we following the appropriate domestic policies?

Mr. BENNETT. At the moment I believe we are. With hindsight one could say it is too bad we weren't tighter late last year because obviously the growth rate was too rapid in the first part of this year.

At the moment I believe we are following them.

Senator BYRD. I assume you are speaking about fiscal policies?

Mr. BENNETT. I am speaking about fiscal policies.

Senator BYRD. What about monetary policies?

Mr. BENNETT. To the best of my ability, to the best of my understanding, I agree with the monetary policies.

Senator BYRD. I am sorry. I didn't understand that.

Mr. BENNETT. I said, I have the same feeling with respect to our monetary policies.

Senator BYRD. Well, now, our fiscal policies are in a rather devastating state; are they not?

Mr. BENNETT. Our fiscal policies at the moment are in surplus and the surplus will be increasing on a full employment basis.

Senator BYRD. You said that our fiscal situation is in surplus?

Mr. BENNETT. On a full employment basis, yes.

Senator BYRD. Let's get down to actual figures. Let's get down to figures on the Federal funds budget.

Now, for fiscal 1973, which ends at the end of this month, what will be the surplus?

You said a surplus?

Mr. BENNETT. There will be no surplus.

Senator BYRD. Or what will be the deficit in the Federal funds budget?

Mr. BENNETT. For the fiscal year just ended the unified deficit will be $17.8 billion and the Federal funds deficit is larger. I don't have the exact number in mind here. It is larger.

Senator BYRD. It is considerably larger?

Mr. BENNETT. Yes, sir, but with respect to the performance of the economy——

Senator BYRD. Now, wait, let's stick with this one question until we get this settled.

So that on a unified basis, which means that after you use your surplus from the trust funds, you will still have a deficit of $18 billion; is that correct?

Mr. BENNETT. Yes, sir.

Senator BYRD. All right, now you don't have the figure for the Federal funds?

Mr. BENNETT. Yes, sir, I have it.

Senator BYRD. What is that?

Mr. BENNETT. $27.9 billion for the fiscal year 1973.

Senator BYRD. So you will have a deficit then by your own figures of $28 billion; a Federal funds deficit of $28 billion, and yet you assert that we will have a surplus.

Mr. BENNETT. I said that for the coming fiscal year we will have a surplus on a full employment basis, which is most relevant to the effect of that budget on the performance of the economy.

Senator BYRD. If it is most relevant to the effect of that budget, why has Secretary Shultz before Ways and Means Committee asked for an increase in the debt limit? The debt is based on the Federal funds deficit.

Mr. BENNETT. The increase in that ceiling is required in order that the executive branch may be permitted to allow the trust funds to invest in U.S. Treasury obligations.

Senator BYRD. There would be no need for an increase in the debt ceiling—and correct me if I'm wrong—there would be no need for an increase in the debt ceiling if we had a surplus in the Federal funds budget, would there?

Mr. BENNETT. That is right.

Senator BYRD. Now, let's get to fiscal year 1974. What are your projections now as to the unified budget surplus or deficit?

Mr. BENNETT. The unified forecast for fiscal 1974 is a deficit of $2.7 billion.

Senator BYRD. What is the forecast for the Federal funds deficit?

Mr. BENNETT. $18.8 billion.

Senator BYRD. So that even with this great improvement that you cite, there will be a deficit of $19 billion in the Federal funds budget for fiscal 1974; is that correct?

Mr. BENNETT. Yes, sir.

Senator BYRD. And there will be a deficit of $28 billion this year?

Mr. BENNETT. Yes, sir.

Senator BYRD. Now that $28 billion deficit for the current fiscal year is almost identical with the highest deficit the country has had prior to 1971, which was the Johnson deficit of $28.4 billion.

Now, candidate Nixon in 1968 strongly and vigorously condemned that deficit. The Senator from Virginia strongly and vigorously condemned that Johnson deficit of $28 billion. Now, I am just wondering why it is such a terrible thing, which I think it is, to have a $28 billion deficit under Lyndon Johnson but such a fine thing to have a $28 billion deficit under Richard Nixon?

Mr. BENNETT. In my view, Senator, it depends on the circumstances. Earlier in this fiscal year we were not at the state of production the economy has reached late in this fiscal year. Early in the fiscal year just ending there was some need for stimulus for our economy.

Now there isn't, and now we are providing no stimulus through a budget deficit.

Senator BYRD. Now, the record shows clearly all through here for anyone who wants to look at the figures that never in the history of the country have we run such smashing deficits except during World War II when we had 12 million men under arms and were fighting a war on two fronts.

Never before has anything approached this, more than $100 billion in 4 years; are you concerned about that?

Mr. BENNETT. I am also aware that over those recent years we have moved from a low or negative level of growth to a high level of growth in our economy, Senator.

Senator BYRD. Am I to take that to mean that you are not concerned about these deficits?

Mr. BENNETT. At the moment I feel our budgetary policy is correct and in that sense I am not concerned.

Senator BYRD. You are not concerned about $100 billion accumulated Federal funds deficit in 4 years?

If that is the case, I don't have any further questions at the moment.

I yield to the gentleman from Delaware.

Senator ROTH. I have just one question, Mr. Chairman.

Last week the chairman of the Ways and Means Committee, Mr. Mills, proposed that there be a 90-day freeze. He suggested he thought this was desirable from the standpoint of building confidence in the economy both from a standpoint of the international situation as well as here at home with the housewife.

Now, he admits this doesn't correct the situation, but this would give time to take whatever monetary actions that are necessary. I wonder if you would care to comment on the proposal of Mr. Mills?

Mr. BENNETT. Senator, I am personally skeptical of the desirability of that move, but I think it perhaps wise to recognize the Deputy Under Secretary for Monetary Affairs is not the spokesman for the Government on the Cost of Living Council's work or the comparable policies——

Senator ROTH. Thank you. I don't have any more questions.

Senator BYRD. Senator Haskell?

Senator HASKELL. I just have one question, Mr. Chairman.

Does it bother you, Mr. Secretary, from the monetary viewpoint that since January the consumer price index has risen on an annualized basis of 9.6 percent? Further, and more importantly from my viewpoint, the industrial commodities index has risen 14.8 percent on a seasonally adjusted basis. Does this concern you as a monetary expert?

Mr. BENNETT. Yes, sir.

Senator HASKELL. What would you do about it?

Mr. BENNETT. Unfortunately I cannot do anything now about a prior period and can only address myself to the period ahead.

For the period ahead I think we are doing the right things. We are moving into a budgetary surplus. As I say, we are probably there. We are having a restrictive monetary policy and we are trying to do those basic things that will improve the productivity of the economy. That is what I would like to do.

Senator BYRD. Would the Senator yield?

I want the record to show you are not moving ahead to a budgetary surplus if you figure that surplus on either the Federal funds basis or the unified budget concept basis.

Mr. BENNETT. I agree with you, Senator, but I think for the purpose of fighting inflation—imperfect as all of these measures are—the full employment basis is probably the best basis——

Senator BYRD. Well, excuse me, but that is something entirely new and completely nebulous. No one knows what a full employment budget is. You don't even expect to have full employment.

I am sorry for the interruption Senator Haskell.

Senator HASKELL. Well, I gather, then, Mr. Secretary, that you feel that using only monetary controls you can change these adverse circumstances as measured by these two indices?

Mr. BENNETT. There are already indications that that may be happening, yes.

Senator HASKELL. Thank you.

I have no further questions.

Senator BYRD. Senator Fannin?

Senator FANNIN. Thank you, Mr. Chairman.

Secretary Bennett, I wish I could share your optimism and confidence in the future of our economy. Let's just take a simple assumption. Our great problem with the dollar is more and more the business of dollars continually leaving this country due to our imbalance of trade, brought about by our inability to compete; isn't that correct?

Mr. BENNETT. That was true until last month, yes.

Senator FANNIN. Well, I certainly disagree that it has been changed to any great extent. We may have some circumstances that would bring about a temporary change, but as far as our ability to compete, it certainly hasn't improved to any considerable degree.

Mr. BENNETT. I think we may have monthly deficits again later this year and a lot of them perhaps, but I think our competitive position has markedly improved.

Senator FANNIN. If we are to recover from our present position which I think is almost devastating, we must have increased productivity if we are going to recover, do you agree?

Mr. BENNETT. We must have it if we are going to stop those price increases, yes.

Senator FANNIN. Well, of course we must be competitive if we are going to continue having any chance at a surplus of trade, and if we don't have a surplus of trade, of course, I don't see how we can possibly ever have a surplus balance of payments.

Mr. BENNETT. I agree.

Senator FANNIN. We could work on that for years.

Mr. BENNETT. I agree.

Senator FANNIN. Now the confidence in gold—you said you felt that it is going to change but it is more in evidence from each passing day. I don't see how you can assume that it is going to change.

Mr. BENNETT. What?

Senator FANNIN. The confidence in gold. In other words, the dollar price of gold has increased again yesterday and they are trying to get rid of the dollars and get gold.

Of course, they can get a return on the dollar and they can't get a return on the gold unless it increases in price so they must feel it will increase——

Mr. BENNETT. Senator, it was also true a few years ago there were comparable rapid increases in the price of silver when were in the process of phasing out silver. Unfortunately, many investors got burned.

Senator FANNIN. Well, I certainly hope that is true as far as gold is concerned, not that I want them to get burned, but I just hope it is true because it is terribly serious that the price has increased to the extent it has in the past few months.

Now, one of our very serious problems is our trade imbalance with Japan. Do you believe we have any chance to expect a surplus balance of trade with Japan in the foreseeable future?

Mr. BENNETT. Not this year.

Senator FANNIN. Well, in the next 2 or 3 years?

Mr. BENNETT. Yes, sir.

Senator FANNIN. Well, I don't know how it is going to be brought about. Do you feel we will have bilateral agreements with Japan, or how do you think that could be accomplished?

Mr. BENNETT. We have, as a result of bilateral negotiations, have had changes in their import restraints. We have had the change in the relative value of the dollar in excess of 35 percent. That is making a difference.

Senator FANNIN. Of course, we still have a problem that their steel costs less even with all of those changes that have come about and their productivity is greater than ours as far as man-hour cost of steel, for a ton of steel. So we can't pay two or three times the wages that Japan pays and expect to compete when their productivity is higher than ours; isn't that true?

Mr. BENNETT. It is true but they have a higher rate of inflation than we do. There has been this change in the exchange rate. Our people are in the ball game of competition again.

Senator FANNIN. Of course they can stand a higher rate of inflation for a long, long time and still not have us catch up with them. That is my concern.

You talk about the imbalance of trade of $4 billion in 1972—not that you have mentioned it, but that is the figure that has been used continuously. Now according to the reports we have had, if you take it on the CIF basis, it may have been as much as $6 billion or more.

Do you see that we can turn that around and still have the cars coming in at 3 percent, and yet we can't ship cars into their country with the nontariff barriers and the tariff barriers at more than 40 or 60 percent; can we change that around?

Mr. BENNETT. I expect improvement this year. I believe the Japanese Government should take further steps, but——

Senator FANNIN. Well, I know they are concerned. They don't want us to go bankrupt because we are a great market for them.

We are taking 35 or 40 percent of their exports right now. So they do have a concern with our economy. They are coming over and putting tremendous assets into this country. Are you in favor of that continuing?

Mr. BENNETT. I believe that this year there will be a noticeable improvement in our trade balance with Japan and they also of course are investing heavily.

Senator FANNIN. Do you feel they will eventually buy out Americans; buy control of this country? Between the Japanese and the Persian Gulf countries, it is not too unrealistic to see the day when they would have the ability to practically do so if we take into consideration the figures.

I just don't think we'll ever get into that position because we would be bankrupt before we reached it, but if we talk about importing $25 billion to $30 billion of petroleum products, anywhere in the world but mostly from the Persian Gulf countries, this isn't too unrealistic. I understand by 1985 their total reserves would be more than all of the other countries combined in the world and, if they did get into that position, they could practically buy up America?

Mr. BENNETT. There are a number of estimates. One figure was that these countries might have as much as $100 billion of reserves by 1980. Now, I suspect that is high, but that is pretty small, a pretty small number, compared to the annual new sales of stocks and bonds in the developing world.

Senator FANNIN. Well, that may be true, but what are the reserves of the United States today?

Mr. BENNETT. The reserves of the United States today are negative if you take into account our liabilities, as well as our assets. If you ignore the liabilities, they are in the range of $13 billion.

Senator FANNIN. But it is pretty hard to ignore the liabilities when you come right down to it.

Mr. BENNETT. Yes, sir.

Senator FANNIN. I am wondering what we can do when we start talking about paying for the importation of oil and consider just what is involved because unless this country has the fortitude and unless the people of this country and the Congress really face reality, we just can't work out this trouble.

We can't solve this—don't you agree—unless we increase our production of our own energy materials?

Mr. BENNETT. I strongly support measures to make possible an increase in our own energy production.

Senator FANNIN. In other words, that is our hope of survival—is it not—that we can develop our resources in this country and get in the position where we will have exports that will be able to offset these imports. And without that, do we have any future?

Mr. BENNETT. Without that the dollar will be worth less in the future. I think we will develop the exports, though.

Senator FANNIN. Well, I certainly wish I could share your optimism. I don't know.

Now, what steps have we taken? You mentioned a few steps have been taken, but in reality when we talk about the Japanese—and we have discussed what they are doing and how they are opening up new markets—but still the electronics people tell me they can't get their products into Japan; color TV's and items of that nature.

The Zenith Corp., for instance, repeatedly reports that they cannot get into the markets of the Japanese. So, what has really changed that is of any great consequence as far as the Japanese are concerned?

Mr. BENNETT. There have been reductions in their restraints in electronics imports. They have not been as large as we think are appropriate unilaterally, and of course, we anticipate that Japan should make further reductions in the course of the negotiations which start in Tokyo in September.

Senator FANNIN. Well, I pay a great tribute to our agricultural industry in this country. I was in Japan not too long ago and they said we should do what we can do best in exporting goods, and they will do what they can do best. They said that they can manufacture cheaper than we can, so we should go back to an agrarian economy.

I looked into that and found if we even produced at the highest rate that would be possible, that we could probably have another $5 billion of exports of agricultural commodities and then we would probably suffer in this country from lack of sufficient food to furnish our own people.

Have you looked into what you think is possible as far as agricultural products?

Mr. BENNETT. I'm sure that our agricultural exports could increase further, but there is no thought that we can balance our payments position purely by reliance on agriculture.

Our industrial machines must also be competitive.

Senator FANNIN. Well, I have heard reports that even with the best of weather, even with the highest crop production that we would be lucky if we could increase by an amount of $5 billion. So I think we must take that fact into consideration.

I just can't see at the present time how we can expect the adjustment in the dollar to take care of our position competitively because here at home as that dollar decreases in purchasing power, then our people naturally need more to take care of their own needs, and so then we have the vicious circle of increased wages. We haven't been able to tie that down to increased productivity. Until we do so, until we increase the productivity per dollar of wages, we are going to have a very difficult time and I think that is what we should start concentrating on.

Thank you, Mr. Chairman.

Mr. BENNETT. I think you stated it very well, that the solution of the international value of the dollar is not some gimmick, but it is stopping inflation and increasing the productivity of our economy.

Senator BYRD. Senator Bentsen?

Senator BENTSEN. Thank you, Mr. Chairman.

Mr. Secretary, I am not as optimistic as you are about this Middle East and Persian Gulf situation. I look at 73 percent of the free world's supply, outside of the United States, estimated to be in those countries. I look at Mr. Aiken's article in Foreign Affairs for this quarter in which he states that if you took the anticipated income increase of the Persian Gulf nations, the Arab Persian Gulf nations from 1973 to 1980 and then you took their budgets and compounded those at a 20-percent annual compounded basis, that they would still have in excess of $100 billion by 1980.

You take countries like Kuwait and some of the other Arabian countries—they already have some of the highest capital incomes in the world, and just what are they going to do with those excess funds? It is a matter of deep concern to me. I know in Kuwait, at their last meeting they talked about floating those $100 billion around from country to country and using it to influence foreign affairs of countries they felt were not friendly to them.

I certainly doubt they will have the full $100 billion to do that, but they do have a sum of excess monies that we have not seen before in such small undeveloped sparsely settled nations.

You take the nation of Iran, for example, it has some things it can do with its funds, but that is not true of some of these other Persian Gulf countries and I think it is something we do have to direct our attention to and do much more than we have done thus far.

I take no great comfort in the fact they are going to invest that money in our markets to buy our companies. I think the thing is further complicated by another indicia and that is the stock market. The

Dow-Jones is not indicative at all of what is happening in the stock market in this country. If you excluded the top 50 companies, I don't know what the number would be.

I am sure you would get it around 700 or 750.

Now, who has been hurt by it? It has been the little investor who has been hurt. You have seen the distortion in the stock market by the large institutions who have come in there and said the only companies they will buy are probably the top 50 because they look to liquidity and they want to get in and out——

Mr. BENNETT. Senator, of course the——

Senator BENTSEN. Then look at the equity funding situation where the little investors found out much too late what was going on and by the time he received the information the big investors and large institutions had been able to get out of it. Then you look at the companies; many, many of our good, solid companies in this country whose stock is selling at four and five times earnings.

Look at the Italian stock market going up because there is confidence in that market, but not confidence in our economic situation.

Look at the Japanese and the excess funds they have. If they come in and start buying up our companies—and at four or five times earnings—we will have an extremely serious situation on our hands and I take no comfort in this.

Do you care to comment on that?

Mr. BENNETT. Of course the Japanese, Senator, are investing heavily in various parts of the world at the moment. It is not that we have concern they may invest here. We are trying to attract them to invest here. And foreign investments are not always solely in the top 50, as you have referred to them.

We are aware of more innovative investments than that. And——

Senator BENTSEN. Excuse me. They are going to put those in the four and five minutes earnings, but we have had a distortion of our market by large institutions, and I think that should be of concern to the Treasury Department and I think we are going to have to have some remedial legislation in that regard because I think they are in the process of seriously hurting the stock market in this country. They are going to deny the stock market to the small investor, and when you do that, creating capital for this country is going to be seriously hindered.

That is where I think you are going to have to propose some remedial legislation.

Let me get to one other point that concerns me, and I don't see that the administration has made the headway I hoped it would, and that is the problem of the balance of payments with Europe. That is the problem of our troops in Europe. We had something in excess of 300,000 troops there. Even if you take the credits from the German nation, we still have a balance-of-payments deficit that approaches $1.2 billion, and that is before the last devaluation of the dollar so it would probably compound the expense of keeping those troops abroad.

I chair the NATO Subcommittee of the parliamentary group, and we met the other day in Brussels to discuss this problem. When I talked to them about our spending 6¾ percent of our GNP for defense then I turned around and looked at the Germans who are right there under the gun of the Russians who are spending only 5½ percent of their GNP. I looked at the English spending just 5 percent and the Norwegians spending 8½ percent. And it disturbs me that they don't seem to have as much concern for their safety as the United States does. And then when I talked to some of the representatives, and they say, well, this is a politically difficult thing for us to accomplish. What makes them think it is politically easy in this country to spend 6¾ percent of our GNP for defense?

Mr. BENNETT. Senator, I share your concern on this exact point.

Senator BENTSEN. Here is where I think we have to get tough in our negotiations with our European partners. They are going to have to pick up more of this tab. You have a grave consumer situation over there in European Common Market, but the situation has changed from what it was at the end of World War II when they were devastated nations and their industries were gone. Today, they are strong and viable and last year they had a surplus of trade of approximately $23½ billion in the European Common Market.

We showed a deficit of $7 billion but if you put it on the FOB basis—and if you took out the soft credit shares—we would be closer to $14 billion. These are the things that have to be brought home to those nations.

Mr. BENNETT. I agree.

Senator BENTSEN. And this is making a major contribution to the run on the dollar. This exact situation, and it has to be corrected.

Mr. BENNETT. I agree.

Senator BENTSEN. What are we doing in that regard?

Mr. BENNETT. There are efforts now to impress upon the Europeans the analysis you have just put forth. I agree that it is a matter that we need to take with extreme seriousness. What the outcome will be I cannot tell you.

Senator BENTSEN. Have we reached the position that we must withdraw some of our troops to show that we are serious about the situation?

Will that get their attention? I don't want to see us totally withdraw our troops. I don't want to see Western Europe become another Finland.

I recognize the strength of NATO and that it has helped contribute to a generation of peace, but what kind of a partner are we if we ruin our own economy? What strength can we give to Europe if our economy is gone? This is what we must transmit to them, it seems to me.

Mr. BENNETT. I would be happy to convey your message to the other end of town, Senator.

Senator BENTSEN. Thank you, Mr. Chairman.

Senator BYRD. Senator Mondale.

Senator MONDALE. Thank you, Mr. Chairman.

Mr. Secretary, I have asked Mr. Flanigan and one of the Governors at the Federal Reserve Board, and I would like to ask you this today, whether there are studies available which would help us understand who was involved in the currency swapping that led or helped to lead to the two devaluations?

Mr. BENNETT. As I mentioned earlier, Senator, we do not know that. We do know that about half of the $10 billion flows that took place in February and the first few days of March were reflected in the accounts of banks in the United States; both U.S. banks and foreign banks.

Senator MONDALE. About half of it?

Mr. BENNETT. About half. A large part of that moved on the basis of instructions from foreign depositors or foreign borrowers who drew down previously existing lines of credit and——

Senator MONDALE. But do we know what kinds of foreign borrowers?

Mr. BENNETT. I do not have a geographic breakdown.

Senator MONDALE. The interests, for example, were who? Was it the oil interests?

Mr. BENNETT. Well, we do have some reports—as I also mentioned earlier—some of the major oil-producing countries, that in fact they did not make any large shifts of funds.

Senator MONDALE. That they did not?

Mr. BENNETT. Did not during that period. I do not have reports for all of them, though.

Senator MONDALE. You mean out of the U.S. banks?

Mr. BENNETT. That they did not make any large shifts of funds out of dollars into other currencies during that period, Senator.

Senator MONDALE. You mean, you are saying, your studies satisfy you that none of the oil interests in the world were involved in any significant way in the dollar swap?

Mr. BENNETT. No, sir; I would have to be more modest. I said, a number of important ones have reported that, but some others, we do not have reports from.

Senator MONDALE. Do you mean U.S. owned corporations?

Mr. BENNETT. No; I was speaking of governments, of oil-producing governments.

Senator MONDALE. So it is your impression then that oil interests were not substantially involved in the devaluation and the money swap?

Mr. BENNETT. When you refer to oil interests, I have spoken thus far only of the governments of oil-producing companies. Now, with respect to U.S. corporations and U.S. individuals, and U.S. nondirect investors, nonbank sellers and creditors, the reports have come in in the last few weeks, and are now being compiled, and we will have our first statistical reports later this month as to how the other $5 billion is broken down; how much is direct investment, how much is export credit, how much is errors and omissions.

Senator MONDALE. Are you conducting that study?

Mr. BENNETT. The Treasury and the Department of Commerce collected this information.

Some comes to us and some goes to the Commerce.

Senator MONDALE. I think it would be helpful, Mr. Chairman, if we could have as much of that study as you feel you could release for this hearing record.

I think it would be very helpful.

Senator BYRD. Mr. Secretary, would you provide that for the record?

Mr. BENNETT. Yes, sir.

Senator BYRD. Thank you.

[The following material was subsequently submitted by Mr. Bennett.]

DEPUTY UNDER SECRETARY OF THE TREASURY,
Washington, D.C., July 20, 1973.

Hon. HARRY F. BYRD, Jr.,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: During my appearance before your subcommittee on International Finance and Resources on June 5 I was asked to provide more information on capital flows from the United States during the first quarter of this year when we were further along in our statistical studies of that period. Further work remains to be done, but the members of the committee may find of interest a report on the information we now have.

As indicated in the summary table below and in more detail in the table attached, a net outflow of $5,780 million in recorded private capital transactions was a major contributor to the official deficit in that period. Moreover, errors and omissions—which were probably largely capital flows—contributed another $3,650 million to the deficit.

U.S. balance of payments not seasonally adjusted, 1st quarter of 1973

[Millions of dollars]

Current transactions, excluding income on direct investments, net	−2,280
Income on direct investments, net	2,200
Government capital flow	−450
Private capital flows	−5,780
Errors and omissions	−3,650
Official reserve transactions balance	−9,960

(The data in the table are derived primarily from those published by the Department of Commerce in the June 1973 issue of the Survey of Current Business. However, the data for those corporate capital transactions which are not related to direct investments have been revised to include statistical information that is collected by the Treasury but was not available in time to be used in the Department of Commerce compilations. The data on these corporate transactions will be published on a country by country basis in the August issue of the Treasury Bulletin. Further revisions of the data for the first quarter will be published by the Department of Commerce in the September 1973 issue of the Survey of Current Business.)

The breakdown of the recorded private capital transactions in the first quarter is given in the following summary table. (More detail is provided in an attachment.) It can be seen in the first column that bank transactions reflected the largest part of the outflows. Net corporate outflows were large, but not greatly different from the comparable period a year earlier, while securities portfolio transactions made a substantial and increasing positive contribution to the payments balance.

— PRIVATE CAPITAL TRANSACTIONS IN THE U.S. BALANCE OF PAYMENTS NOT SEASONALLY ADJUSTED

(In millions of dollars)

	1st quarter 1973	Change from— 1st quarter 1972	Change from— 4th quarter 1972
Transactions of agencies and branches of foreign banks in the United States	−2,250	−2,350	−1,970
Transactions of U.S. banks in the United States	−2,330	−2,050	−2,330
Subtotal, bank transactions	−4,580	−4,400	−4,300
U.S. direct investment abroad	−2,540	−850	−2,280
Foreign direct investment in the United States	250	610	90
Other corporate transactions	−260	−260	−940
Subtotal, corporate transactions	−2,550	−500	−3,130
Transactions in securities and brokers funds	1,350	1,080	190
Total private capital	−5,780	−3,820	−7,240

Within the banking category the table indicates that the net outflow in the first quarter was about evenly split between transactions by US banks in the United States and transactions by branches and agencies of foreign banks in the United States. The US banks in the United States are cooperating in limiting outflows of their funds on the basis of a specific set of guidelines agreed with the Federal Reserve, and the US branches and agencies of foreign banks have been requested to abide by the spirit of the same guidelines. On July 10 the Board amended its guidelines to make them as specific for these agencies and branches as those applying to US banks. Such guidelines do not, however, apply to export credit and do not restrain the outflow of foreign funds deposited in the United States. In the short run, moreover, the guidelines may be exceeded when there is a sudden concentrated call by foreign borrowers on their existing unused credit lines. All of these special factors were probably present in the banking flows of the first quarter.

Within the corporate category, the principal outflow resulted from net transfers to US direct investment operations abroad. These outflows of $2,540 million were large in absolute terms. However, in recent years direct investment outflows have normally been high in the first quarter, presumably as a result of incentives created by the working of the controls administered by the Office of Foreign Direct Investment. The increase in 1973 from a year earlier was thus significant, but not the principal "swing" item as compared to the banking flows.

During the first quarter of this year there was also an outflow of $260 million in other corporate capital outflows, for example through deposits in foreign banks, repayment of foreign borrowings, and credit on trade transactions with unaffiliated foreign enterprise.

In all probability some direct investment and other corporate outflows in the first quarter were caused—or accelerated—by the widespread expectation of exchange rate changes at times during the quarter. Nevertheless, the excess of all these outflows during that period over the same period in the previous year of $1.1 billion suggests that the US corporate reaction to the expected exchange rate changes was not the major component of the flows which led to the worsening of the US payments balance in that period. And during the same period, despite the exchange rate expectations, there was an increase in foreign direct investment in the United States.

During the first quarter portfolio transactions also strengthened the US payments position, and the major component of these flows was foreign purchases of US securities.

In order to gain as complete coverage as possible of corporate capital flows during the first quarter letters were sent by the Secretary of the Commerce and the Secretary of Treasury to the chief executive officers of 1,600 US corporations to request their personal attention to their reports to the Government for this period. In addition, visits have been made by a team of experts from Commerce, the Federal Reserve, and the Treasury to a number of representative companies to review procedures in detail. These reviews have uncovered some omissions from previous reports, but probably not in a magnitude to alter the trends revealed by the reported figures. Under the circumstances we are led to the conclusion that the bulk of the unreported transactions revealed by the errors and omissions of $3,650 million in the first quarter were undertaken by US residents other than the major US business corporations, which are well covered by the present statistical reporting system.

I hope this information will be of value to your Committee.

Sincerely yours,

JACK F. BENNETT.

BALANCE OF PAYMENTS 1972 AND 1ST QUARTER 1973

[Millions of dollars]

	Not seasonally adjusted, 1972						Seasonally adjusted, 1972				
	Quarterly average	I	II	III	IV	1973, I [1]	I	II	III	IV	1973, I [1]
Current transactions excluding income on direct investments, net	−3,909	−3,431	−4,052	−4,965	−3,192	−2,279	−3,989	−4,042	−3,717	−3,889	−3,015
Income on direct investments	1,821	1,578	1,581	1,632	2,495	2,198	1,646	1,678	1,824	2,138	2,265
Government capital	−335	−393	−219	−313	−414	−446	−289	−95	−366	−586	−344
Private capital	439	−1,959	2,977	−723	1,459	−5,778	−1,966	2,372	−816	2,166	−5,779
Errors and omissions	−778	989	−1,029	−1,221	−1,851	−3,656	944	−940	−1,626	−1,490	−3,629
Official reserve transactions balance	−2,762	−3,216	−741	−5,590	−1,503	−9,961	−3,654	−1,029	−4,701	−1,661	−10,502

[1] Preliminary.

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PRIVATE CAPITAL TRANSACTIONS IN THE BALANCE OF PAYMENTS, 1972 AND 1ST QUARTER OF 1973

[Millions of dollars]

	Not seasonally adjusted, 1972						Seasonally adjusted, 1972				
	Quarterly average	I	II	III	IV	1973 I [1]	I	II	III	IV	1973 I [1]
U.S. corporations:											
Direct investment	−851	−1,692	−398	−1,058	−256	−2,539	−1,302	−183	−1,148	−771	−2,139
Other assets	−231	−247	−160	−198	−322	−725	−179	−118	−289	−341	−658
Liabilities	709	244	1,071	523	998	465	289	1,081	626	840	513
Total	−373	−1,695	513	−733	420	−2,799	−1,192	780	−811	−272	−2,284
Foreign direct investment in the United States	40	−361	183	178	160	247	−361	185	178	160	247
Total corporate transactions	−333	−2,056	696	−555	580	−2,552	−1,553	965	−633	−112	−2,037
Banks:											
U.S. assets, total	−876	−966	138	−724	−1,954	−2,896	−1,401	106	−894	−1,317	−3,346
Of which U.S. agencies and branches of foreign banks	(−475)	(−376)	(−126)	(−374)	(−1,024)	(−1,336)					
U.S. liabilities, total	1,231	789	2,272	189	1,675	−1,684	714	1,430	344	2,437	−1,750
Of which U.S. agencies and branches of foreign banks	(639)	(477)	(1,206)	(130)	(743)	(−913)					
Net flow of funds	355	−177	2,410	−535	−279	−4,580	−687	1,536	−550	1,120	−5,096
Of which U.S. agencies and branches of foreign banks	(164)	101	(1,080)	(−244)	(−281)	(−2,249)					
Securities:											
Foreign securities	−154	−437	−346	20	−40	47	−437	−346	209	−40	47
U.S. securities (excluding new issues by corporations)	578	762	198	181	1,179	1,324	762	198	181	1,179	1,324
Net	424	325	−156	390	1,139	1,371	325	−156	390	1,139	1,371
Brokers funds, net	−7	−51	27	−23	19	−17	−51	27	−23	19	−17
Total private capital	439	−1,959	2,977	−723	1,459	−5,778	−1,966	2,372	−816	2,166	−5,779

[1] Preliminary.

Note: Figures in parentheses denote debits.

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Senator MONDALE. What is your opinion about the advisability of returning to a tougher incomes policy of wage and price, profit, and interest controls to try to take some of the heat out of what I regard to be an intolerable inflationary period of phenomena. Does that appeal to you?

Mr. BENNETT. Well, as I mentioned earlier, the Deputy Under Secretary for Monetary Affairs is not the administration spokesman on incomes policy. I do not agree with you when you say, take the heat out, because in my judgment an incomes policy in the sense of restraints does not take the heat out.

What takes the heat out is budgetary policy and monetary policy.

Senator MONDALE. Well, if I understand your answer, you are not going to comment on the question of whether we need wage-and-price controls because that is not in your field?

Mr. BENNETT. I would be happy to give you my personal judgment, but I didn't think you wanted that.

Senator MONDALE. Let's have that.

Mr. BENNETT. My answer is no. I do not believe it would.

Senator MONDALE. It doesn't help at all?

Mr. BENNETT. No, sir.

Senator MONDALE. Well, when we had phase II, as I recall, the level of inflation was half of what it has been under phase III; does that affect your judgment at all?

Mr. BENNETT. Well, I would make two comments with respect to that. When we went from phase II to phase III, we did not remove the existing controls in the food sector and in fact we tightened them, yet one of the largest contributions to the price increase in phase III was in food and that was not as a result of the move from phase II to phase III. Furthermore, when you say it was lower in phase II, I always wonder how much of the move in phase III might have been left over from phase II.

It had to come out sometime. So those are two factors that weigh heavily, in my judgment. I also am concerned about the effect of these income policies in reducing the productivity of the U.S. economy. As I said earlier, I feel that increasing of the productivity is the real cure.

Senator MONDALE. Do you see any evidence that there is a substantial increase in foreign investments in the United States as a result of the two devaluations?

Mr. BENNETT. There are two kinds of evidence; the portfolio investment here in the first quarter of this year was at the highest level in history and——

Senator MONDALE. Would you say that again?

Mr. BENNETT. The flow of foreign portfolio investment to the United States in the first quarter of this year was at the highest level in history.

I wouldn't be surprised if it has been lower in the last few days, but I expect it is going to be high in the coming months.

Second, when I go to Europe I meet with government officials and with industrialists. The industrialists are concerned and feel that plants in the United States are more competitive than plants in their country and they are concerned about the competitive position of their plants there.

That is the change that is encouraging.

Senator MONDALE. Well, do you anticipate an expanded flow of foreign capital into the United States, partly as a result of these devaluations?

Mr. BENNETT. Yes, sir.

Senator MONDALE. And how do you think that will show up? Will that be in terms of foreign ownership of U.S. plants or creation of new plants?

What will its characteristics be? Investment stocks, do you think? What will——

Mr. BENNETT. Senator, it will be in the direct investment flow and in the portfolio purchase of U.S. stocks.

Senator MONDALE. You think that is happening now?

Mr. BENNETT. Yes, sir.

Senator MONDALE. Do you see any evidence that, say, the Japanese and European multinationals are considering establishing plants in the United States as we have done in, say, the Common Market?

Mr. BENNETT. Yes, sir.

Senator MONDALE. Are there announced examples of this?

Mr. BENNETT. There have been a number of announcements since February.

Senator MONDALE. Could you give me just a few examples?

Mr. BENNETT. There have been some South Carolina examples.

Senator MONDALE. That was a German plant in South Carolina?

Mr. BENNETT. Yes.

Senator MONDALE. That is some months old, though.

Mr. BENNETT. Well, there have been a number of them. It is my understanding—if you would like, I will try to accumulate more specifics and send them to you——

Senator MONDALE. The German investment was predicted. I have been watching the newspapers about this closely, and I was just wondering whether you are seeing some of this investment going on?

Mr. BENNETT. I think you might also have noticed the other day, there was a large announcement, I believe, of an expansion of a refinery here by a company that is in large part a subsidiary of a foreign company. That again is as a result of new policies.

We will get the investment here rather than in some offshore island or some other part of the world.

Senator MONDALE. Well, thank you, Mr. Chairman.

Senator BYRD. Thank you, Senator Mondale.

[Mr. Bennett subsequently submitted the following information:]

SELECTION OF RECENT DIRECT INVESTMENTS IN THE UNITED STATES BY EUROPEAN AND JAPANESE DIRECT INVESTORS

Libby McNeill & Libby (Nestle Alimentana, S.A., Switzerland). Majority control acquired. (March, 1978)

Stouffer Foods Inc. (Nestle Alimentana, S.A., Switzerland). Acquired for $100 million from Litton Industries. (March, 1978)

Cadbury Corp. (Cadbury-Schweppes, Ltd., United Kingdom), Company announced it will build a $10 million plant in Hazelton, Pennsylvania. (March 15, 1978)

Robert Bosch A.G., Germany, announced the building of a fuel injector assembly plant in Dorchester County, South Carolina. (May 31, 1978)

Klockner Moeller A.G., Germany, announced the building of a $1 million electrical switchgear plant in Rhode Island. (June 7, 1978)

Hitachi Metals Ltd., Japan, announced a partnership arrangement with General Electric to build a specialty steels plant in the United States. (March, 1978)

Nippon Seiko, Japan, announced a joint venture with Hoover Ball and Bearing Corp. of Ann Arbor, Michigan, to build a $10 million anti-friction bearings plant at Ann Arbor. (March, 1973)

Mitsubishi International Corp. (Mitsubishi, Japan), announced the building of a $10 million plant to produce synthetic uppers for the shoe industry. (February 22, 1973)

Toyo Bearing Manufacturing Co., Japan, announced the building of a $1 million specialty ball bearing plant in Chicago. (April, 1973)

Sony (Japan), announced the building of a $15 million plant in San Diego to produce color TV sets. (April, 1973)

Marubeni Corp., Japan, announced the construction of a $5 million textile plant in South Carolina. (May 31, 1973)

Meiwa Gravure Chemical Co., Ltd., Japan, announced the building of a $4 million plant in Charleston, South Carolina, for the production of plastic household articles. (June 1, 1973)

Kikkoman Foods, Japan, announced the construction of a $6 million plant in Wisconsin. (February 18, 1973)

Volkswagen Werk A.G., Germany, has announced that it is actively considering the establishment of several assembly plants in the United States. (March 15, 1973)

Kuwait Investment Co., Kuwait, is reportedly making real estate investments in the United States amounting to $84 million. (April 19, 1973)

Farbwerke Hoechst, Germany, is undertaking a $80 million expansion of two U.S. chemical plants already owned by the company. (April, 1973)

Source: Unofficial information available from the Department of Commerce and on the basis of reports in commercial and financial publications.

Senator BYRD. Mr. Secretary, I must say that I am shocked at the lack of concern that the Treasury Department shows in these huge and continuously expanding Government deficits.

It is shocking that your comment in reply to my question a little while ago was that you are not concerned about these deficits. I don't see how we are going to get our problems under control until the persons responsible regard them as a problem.

Here is a 4-year period, from fiscal 1971 through fiscal 1974, the accumulated Federal funds deficit will equal $106 billion. We had a $30 billion Federal funds deficit in 1971; $29 billion in 1972; and $28 billion for this current fiscal year, and you project a $19 billion deficit for next year. Yet one of the top people in the Treasury Department says that he has no concern.

Let me ask you this. What is the amount the Treasury Department seeks in the current budget to pay the interest on the national debt?

I will give you the answer. It is $26.1 billion.

Mr. BENNETT. Yes, $20 billion something.

Senator BYRD. $26.1 billion.

Mr. BENNETT. Yes, sir.

Senator BYRD. That has doubled in 8 years. In 1967 the interest charges were $13.4 billion. They are now $26.1 billion.

Who pays that interest, the guy who goes out and works in the plants and factories and earns a living, pays it.

Seventeen cents of every personal and corporate income tax dollar paid into the Federal Treasury goes for that one purpose, namely, to pay the interest on the debt and the Treasury Department is not concerned about this problem.

Now, let me ask you this. I will assume you will agree that we are in a period of inflation?

Mr. BENNETT. Yes, sir.

Senator BYRD. You do agree to that?

Mr. BENNETT, Yes, sir.

Senator BYRD. What, in your judgment, is the major cause of the inflation we are experiencing?

Mr. BENNETT. With hindsight, it is quite possible to say three things: Over the years, the budget deficits were too high, that over the past period, with hindsight, perhaps our monetary policies should have been tighter, and certainly over the periods past we did not take sufficiently strong measures to remove the impediments to the productivity of our economy.

Senator BYRD. William McChesney Martin testified last week that while there were various reasons for the inflation—and you have cited some of them—that the major reason in his judgment are these continued huge Government deficits.

I take it that you don't regard that as a major reason, though?

Mr. BENNETT. I would like to distinguish as best I can from the accumulated past and the exact present moment. In other words, at the moment I do not think we have cause for serious concern about the state of our budgetary outlook.

Senator BYRD. Well, if you are right about that—and I don't think you are—there isn't much reason for us in the Congress to take the political heat, so to speak, and vote to sustain the President's veto on many of these bills. I voted to sustain his veto because I think we are in a very desperate situation financially.

Mr. BENNETT. Senator, I would agree with you that if this restraint were not exercised, if you did not continue to show responsibility, we would be in trouble——

Senator BYRD. Continue to show? We haven't even begun to show restraint, and the figures show that. Again I cite: we had a $30 billion deficit in 1971; we had a $29 billion deficit in 1972; and we have a $28 billion deficit in 1973—you might say we are improving, and I suppose that is some improvement—and you project a $19 billion deficit for next year, which may or may not be accurate because the Treasury forecasts have not been very accurate in recent years, and I think you will admit that for whatever the reason.

Mr. BENNETT. Yes, sir.

Senator BYRD. Now, in your testimony you say that you feel that it is a considerable overstatement to describe the present situation as a monetary crisis.

Mr. BENNETT. Yes, sir.

Senator BYRD. On Friday, William McChesney Martin told the subcommittee, and I quote, "I think it is good that your committee is taking a look at this international financial crisis"—and I am quoting from a transcript—"because I think in this instance crisis is the right word, given the $10.2 billion payments deficit in the first quarter, the huge speculation against the dollar abroad, a current annual rate of inflation of 9.2 percent of the consumer prices, and a drop of more than 100 points in the stock market during the past 5 months."

How would you characterize the present situation?

Mr. BENNETT. One thing I would point out, that we are at the moment having a balance-of-payments surplus and not a deficit. We have had that since the first week in March.

Senator BYRD. Did we not have a balance-of-payments deficit of $10.2 billion for the first quarter of this year?

Mr. BENNETT. Yes; we did but since the first week in March we have had a surplus.

Senator BYRD. Do you expect that surplus to continue to the end of the year?

Mr. BENNETT. I expect we may have overall deficits in some of the coming periods, but over the next several years, we will have on balance surpluses.

Senator BYRD. Several years, I heard you say?

Mr. BENNETT. Yes; we have a surplus now and we will have surpluses over that period, but there will be perhaps periods inbetween when we have deficits.

Senator BYRD. Even if you don't use the word, "crises," Mr. Martin feels it is appropriate. How do you characterize the present situation, rosy?

Mr. BENNETT. As far as the international area is concerned, I would say that we have been rewarded in that the system put in place in February and March has showed its resilience; it has showed its strength and its viability.

Senator BYRD. Do you think devaluation is a solution?

Mr. BENNETT. As I said earlier, I do not expect this Congress to be asked again to change the par value of the dollar.

Senator MONDALE. Would you yield there?

As a matter of fact, devaluation is going on right now. It isn't a formal devaluation, of course, but what would you call it?

Mr. BENNETT. In the marketplace the dollar has reduced in value. You can use the word "devalued."

Senator MONDALE. Sure, because that is what it is. What is a devaluation? It is the relationship of, say, the dollar to the German mark; isn't it? And hasn't it devalued further since the two official devaluations?

Mr. BENNETT. Devaluation, as you say, is a word of many meanings and sometimes it is used to refer to that thing which has happened in February and then again in December of 1971, which was a formal change. In the marketplace the dollar can devalue or appreciate day by day.

Senator MONDALE. Which way has it been going?

Mr. BENNETT. I hope you got a copy of my chart that shows it has been going in one direction the last couple of days——

Senator MONDALE. Which way?

Mr. BENNETT. The dollar has been weakening relative to the European currency, or to put it another way, they have been increasing relative to the dollar.

Senator BYRD. Do you expect a balance-of-payments surplus for the second quarter?

Mr. BENNETT. Yes, sir.

Senator BYRD. As an expert, would you tell a nonexpert, what does the rise of price of gold mean?

Mr. BENNETT. It means gold has become too valuable to waste on money.

Senator BYRD. Would it be equally accurate to say that mostly the trading has been in American dollars and the American dollars are regarded as less valuable than the gold?

Mr. BENNETT. Well, there has been some decline in the dollar in recent days relative to other currencies, but it has been a small fraction of the decline in all currencies vis-a-vis gold. I mean, the large change in gold has been against currencies in general and not just against the dollar.

Senator BYRD. In other words, a great many buyers would rather put their assets in gold than to put it into paper currencies?

Mr. BENNETT. You say a great many, I think it is a pretty small market, but enough have made that decision to push up the price, yes.

Senator BYRD. Now, the President stated in December of 1971 that the Smithsonian Agreement was "the greatest monetary agreement in the history of the world" and yet your statement seems to make clear that the Smithsonian Agreement was not a solution to our monetary problems and that the second devaluation therefore was necessary?

Mr. BENNETT. The Smithsonian was a great agreement. It got together at one time for the first time in history a large proportion of the monetary powers, and they agreed on a change. It turned out the change wasn't big enough, though.

Senator BYRD. Former Chairman Martin feels that there should be another international monetary conference called at an early date; do you agree with that?

Mr. BENNETT. In one sense I have to because there are a lot of them already scheduled, but if you mean do I want another one scheduled in addition to the ones already scheduled, no.

Senator BYRD. Well, the ones already scheduled, are they of a major nature?

Mr. BENNETT. Yes, sir.

Senator BYRD. What are scheduled?

Mr. BENNETT. Well, in the coming weeks there are meetings of the Committee of Deputies—the Paul Volckers of this world—of the Committee of Twenty.

There may be another meeting of the Ministers of the Committee of Twenty this summer. In any event, there will be a meeting of the Ministers in September and a meeting of the Governors from all 125 members of the International Monetary Fund in September, in addition to which, meanwhile, there will be many other meetings of the Central Bank Governors and of experts in the OECD——

Senator BYRD. I can't find it in your statement at the moment, but didn't you say somewhere in your statement that you did not favor another monetary conference?

Mr. BENNETT. I do not favor another Bretton Woods.

Senator BYRD. Do you mean another major conference?

Mr. BENNETT. Well, I don't favor another meeting patterned on that one in which it was expected to get everybody together for 2 weeks and solve the world's problems.

Senator BYRD. The Morgan Guaranty Trust Co.'s latest world currency survey forecasts many improvements in the basic balance-of-payments deficit in the United States this year. You feel they are inaccurate and incorrect?

Mr. BENNETT. I feel there will be a marked improvement this year, Senator.

Senator BYRD. How much improvement in the trade balance thus far was due to the Soviet agricultural sales?

Mr. BENNETT. The total of Soviet agricultural sales was between \$1 billion and \$1½ billion, I believe, so it is of some magnitude, but some of that might have been sold elsewhere.

Senator BYRD. So the Soviet grain sale had an impact of about \$1 billion or \$1½ billion?

Mr. BENNETT. Well, \$1 billion to \$1½ billion, yes.

Senator BYRD. Is it your feeling that the Nation as a whole benefited from the Russian grain sale?

Mr. BENNETT. I wish we had sold it at a higher price. I do think we benefited.

Senator BYRD. Would you give me the figure on the current—well, we will take March 31, our current gold holdings as of that time, and our total assets and our total reserve of assets, and our total liabilities to foreigners as of March 31?

Mr. BENNETT. Our gold, as I recall, was about \$10.4 billion as of March 31 and our liabilities to foreigners, official institutions—I have that somewhere—the total to foreigners was \$88 billion.

Senator BYRD. Now, the Federal Reserve's representative, Governor Daane, the other day gave a figure of \$90.9 billion.

Mr. BENNETT. He was talking about—oh, wait a minute. I am sorry. I jumped a line.

You are right. It is \$90.9 billion. It was \$90.9 billion for March 31. There is a line missing here.

Senator BYRD. What is our total reserve assets?

Mr. BENNETT. Our total reserve assets?

Senator BYRD. Yes.

Mr. BENNETT. Let me get it exactly, if I may.

Senator BYRD. For March 31.

Mr. BENNETT. It was \$10.4 billion of gold. I think in addition to that we had about \$1.9 billion of special drawing rights, so all together we had about \$13 billion.

Senator BYRD. So, putting that \$90.9 billion in perspective, we'll say \$91 billion was the figure as of December 31; just 3 months prior to that the liquid liabilities to foreigners was totaled at \$79 billion.

Mr. BENNETT. Well the number comparable to the \$90.8 billion as of the end of December was \$83 billion.

Senator BYRD. The \$79 billion then would be to the institutions only?

Mr. BENNETT. Well, I am just not sure where that number came from. At the end of December the official institutions figure was \$61.5 billion.

Senator BYRD. Your figure shows \$83 billion for the end of December for the total liquid liabilities?

Mr. BENNETT. Yes, sir.

Senator BYRD. Now, just one further question. Why should not private citizens in the United States be permitted to own gold?

That is the first question. The second question is: Is it not correct that citizens in most countries, virtually all countries, have the right to own gold?

Mr. BENNETT. Well, if I may take your second question first, Senator, the majority of the citizens of the world and the majority of the countries of the world are not permitted to hold gold.

Senator BYRD. Are what?

Mr. BENNETT. The majority of the citizens of the world and the majority of the countries do not permit it. However, the variations are many. The Canadians are allowed to, but the British citizens are not; Japanese are allowed to, but Australians are not; Norwegians and Danish are not allowed to, but French and Italians are, so it varies as far as being allowed to.

Senator BYRD. Why should an American citizen not be permitted to?

Mr. BENNETT. Well, the prohibition, as you know, was put in place in 1933 and the conditions are now markedly different so it is a subject that ought to be reviewed, but I think that there are conditions and appropriate reasons today why that action of removing the prohibitions should not be taken. We are not long out of that period in February of market instability. If we were today to allow citizens to hold gold or announce that we would allow them to hold it soon, that could lead to a worsening of our balance of payments in the short run and it would lead to a further move in the price of gold.

To the extent that had some reflected impact on the currency markets, it would be unfortunate.

I think the time should come and will come when we can treat gold just like any other commodity, but I don't think it ought to be this week and I don't think it would be wise to legislate that it would be changed as of December of this year.

Of course, American producers of gold can sell their gold at the market price and anyone in America needing gold for artistic or industrial purposes can buy gold.

Senator BYRD. Well, thank you very much, Mr. Secretary.

Senator HASKELL. Mr. Chairman?

Senator BYRD. Yes; I will yield to Senator Haskell.

Senator HASKELL. May I ask just one question?

Mr. Secretary, as I view it, our country's tax policy provides inducements for our capital to be invested overseas, and then to accumulate and to leave the profits overseas.

Speaking as a member of the Treasury Department, do you agree with that policy? Do you think that is a wise policy?

Mr. BENNETT. I don't agree with your characterization of the tax law as providing inducements. There are circumstances which could justify a change and, in fact, the Treasury has recently proposed certain changes in the tax treatment of foreign income.

There are circumstances when foreign governments attempt to use tax policy to attract American capital, but basically in taxing a U.S. investment abroad our law tries to recognize that there is a need to balance competitiveness relative to a plant in America and the competitiveness relative to a foreign-owned plant. It does us no good if there is a business opportunity in East Africa and we impose a tax on top of the local tax so that an American company couldn't compete for that business, but a French company could take it.

On the other hand, we don't want our tax policy to give any inducement for the American company to put the plant in East Africa and not in South Carolina. But those two factors have to be balanced. But we do earn a great deal from investment abroad. One of the strongest elements of our balance of payments is the earnings of our foreign investments.

Senator HASKELL. As I understand it, the great bulk of those earnings is not repatriated for very obvious reasons due to our tax policy. Would you agree with that?

Mr. BENNETT. No, sir. I think that the great bulk—over half—are repatriated. First of all, the earnings of all branches abroad are taxed currently, and the earnings of the subsidiaries, since they are already taxed abroad—for example, the oil companies are almost universally taxed higher abroad than here—can be brought back without any great U.S. tax penalty.

In fact, in many cases, no U.S. tax is paid since they have already paid so much abroad.

Senator HASKELL. Let me put it this way. Assuming there were a situation where it would be more advantageous financially to invest abroad due to our tax policy, would you consider that a wise Treasury policy?

Mr. BENNETT. To prevent exactly that possibility the new tax package, which has been sent here, provides for three changes to reduce the possibility of that happening, Senator.

Senator HASKELL. Well, I will be glad to examine those three changes.

Thank you, Mr. Secretary.

Mr. BENNETT. Thank you.

Senator BYRD. Thank you, Senator Haskell.

Just one question. Do you feel that the 8.3-percent expansion of the money supply in 1972 was perhaps somewhat heavy?

Mr. BENNETT. As I said earlier, in retrospect we did something wrong if we had that rate of price inflation in the first quarter, in the first 4 months of this year.

Senator BYRD. Well, thank you, Mr. Secretary.

[The prepared statement of Mr. Bennett follows:]

PREPARED STATEMENT OF HON. JACK F. BENNETT, DEPUTY UNDER SECRETARY OF THE U.S. TREASURY

Mr. Chairman, I am flattered by your invitation for me to present the Administration's thinking on current international monetary developments. I shall present a viewpoint which differs substantially from those of several of the witnesses who appeared before you last week. They spoke—as does the blue briefing book prepared by your staff—of an International Monetary Crisis. There are changes underway in the world but in my view it is a considerable overstatement to refer to them as a crisis.

Current developments indicate that we have great responsibilities before us in the management of our domestic economic affairs and great opportunities for negotiating further improvements in international monetary arrangements. But, while recognizing these responsibilities and opportunities, we should recognize that current international monetary arrangements have performed well in recent weeks, far better than would have been likely if earlier arrangements were still in place. The market exchange rates between currencies have moved, but the movements have not been disorderly. The price of gold has moved in large jumps in the private markets not only against the dollar but also against all other currencies as well. That experience has further underlined the unsuitability of gold as a base for money, but, despite the still lingering formal links between gold and the international monetary system, the instability of the private gold price has not caused serious disruption of currency markets.

We have been living through a difficult period in terms of an unexpected and unacceptable rate of price inflation and in terms of foreign questions about the reliability of our governmental processes, but the outlook is strong for the basic determinants of our international payments position. There has been no faltering in the economic policy procedures of our Government. Prices will be rising at a lower rate in the coming months. Our trade balance has been moving strongly in the right direction, and foreigners have increasingly recognized the opportunities for attractive investment in the U.S. economy.

Looking backward a few years it may be helpful to recall that the dollar and our balance of payments weakened sharply in the 1950's and 1960's, not because of a poor relative record on inflation—the U.S. performed better than most countries—but because of abnormally rapid increases in productivity elsewhere as Japan and Europe were "catching up" with us after World War II. This major structural change in the world economy was not matched by comparable changes in exchange rates—under the Bretton Woods system there was a certain inertia if not rigidity in exchange rates. The result was a progressively growing upward pressure on the currencies of Europe and Japan and downward pressure on the dollar.

By 1971 it was apparent that a fundamental mal-alignment of exchange rates had been allowed to develop. The actions taken since the President's initiatives in August, 1971, have now removed that fundamental mal-alignment from the system. The fact that it took a year and a half to accomplish the necessary changes can serve to remind us that a market exchange rate is a relationship between two currencies, a relationship which the governments of either or both issuing countries may try to influence.

In August, 1971, the U.S. Government stopped trying to peg the international value of the U.S. dollar, and at the International Monetary Fund annual meeting in September Secretary Connally suggested that for a transitional period other countries also stop intervening to hold up the value of the dollar relative to their currencies. He suggested that the market be allowed to determine a new and realistic value for the dollar. The others would not agree and during the fall of 1971 modified their points of intervention to allow only varying degrees of small change in the relationship between the dollar and their currencies. After hard negotiation an agreement was reached in December at the Smithsonian that the U.S. would remove its 10% import surcharge and that other major countries would make more substantial changes in their intervention points, permitting a greater decline in the dollar relative to their currencies.

We argued for greater changes. We felt that more was needed, but in the end a deal was struck to get at least the changes which were made, and in the realization that no one could forecast with high degree of certainty the precise effect of substantial exchange rate changes in such circumstances. The deal was in a sense implemented by a formal change in the par value of the dollar in terms of gold, a change which has been accurately referred to as a change in the price at which we did not trade in gold. But the real implementation took place in the market place as a result of the actions of the other governments in moving the points at which they were intervening in the exchange markets.

The resulting changes in exchange rates were probably helpful to the U.S. payments position, but a year later a consensus began to develop among traders around the world that the U.S. projections had probably been right, that larger changes in market rates were needed. No clear trend of improvement in the U.S. trade balance had appeared, and indeed the trend at the time seemed to be toward a worsening of the U.S. trade deficit.

Increasingly private businessmen and bankers and the officials of the central banks of the smaller nations around the world began to base their decisions on their judgment that the authorities of some of the major countries in Europe and of Japan would not continue their intervention to hold down the value of their currencies relative to the dollar at the current levels. Accordingly, despite increasing controls, foreign holdings of obligations expressed in the currencies of those countries began to increase markedly, and as a counterpart the central banks of those countries acquired increased holdings of U.S. dollar-denominated assets, principally U.S. Treasury bills.

The question is sometimes asked, "Why was this development of concern to the U.S.?" "Since the U.S. was receiving more goods in import than it was having to export, wasn't this helping us to combat inflation in the U.S.?" The answer is that the U.S. fight against inflation probably was strengthened in the short run by the import surplus. And the U.S. Government wasn't borrowing any more just because some foreign governments were buying U.S. Treasury bills; in effect some U.S. citizens were finding it better to sell than to hold U.S. Treasury obligations at the high prices the foreigners were offering. Yet these factors were more than offset by other considerations. For one thing the unreasonable exchange rates were unfair to large segments of our economy forced to compete under a great handicap with goods produced abroad. The U.S. could—and was—providing an adequate level of total demand in the U.S., but that was not adequate consolation for those whose livelihood was lost or threatened by foreign competitors benefitting from an unfair rate of exchange. Moreover, we could not reasonably expect foreign countries to continue to ship more to us than they received as a result of their government's actions to hold up the price of the dollar by buying low-interest-rate U.S. Treasury bills. Sooner—rather later—this imbalance was sure to be brought to a halt, probably with great recriminations, probably with new forms of government trade and investment controls abroad, probably with a suddenness which would cause larger economic dislocations the longer the correction was delayed.

It was in these circumstances that the U.S. Government again took the initiative to gain the agreement of the major foreign governments to modify their intervention in the markets thus allowing a further change in the relationship between the dollar and their currencies. After several days of negotiation a change was agreed on. Again, as at the Smithsonian, the U.S. agreed to propose a change in the price at which it doesn't trade in gold, and a number of other major countries moved their intervention points.

In subsequent weeks, however, the markets effectively expressed their disbelief in these newly declared intervention points, and foreigners continued to acquire the currencies of some of the intervening countries, particularly Germany. After a few weeks these governments abandoned their announced intentions of regularly intervening in the market between their currencies and the dollar, and in mid-March an agreement in principle was announced in Paris among the principal countries and the U.S. that in future "official intervention in exchange markets may be useful at appropriate times to facilitate the maintenance of orderly conditions . . ."

Since that time, as you can see in the illustrative chart attached to my table, market rates have varied but no large-scale intervention has been necessary to maintain orderly conditions. The rates are free to move but there is a difference from the situation for the year and a half after mid-1971. During that period there was a large backlog of needed adjustment—all in the same direction—which some governments were reluctant to allow. Now there may be changes, but they are likely to be largely as a result of new developments of the future—and no one knows from one day to the next what those developments will be and whether they will push the dollar up or down in value. The adjustment for the backlog has been accomplished, and I see no justification for the statement in your blue book that the present situation is "inherently unstable."

A little later I would like to list some of the reasons why I suspect the dollar will be worth more on the exchange markets relative to other currencies three months and twelve months from now, but whatever the change I would expect it to be brought about gradually. I am convinced that when the Congress completes action shortly on the Par Value Modification Act now before it there will not be another occasion when the Congress will be asked to devalue the dollar by lowering its official price in terms of gold.

Many questions have been asked about who were the speculators who brought about the exchange rate changes in February and March. And we are sometimes asked what can be done about such destabilizing speculations. Before commenting on what facts we do have at this time, however, I would like to add to the list of questions. Has there been an irrational degree of emphasis on the word speculation? Is there really any good reason to attempt to delve into an individual's motives to try to determine whether he was hedging or speculating, that is whether his lack of belief in some government's official line was expressed through changing the timing of a foreign exchange transaction which would have been made in any event at some time or was expressed through a transaction which would not have taken place if there had not been the lack of belief? Is there any reason to consider it unpatriotic for an American to doubt that a foreign government would be successful in its effort to subsidize exports through intervention in the exchange market to hold down the value of its currency relative to the dollar?

These questions should be borne in mind I think when studying the chart attached to the statement. Certainly a case can be made that those movements of funds which led to the change in the basic level of the dollar value of the mark and the Swiss franc from, say, late January to late March were not irrational and destabilizing. They could be considered a final part of the suppressed need for adjustment which had built up over quite a few years.

The smaller changes more recently could be different. They are for one thing not the sudden result of breaking through a level of governmental opposition to change. The rates have been free to move on a daily basis since mid-March. And there have been developments which private traders and investors might judge to be likely to lead to some decline in the foreign exchange value of the dollar.

While these judgments are understandable, I wouldn't be surprised if it turns out that they give undue weight to some of the adverse factors. Yet I mention them to explain why it would seem wrong to me to consider the recent exchange rate moves in the market place totally irrational. Probably there were irrational elements, but our rate of price inflation in the first quarter was higher than expected, and this was not a favorable development for our trade balance. Germany did introduce severe anti-inflationary measures and did increase its interest rates. The Senate did pass legislation to permit private U.S. citizens to hold gold for investment and speculative purposes starting at the end of this year, and such permission, if finally enacted into law, could well, not only increase the cost of our substantial level of imports of gold for industrial and artistic purposes, but also lead to a large additional import burden. It is for that reason that it is my hope that the Senate-House conference committee on this legislaiton will adopt the House version, which defers the move to private ownership until such time as the President determines that sufficient reform of the monetary system and sufficient demonstrated improvement of our payments position have been accomplished to permit the change to be made in an orderly fashion.

I mention these considerations in part to explain my belief that the exchange rate changes in recent weeks were not the result simply of some spontaneous instability in current exchange arrangements.

In recent weeks, as you know, the exchange rates rather than the levels of exchange reserves have reflected the market's changing viewpoints on various currencies. One can never be sure but my own guess is that if we had tried the reverse, if governments has consistently intervened to attempt to hold the exchange rates unchanged while absorbing the currency flows in reserve changes, then we could well have generated an old-fashioned monetary crisis with markets closed abroad and financial officials flying off to emergency meetings.

That, of course, was what happened in February and March. During that period the reserve holdings of dollar assets of the foreign countries increased by about ten billion dollars. From reports which have been made public already, it appears that about a half of the accumulation was reflected in transactions of U.S. banks in the U.S. and of the branches and agencies in the U.S. of foreign banks. Some of the transactions took the form of reductions in privately held deposits in the U.S. Some took the form of new loans from the offices in the U.S. either in the form of new credit approvals or—in most cases probably—in the form of drawdown of already existing lines of credit. What we don't know in any precise numerical way is to what extent the initiative for the transactions came from within the United States and to what extent from instructions received from abroad. In a qualitative way the banks have reported that the preponderance of the initiatives came from abroad.

Apart from the reported bank transactions there were probably about five billion dollars of other transactions which increased the dollar asset holdings of the foreign central banks. Later this month we'll get our first statistical reports for the first quarter showing a breakdown of this outflow among the current accounts and the direct investment flows of U.S. corporations, the credits of U.S. non-bank corporations, and errors and omissions. The company reports from which the Government's statistical reports are prepared were received in recent weeks by the Treasury and the Commerce Departments and are now being compiled and analyzed. To insure the accuracy and comprehensive coverage of these reports to the Government, a joint letter was sent by the Secretary of Commerce and the Secretary of the Treasury to the heads of 800 reporting companies asking these men to give their personal attention to insuring the quality of the reports submitted. More recently the two secretaries have sent another letter to about twenty selected companies in various parts of the country requesting the companies to receive a joint Commerce, Federal Reserve, Treasury team of experts which hopes to discuss these companies transactions in detail to insure that present forms and procedures are not missing any significant types of transactions involving the U.S. companies.

As you can see, there is still a great deal we do not know about the transactions in the first quarter. The lack of the knowledge was not a handicap at the time, since for any operations we might have wished to undertake there was ample prompt knowledge of the magnitude and direction of the flows taking place even though the purpose of the flows was not known. Later this month we will know more, but to the extent that the movements were originated by foreigners, for example by foreign trading companies and foreign central banks reducing their deposits in the U.S., we will never know the full story. As a point of interest to you, however, I should mention that we have had reports from a number of important oil producing countries indicating that they had not originated large movements during the first quarter.

You might also be interested in a contrast which I have observed between the periods, such as that early this year, when official reserves were absorbing changes in international monetary conditions and the more recent period. In those earlier periods whenever I went to one of the recurrent meetings of international monetary officials I observed these officials frequently and nervously arranging to obtain reports as to what was going on in the foreign exchange markets. On the other hand, week before last, when the C-20 deputies and their advisors met here for five days, there seemed to be no particular interest as to what was going on in the exchange markets on an hourly or even daily basis.

I mention this observation as just one indication of the fact that the interim monetary arrangements which have been put in place have provided a favorable climate in which the negotiations on longer-term international monetary reform can proceed. Of course I cannot guarantee that there will not be renewed disturbances in the exchange markets at some future time.

I do believe that the present monetary arrangements represent a substantial improvement over the recent past, and that with international cooperation, these arrangements are serviceable and sustainable for the period required to negotiate and introduce needed further reforms. But the present system is far from perfect, and the U.S. is committed to the effort to build a better system. We helped launch the Committee of Twenty, and last September the President and Secretary Shultz presented a comprehensive outline of U.S. views on reform. Subsequently we have presented various papers filling out details of the U.S. monetary proposals and we have pressed the Committee of Twenty to examine the broad rules related to trade and investment.

Our view is that a reformed monetary and trading system must:

a) Be equitable in its application to all participants;

b) Effectively and equitably promote adjustment of payments imbalances, by both surplus and deficit countries;

c) Introduce enough exchange rate flexibility to facilitiate needed adjustment;

d) Promote fair and liberal practices regarding trade and investment; and

e) Leave countries adequate scope for policy flexibility.

In essence, our proposals are for an open and equitable international economy, free from reliance on controls but with effective means to prevent development of large and persistent payments disequilibria whether surplus or deficit.

At this level of generality there is little disagreement. But we have not yet reached agreement on specifics—for example, on the rules and procedures which should be introduced to assure that countries do eliminate their balance of payments surpluses and deficits, on the means for determining the amount and types of reserve assets in the system, on the way in which gold will be phased out of its central position in the system. On that last point there is not yet agreement on the most practical route to the objective. Various of the alternative routes which change existing agreements so that monetary authorities could sell gold into private markets at the market price, but there are differences as to whether and when, if ever, monetary authorities would be permitted to buy gold from the private markets.

In addition to these questions your Subcommittee has two other specific questions on the reform: first, should the short-term liabilities of the U.S. be funded; and second, is a new monetary conference similar to Bretton Woods needed to reshape the international economic order.

The first question, on the possible desirability for funding or exchanging some or all of the $70 billion held by foreign official institutions, has been the subject of much discussion. But funding these dollar holdings is no magic solution to monetary reform. The large dollar holdings of foreign central banks are more the result of past instabilities in the system than a source of present danger. It would be useless or even harmful to the system to fund or otherwise tie up these dollar balances without at the same time changing other elements of the system so that continuing instabilities would not simply lead to new accumulations of dollar balances or other currency balances replacing those which were funded. We need, in short, a system which will promote prompt and equitable adjustment of payments imbalances. With effective adjustment arrangements and other elements of a reformed system, possibilities for funding or exchanging part of existing dollar holdings into SDR obligations warrant careful consideration. We have stated our willingness to give them careful consideration.

The second question, the possible need for a Bretton Woods conference, has been considered more than once. Our feeling is that such a move would not be helpful at the present time. At the time of Bretton Woods, conditions were quite different from today—a wartime period, when travel was difficult and communications limited, and a relatively few voices were involved in the major negotiations. Also we did not have, as we now have, annual meetings of the IMF Governors, where the financial leaders of 125 members states can regularly convene. It has seemed to us that a better way to proceed was with periodic meetings of the Committee of Twenty, and regular meetings of the IMF, without the fanfare and potential for market disturbance of a special conference like a new Bretton Woods.

Several meetings of the C–20 have been held, at both Ministers and Deputies levels, with considerable progress toward understanding of respective positions and definition of critical issues. Another meeting of the Deputies is scheduled for early next month. There is the possibility of another meeting of the ministers before they are scheduled to meet again at the time of the annual meeting of the IMF Governors in Nairobi, Kenya, in September. We, and others have expressed the hope that the main outlines of a new monetary system can be agreed upon by the time of the annual meeting of the IMF Governors' meeting in Nairobi in September 1973. The U.S. will do all it can to meet that goal.

Meanwhile, of course, as these reform discussions continue, international business goes on, and you have asked three basic questions about the period just ahead. What steps can be taken to strengthen the dollar? How can the U.S. deficit be cut? And how can speculation be reduced? In practice I suspect those three questions are just three ways of asking the same question. At any rate it seems to me that the right answer is the same to all three questions: take care of the fundamentals. We must insure that we follow the appropriate budgetary and monetary policies, that we remove impediments to the full productivity of the U.S. economy, and that our businessmen are not handicapped by unfair international conditions of trade.

With respect to the budget, you have, of course, just received the mid-session review indicating that on a full employment basis there will be a surplus of $5 billion in the fiscal year starting at the end of this month. In fact, I would guess that the economy has already moved into a posture of surplus. With respect to monetary policy, Governor Daane has already reviewed for you in detail the gradual and persistent tightening which the Federal Reserve System has introduced over the past year.

For the release of the full productivity of the U.S. economy you have had reports of the short-run measures which have been taken and those that have been proposed, including the release of forty plus million acres of land into production and the planned reduction of our material stockpiles to more appropriate levels. For the long run you are aware, for example, of the decisions that have been taken to amend the oil import program to make it possible in the future to build oil refineries in this country rather than to have to rely on new construction abroad, and you have received the President's recommendations for the deregulation of newly produced gas to encourage expanded exploration and production in this country.

These basic measures are the proper response to inflation at home. It is true that in the past year the increase in our cost of living was less than that of any other one of the 20 members of the OECD. But the performance of our wholesale price index, which is more relevant to our international trade was not equally good and, of course, we were greatly disappointed by the increases in our price indices during the first quarter of this year. Yet I think there is justifiable confidence that the basic measures which I have outlined will increasingly be reflected in lower rates of price increase. Moreover, I have no evidence of hesitation within the Administration to take additional basic measures if it should be decided that they are needed, always bearing in mind that there is a time lag between decision and results and there would be no wisdom in overturning the boat in the other direction.

In our international trade the improving trend is apparent to all. Over the first part of this year the improvement is of course in large part a reflection of our higher level of agricultural sales. It is quite possible these sales will not be at the same high level in the coming quarters. Yet the marked improvement which provided a $196 million trade surplus last month, in contrast to the deficit of the previous month, depended only in small part on an increase in agricultural sales. It seems to me there would be a strong likelihood that the first half of next year our trade balance will be markedly stronger than in the first half of this year even with lower agricultural sales and with the forecast continuing growth in our oil imports.

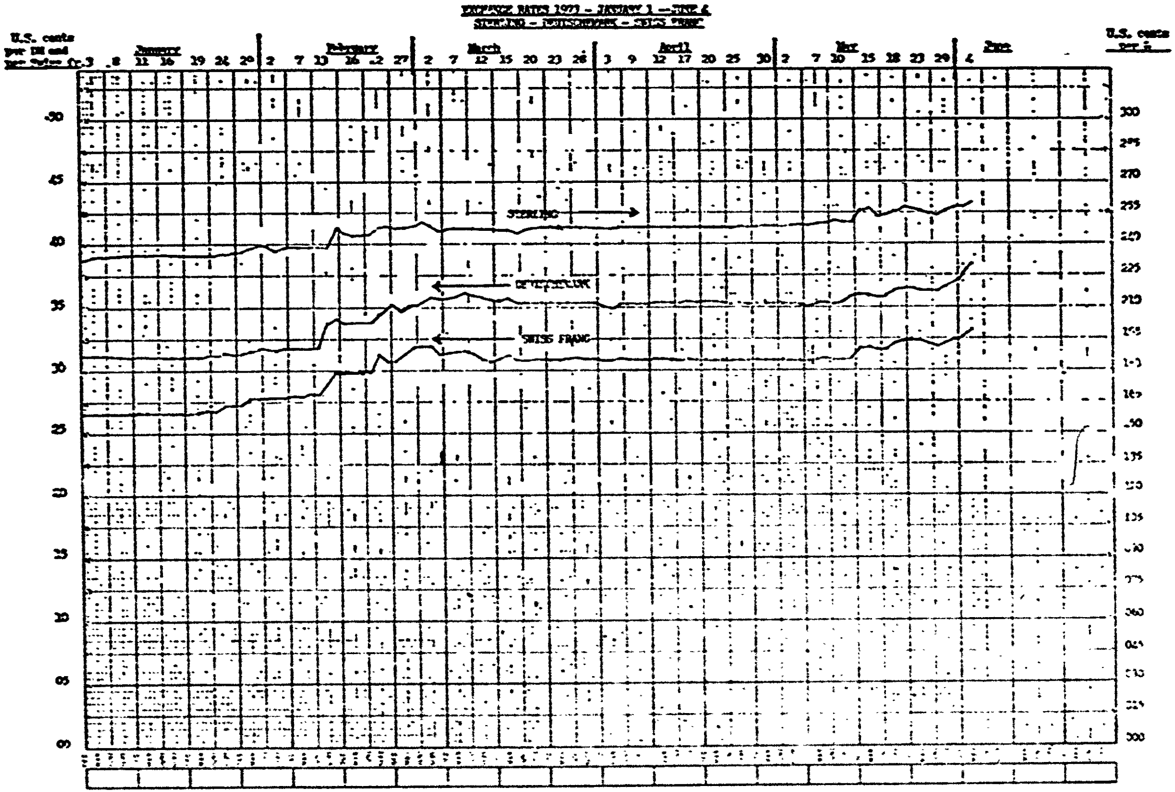
The real costs of a barrel of imported oil is rising and will probably continue to rise. The total dollar costs rose from $2.7 billion in 1969 to $5.1 billion last year. And there are many projections that the figure will reach $15 billion per year well before 1980. Yet no confidence can be placed in the precision of such long range forecasts necessarily they tend to be based primarily on extrapolation of past trends and cannot yet have taken adequately into account the results of be achieved from the President's new energy program designed to increase production of all forms of energy in the United States and designed to use that energy with greater care and efficiency.

I realize that there have been concerns expressed that the large income of some small producing countries will endanger international monetary stability in the future. On the other hand, I am aware that these countries will have large needs for imports to meet their developmental and their defense needs. I am aware that they will be seeking secure and productive investments to replace their assets from the ground. They know that their reserves of oil will not last forever and that an important part of their income must be invested wisely in order that it may provide income for the time when their production is declining and newly developed alternative sources of energy have reduced the dependence of the industrialized world on their supplies. Furthermore, large as their assets may be compared to their holdings today, their combined assets will not comprise any large fraction of the capital assets of the world as a whole.

The large income of these countries will represent a real cost to the importers but they represent no reason to forecast a weakening of the dollar relative to the currencies of Europe and Japan. These countries taken together will be increasing their imports in absolute terms by far more than the United States. They too will be competing with us to provide exports to the oil producers and to offer them attractive investment opportunities. In such competition we expect United States to be competitive, and the dollar could well come out ahead.

In the short run, of course, we are all familiar with the recent declines in the value of the dollar in the foreign exchange markets and in the value of shares on the U.S. stock exchanges. Fears have been expressed that these developments will drive away prospective foreign investors, and it is true that an investor may choose to wait so long as he expects that trend to continue. It is probably wise to recall that one's reaction to a decline in the effective price of a U.S. stock may depend upon whether one is a prospective seller or a prospective buyer in the near future. There are large sums in the hands today of foreigners who are definitely prospective buyers and I expect they will not fail to notice that the value of the dollar has been increasing in terms of United States shares. I do not have any reports on net trading in the last few weeks but I do know that in the first quarter of this year the net flow foreign portfolio investment into the United States was at an all-time record rate. I would expect it to be at an even higher rate in the coming quarters.

I do not have the skill—or the temerity—to attempt to predict exchange rates precisely in the coming weeks. My own judgment is that foreign exchange market has probably misjudged the extent to which basic fundamentals will in the near future be reinforcing the improvement in our trade balance and enhancing the attractiveness of investment in United States dollar assets. On balance, therefore, I would expect the dollar to strengthen. Fundamentally, however I think what is important is not what changes may take place from day to day in the market valuation of the dollar. What is important is that we appear now to have in place a system which has demonstrated its capacity for accommodating such changes without disrupting the fabric of international trade investment and cooperation.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Senator BYRD. The next witness will be Mr. Edwin L. Dale, Jr., international economic writer for the New York Times.

Mr. Dale has had many years of experience analyzing international economic affairs, and presenting the issues with clarity and precision. The committee feels fortunate today to have Mr. Dale as a witness before the committee. We welcome you, Mr. Dale.

You may proceed as you wish.

STATEMENT OF EDWIN L. DALE, JR., INTERNATIONAL ECONOMIC WRITER, NEW YORK TIMES

Mr. DALE. Thank you, Mr. Chairman.

It is a genuine honor to be asked to testify before your committee. I would like to begin this statement by suggesting that we should all be a bit humble in assessing this most unusual and unfamiliar international monetary situation, accompanied by a distressing inflation at home. If I may say so, I do not feel a sense of impending crisis which can be fairly defined as follows: (1) Stagnation of business at home—major recession if you like—with unemployment rising to 8 percent or more; (2) an inflation rate of the Latin-American type—10 percent or more lasting for at least a year; (3) inability to buy with my dollars French francs or German marks or Japanese yen at any price; or (4) a drying up of world trade.

But having tried to shy away from the semantics of crisis, I certainly do not claim that things are good. The inflation rate in this country is almost without precedent in peacetime. Internationally, the world of finance is going through a period of great uncertainty, particularly about the relative values of currencies, with a spillover into the gold market. This, in hindsight, is a clear consequence of the end of the 25-year role of a fixed-rate dollar as the anchor of the whole system.

When a normal and familiar way of doing business changes—when a Swede used to quota in dollars when he sold to Japan, and this now raises problems—you can expect turmoil. You can expect dire prophesies. Above all, you can expect, jumpy reactions: In the London gold market, in the Chicago soybean market, in the Frankfurt foreign exchange market, and in the New York stock market. To repeat, I am not persuaded that jumpy reactions to an unfamiliar situation mean crisis, though calm is obviously preferable.

I shall touch on two matters and make no proposals. So much new is at work that I respectfully suggest that this is a time for suspension of judgment by Congress for the time being, rather than action for action's sake.

THE TWO-PHASE DEVALUATION OF THE DOLLAR

There is no doubt, Mr. Chairman, that the shattering end of the old, familiar monetary system has had all the bad results for confidence, at home and abroad, that have been described at these hearings. But it had to happen. The reasons for it are not all to do with the fact that we were sinners at home by permitting too much inflation, though we were definitely sinners in part of the period starting in 1966, including the 1971–72 period, by running overlarge budget deficits.

In brief, the fetal flow of the old system anchored on one currency—the dollar—was that the dollar's exchange rate could never change. Given the catching up period of mechanization and technology and high productivity growth in Europe and Japan in the 1955–70 period. I am convinced that the dollar would have become out of line—overvalued—by 1970 even if we had been as virtuous in controlling inflation as you, Mr. Chairman, rightly insist that we should have been, including a smaller budget deficit for much of the time.

In any case, the dollar's exchange rate has now changed by a significant amount—a change that brought down the system but that had to happen. Nobody, experts included, knows how much this will accomplish in balancing first our foreign trade and then our overall balance of payments. Most economists think it will do a great deal. Many labor leaders, Members of Congress and businessmen are doubtful. With a bet of one devalued dollar, I side with the economists. And I say this despite the inexorable growth of our oil imports. They are not all that big—year-by-year growth in the short run—set against the likely growth of our exports. As for the long run—1980 or 1985—I shall not say with Keynes that in the long run we shall all be dead, but only that I have no faith in longrun projections. We could well be running a big trade surplus in 1980 even with much larger oil imports.

For what it is worth, I have a feeling that the Smithsonian devaluation of late 1971 was not enough to correct the overvaluation of the dollar that had built up for so long, and that the second dose early this year was necessary to get the dollar's exchange rate—and therefore American competitiveness—roughly right. Regardless of whether this feeling is correct, there is no dispute that the second devaluation added greatly to loss of confidence and the present sense of uncertainty in the world.

FLOATING EXCHANGE RATES

Here is the really new thing in the world. These hearings have not touched much as yet on this subject. The innovation could be of decisive—and constructive—importance.

Let me begin with a slightly irreverent point—a point made, however, by Senator Mondale a moment ago. While members of this committee last week were, quite properly, asking whether there might be a third devaluation of the dollar, it was in fact being devalued in the newly free foreign exchange market by about 5 percent—against the cluster of European currencies, though not against the yen this time—as compared with the values of early May. This can fairly be called the Watergate flurry, and is a good example of jumpiness; I do not welcome it, but the fact is that it happened. As long as the floating system lasts—which could be for a very long time—the question of the U.S. Government devaluing the dollar does not arise. The markets devalue or upvalue the dollar. And the dollar might very well go up in the period ahead.

The second point may seem technical, but it is crucial to the subject of these hearings. To state it slightly dramatically: You could abolish the Eurodollar market tomorrow, and also the overhang of some $70 billion held in foreign central banks, and there would be as much potential for speculation against the dollar as before—or in favor of it. There can be runs on currencies in the modern world even if you somehow wipe out all the dollars that are supposedly sloshing around abroad. This is a fact not widely realized. Consider only leads and lags. There is now more than $1 billion of export-import business—not to mention other international business such as travel and investment—being done in the world every day of the year, including weekends and holidays. If German importers simply decide to delay their payments for goods they have bought because they think the value of the mark might rise, that can swamp the dollar-mark exchange rate even if every speculator in the world were in jail and every multinational corporation were out of business. And this is true of American importers, too, and other American citizens and companies. There is a literally infinite capacity for a run on the dollar by Americans alone, in the sense of buying foreign currencies, with no Eurodollar market at all. I respectfully suggest, Mr. Chairman, that you will not find it fruitful to search for scrapegoats.

The key new element is that a system of floating exchange rates introduces some risk. A man or a company no longer has a sure bet, as he did in a fixed-exchange rate system with currency values clearly out of line, now if he switches, for example, out of dollars and into marks or guilders. The mark can go down as well as up. We shall have to wait and see how it works out—I return to my original humility—but I believe that the system of floating rates has far more promise for ending currency crises than a painful and perhaps futile effort to mop up the dollars held abroad. They are not the real problem. Neither are speculators. The problem was the fixed-exchange rate system itself.

To conclude, Mr. Chairman, we are all going through a new and unsettling—but quite possibly promising—experience. I don't honestly think that anyone in this country, mystified by headlines about record-high gold prices, need fear a calamity, mass unemployment or runaway inflation. Nor do I believe that the real essence of the world money system, the ability to change one currency for another, is in danger. Thanks to the ingenuity of private dealers in goods and money, world trade goes on. That is what matters.

Senator BYRD. Thank you very much. That is a very interesting presentation and I think that it tends to put this whole problem in focus. I certainly agree with you, all of us should be a bit humble in this regard. I am more than a bit humble; I am quite humble. I certainly agree with you also when you say you have no faith in long-term projections.

I find it very difficult to have much faith in short-term projections these days.

Let me ask you this, the Soviet grain deal, how do you size up the impact of that deal on the American economy?

Mr. DALE. I think it had both plusses and minuses. It definitely added with one big wallop to the demand in our agricultural sector, which has, as you know, resulted in a recordbreaking rate of increases in prices. It obviously helped our balance of payments in this period of time.

I think Jack Bennett was right in saying, in hindsight I wish we sold it to them at higher prices. However, they bought it at relatively low prices. So it had an effect in both directions. The exports helped but the prices didn't.

If I may add, there, I happened to be working on a story last week about the rise in our farm prices, that is, the prices received by farmers, and that figure is really quite staggering. In the year 1971 the index used for that—well, this was for 1967, taken as 100, it was running at 111 or 112 all year long. Last month it was 166, so you can see——

Senator BYRD. It has increased. And take a specific commodity like soybeans, just as an example——

Mr. DALE. They are out of sight; absolutely out of sight.

Senator BYRD. How much of that is the result from our own weather problems here, though?

Mr. DALE. I am sure some of it—and I am not an expert in soybeans—but some of it is simply transportation problems. There is an absolute shortage of soybeans. If you look at the futures market, they are only one-third to one-half of the present spot market for July.

Senator BYRD. But the Russians purchases had a significant impact on this?

Mr. DALE. I cannot be so sure about the soybeans, Senator, I think so, but not a massive effect. Our weather definitely was the major effect.

Senator BYRD. I will at this point yield to the distinguished chairman of the Finance Committee, Senator Long.

The CHAIRMAN. I think the chairman is certainly doing a fine job. You go right on ahead, Senator

Senator BYRD. Thank you.

I yield to Senator Haskell.

Senator HASKELL. Mr. Dale, I really have only one question. I am glad you avoided using the word crisis. On the other hand, I don't suppose it is healthy to have the dollar continuing to go down in relation to other countries' currencies. How would you prevent a continued decline of the dollar?

Mr. DALE. Well, it is a very good question and I don't have a very good answer. I am of the school which is not used to the floating world. This is an unfamiliar situation to me, as to all of us, because we have not lived in a floating world.

I am of the school that we should stand pat and do nothing with the caveat, of course, that we have to continue to get our own budget into better control. I would love to have a dialog with the chairman on that. At the moment, we must continue to have a monetary policy roughly as we are doing and wait and see. I think the people who have been selling dollars these last 4 or 5 days may lose money because the underlying payments flowing in and out everyday—the tourists and investment and trade—goes on and, if I am correct that the dollar's exchange rate is now roughly right, then the dollar is going to have to go back up.

Again, this is the formal exchange rates, which would be 2.81 marks instead of 2.61 yesterday. So I think doing nothing and letting it float is the right policy.

Senator HASKELL. You would advise the use of certain domestic policies?

Mr. DALE. Oh, yes; that is, a longrun business of checking our inflation. What I would advise against—unlike Bill Martin, for whom I have the highest respect—I would not advise intervention in the foreign exchange markets in order to fix the dollar at any given rate.

The CHAIRMAN. Since you brought that up, let me ask you one question. Is it not true that quite a bit of this unfavorable balance of payments that we have been experiencing over a long period of time had to do with the fact that the dollar was overvalued?

Mr. DALE. That is right.

The CHAIRMAN. Now, if the dollar is overvalued, the only way you are going to get your house back in order is to devalue; isn't that right?

Mr. DALE. That is right. The only thing at issue here is whether the rates that were fixed in mid-March were or were not enough. The markets are saying this week that was not enough, but I am not sure that is a permanent condition and——

The CHAIRMAN. But the thing that occurs to me, Mr. Dale, if I was some foreign nation that is counting on selling into the U.S. market, I would persuade the United States it should do business on the traditional free trade concept and then any time I have more production than I could sell into a market, all I would have to do is just value my currency low compared to the dollar and ship all of my economic problems to Uncle Sam and let it be his worry: If I had a problem with unemployment, I wouldn't have it any more because I would just ship it over to Uncle Sam and then it is his problem. Now, the only way we will ever overcome that and get back into line is for us to make it clear that we have the power to devalue the dollar compared to the other country's currency.

Mr. DALE. I thoroughly agree, Senator. However, I think your description applied much more to the period up to the late 1971 than it applies now. The Japanese were the most atrocious sinners in this regard with an undervalved currency. That currency is now 35 percent higher against the dollar than it was in May 1971 and that is an enormous change in exchanges rates.

I am sorry Senator Fannin isn't here because I happen to believe—although we only have sketchy evidence so far on this—but there is already in process a very major swing in our trade balance with Japan solely because of the devaluation and not because of some measures they have taken in grapefruit and so on, because they have liberalized but it hasn't been significant. Their advance figures on imports show a very sharp increase and their export advance indicators show some decrease. So I think, frankly, that we may be pleasantly surprised, particularly in our trade vis-a-vis Japan by the results of this devaluation.

The CHAIRMAN. Are you aware of the point I have been making for a long time to the effect that these official trade figures are fundamentally fraudulent because they fail to take into account the freight on the imports which, in view of the fact in the overwhelming majority of the cases, the exports are brought in the other fellow's ships so it really means when you add the freight to it, many of those years that were given to us as being surplus years turned into deficit years. We had 5 years in a row when they were reporting a rosy favorable trade surplus but actually, if you took into account the freight and you discounted the foreign giveaways you didn't have a favorable balance.

Mr. DALE. Yes.

The CHAIRMAN. I think there was a 5-year period where each year they gave us the good news announcement that we had a favorable trade—each quarter—and they said the favorable balance was at *X* figure and then again at *Y* figure, but actually it was an unfavorable balance. I mean, here we had good news announcements every quarter for 5 long years, totaling up to a favorable trade balance of $14 billion; but, if you took out the giveaways and you took into account the freight, which is something anybody has to pay if he ships, then it turned out to be not a $14 billion favorable trade, but a $12 billion unfavorable trade, a minus. We lost money every year; every quarter, but they were giving us the figures all that time for 20 long quarters to the effect that we were making money all of that time.

Do you have any comment?

Mr. DALE. I am aware of that, Senator, and I am also aware of the long debate among the statisticians about which is the better figure. I won't dispute your view of it. I will add, however, which I am sure you are familiar with, that it does distort the trade figures but it does not distort the balance-of-payments figures because they do report the freight and record the foreign aid for what it is, so that the basic balance-of-payments figure, which is the crucial one, is still correct.

The CHAIRMAN. But it distorts what the real trade situation is. They distort what they want to for policy reasons. For example, we had a great big military program that is costing us a lot of money to keep these troops abroad and give foreign military aid. Now, these people try to make all of that look as though it wasn't costing a fraction as much as it really was. And even right now, we have tremendous arguments as to what it is costing to have these troops in West Germany.

I talked to some West Germans a few days ago and they were contending that they are paying 90 percent of that cost and it is costing us practically nothing. They are even considering paying us—so they said—100 percent. Well, now, if they calculate that 100 percent the same way they calculate that 90 percent, that is not going to do us too much good. That is the way I look at it.

We had Pierre Renfret here. Here is a man who has been advising on this for this Government. I asked him how much did he think that was costing us and he said that his guess was about $4 billion a year. And here are the West Germans telling us it is costing us around $300 million. Our people are trying to give us an honest calculation and they reached the conclusion it is costing us around $4 billion.

Mr. DALE. Senator, I think that applies to all Europe, of which, of course, the bulk is Germany.

The CHAIRMAN. And it applies to the dependents as well as the servicemen, and all of that. I know that. But they can really throw dust in our eyes when we have a situation where it is costing us $4 billion and the West Germans are telling us it is only costing us $300 million. I guess it is just a small item that they hope to wipe out sometime soon.

Mr. DALE. I don't think so.

The CHAIRMAN. But this is pretty serious when you look at the fact they have been deceiving the American public for 5 long years by saying that we had a favorable balance when, in fact, we had an unfavorable balance. When you consider that we are losing money on military aid and losing money on maintaining troops overseas, then the only way we can do things of this sort is to have a favorable trade balance, but we don't.

The only way we can continue this aid and doing things of this sort is to have a favorable trade balance. So, according to these figures, theoretically you are making about $3 billion a year and we are told we must do a lot more of this. But the fact is we are not making $3 billion, but are losing $2 billion, and to do more means you will lose $5 billion and——

Mr. DALE. Senator, if I could say, if we lose $12 billion, which was your calculation in 1972, it is surely a lot better to lose only $3 billion this year.

The CHAIRMAN. Right, but it is better not to lose any.

The point about it is this: if we must earn a favorable balance of trade in order to afford all of these troops overseas and all of this military commitments that have been made in our name, then the least that we can do is give the American people an honest set of books that tells them whether they are making money or losing money on this account and if we must change our way of doing business—as I am positive we have to do sooner or later—then the sooner we give the American people the facts, the better off we are all going to be.

But as I was saying, the answer is not to say that we must expand what we are doing now in the trade area—because we have an unfavorable balance of trade—but the answer is that in that area we must change our way of doing business in order to wipe out this deficit with Japan, for example. That is one of the first things we should do.

And let the record show your head is nodding to all of this——

Mr. DALE. Senator, yes; I would just repeat my point that I think the 35-percent change in the values of the two currencies is going to go a long way toward doing that.

The CHAIRMAN. Right. Now, we are doing some of the things that must be done and I think that is very important and I think that is very fine, but it is well to point out that to solve this problem we are going to need to have some honest trade figures, as well as some honest figures in other areas.

Part of this whole problem is how they handle Public Law 480 sales. If you are giving away $400 million and you put that down as a minus against the farmers, as though that was something that we were subsidizing them for, then the farmer is billed for that. He is not required to accept less for his quantities than he would have had otherwise because he is charged with the $400 million of the grain they gave away.

Then they take the AID program and on that one they enter it on the books as a zero on the theory that this was surplus commodities and if we hadn't given it away, we would have had to dump it in the ocean, so that it really cost nothing to the AID program. So, that just gets a zero.

Then they take the trade program and put that down as a plus $400 million. We made $400 million on that one because by adding it on the trade figures, it would appear that this Government made a great big profit because $400 million worth of quantities were shipped from here over to India somewhere to somebody who has no intention whatever of paying us and we have no expectation of receiving anything for it. But that is just put down as a plus.

Now, for instance, (a) I don't think it is fair to charge all of that against the poor old farmer; and (b) I think it is completely erroneous to put any of that down as a favorable trade balance. Do you agree with that?

Mr. DALE. Oh, yes. I think you have a better point, there on the way we treat our giveaways. That is, this is distorting the figures even more than you do on the FOB problem. Of course, this is not anything I can do anything about except as I write stories but——

The CHAIRMAN. Well, you could do something about it by putting the record straight.

Mr. DALE. Yes.

The CHAIRMAN. It seems to me the AID program ought to carry at least some of that burden.

In trading with the Soviet Union, we could get gold for the grain if need be. Now, if we put part of the burden for that, or at least a major portion of it, on the AID program, then you wouldn't have to slug the poor farmer with the whole $400 million; you could just let him carry half of it, or even a lesser portion, depending upon what you thought that stuff would have been worth if you actually sold it.

Mr. DALE. I am wondering, though, if we are going to have any more Public Law 480 to give away.

The CHAIRMAN. That is another problem.

Well, thank you very much. I appreciate your very wise answers on that subject, Mr. Dale, and I am positive that they are wise and well informed because I agree with them.

Senator BYRD. Senator Roth?

Senator ROTH. Could I pass for the moment, Mr. Chairman?

Senator BYRD. Mr. Dale, your views seem to me to be very well-balanced ones and, as I understand it, you feel the second devaluation of the dollar did add much to the loss of the confidence in the dollar?

Mr. DALE. And in currency exchange rates generally.

Senator BYRD. And I think what you said appears to me also as being very logical that the dollar fluctuates up and down so that you will get fluctuations in the dollar as the days go by, but at the moment it has not been a subject of formal devaluation since the second devaluation. But there has been a devaluation insofar as the dollar compares to the European currencies.

Mr. DALE. Yes; in the markets.

Senator BYRD. In the markets, yes; without a formal devaluation.

Mr. DALE. That is correct.

Senator BYRD. And that does not apply, as I recollect to the Japanese yen?

Mr. DALE. No; and I would like to explain that if I may, Mr. Chairman. In April, there was a large outflow of dollars from Japan, which was supposedly floating the yen. They did not let the yen drift down, though. They acted like good soldiers and supported the yen at its new higher rate, which was a very gentlemanly thing to do. They are not running a clean float.

In the latest flurry—and I don't know for a fact—but I wouldn't be surprised if the Japanese were intervening and taking in dollars again to keep the yen just at about 265 to the dollar. So they are dirty floaters, or managed floaters, but the others are all clean.

Senator BYRD. Do we get much gentlemanly conduct in the international financial scheme of things?

Mr. DALE. It is a little hard to define. Governments in the past have not been gentleman like in this area but there is a very real spirit of cooperation that began with Bretton Woods and has continued through all of these crises and we have not gotten back into the famous condition of the thirties called "Beggar thy neighbor." So we have not yet gotten there. There is always the potential for that in a floating world if people intervene to manipulate the value of their currency up or down.

So far, though, I think people are being gentleman-like in the short run. I can't guarantee the future though.

Senator BYRD. It seems to me it is not advantageous for any country for other countries to be in serious difficulty with their currencies.

Mr. DALE. Correct, and that is the new awareness in the world. This is a most significant change in that in this committee of 20 that is negotiating world monetary reform, there has finally been acceptance, Mr. Chairman, by the other countries that a persistent U.S. deficit is not good for them.

Senator BYRD. I should think it would be very bad for them in the long run.

Mr. DALE. Well, they have finally realized it.

Senator BYRD. And I think if the British pound or the German mark or the Japanese yen get in serious difficulty, it would be disadvantageous to us in the long run?

Mr. DALE. That is right. And the whole thrust of the American plan in the reform negotiations—and it is a plan which is the working document—is that the future system must accomplish one thing above all and that is nobody should ever have persistent deficits or surpluses and that there should be a recognized mechanism or mechanisms in place to force nations to do what has to be done to remedy this, including changing the exchange rate but not limited to that.

Japan even agrees that they no longer want to run persistent surpluses.

Senator BYRD. It gets back to—how shall we say it—to a country imposing discipline on itself?

Mr. DALE. Yes.

Senator BYRD. And if so, how do you do that?

Mr. DALE. Right and, if I may, would like to make a little mention of your concern about the budget.

First, Senator, to adjust a balance-of-payments deficit, one method is more discipline at home, which can be defined simply as less inflation, and that is an accepted method. Sometimes, however, if a currency's exchange rate is too far out of line, you have to add to it a devaluation of the currency.

Now, going back to our situation, there is no doubt in my mind—as I said in my statement—that we had insufficient discipline for much of the period since 1966—though, by no means, all. As for right now, I believe, sir, that you have overlooked, whichever budget figures you want to use, a very significant improvement.

I would like to use the unified budget. There was a $25 billion deficit in fiscal 1972, and the latest estimate is now down to between $17 billion and $18 billion in the current year, which is not much of an improvement but it does drop down to 2.7 in 1972 if the line on expenditures is held, that is an improvement. Now that may be still too much of a deficit, but it is an improvement.

Senator BYRD. That is sort of in the nature of a long-range forecast so even though it is only a year off because the Treasury isn't too accurate in its estimates——

Mr. DALE. There has been some very poor estimating, but it is simply a natural consequence of an inflationary boom; our revenues are going up very, very fast and that is the cause of the improvement.

Senator BYRD. The whole fact that business is good?

Mr. DALE. That the corporate tax take will be substantial; yes.

Senator BYRD. But, after all, the bulk of the money comes from the individuals rather than from the corporations; correct?

Mr. DALE. And they are up, too, Senator.

Senator BYRD. They are up also but I doubt to the same extent.

Mr. DALE. As I recall, there is an estimated increase—as compared with last January in the receipts side—there is an estimated improvement of exactly $10 billion, of which a little more than half is in the individual tax.

Senator BYRD. Is this for 1974?

Mr. DALE. Yes, for 1974. But in any case, Mr. Chairman, I would estimate that the budget posture for 1974—again, also assuming that expenditures can be held to 269—is sufficient to accomplish the purpose, namely, to slow this economy down. Others may disagree. You may still think it is a little bit too stimulative, but my estimate is it will do the job and that job is simply described to slow the economy down from an 8-plus growth rate to a 4-percent growth rate, in which case, if anything remains true in this world, the inflation rate should decline, too.

Senator BYRD. I admit that my view is a minority view, particularly in the Congress. I think it is accurate to say that the vast majority of my colleagues do not agree with me in my deep concern as to the long-range effect of these continued heavy deficits.

Mr. DALE. Well, if I may, Mr. Chairman, I would like to register a dissent from your emphasis on the Federal funds, but I know that is an esoteric argument and we perhaps don't want to get into that right now.

Senator BYRD. Well, the reason I feel the Federal funds is the budget figure you need to take—certainly, one of the reasons—is that based on that you can decide whether you must increase or decrease your national debt.

Mr. DALE. That is right, sir, but don't forget, of that $25 billion worth of interest that you included in your dialog with Jack Bennett that $10 billion or a little more is interest paid to the trust funds; that is, it is just shuffled inside the Treasury. The reason the unified budget is more useful, I believe, sir, is that it tells how much money the Government, in total, is pumping into the economy and how much it is taking out.

Senator BYRD. Yes; from that point of view I certainly agree with you. But the reason I object to using the trust fund surplus in figuring how we stand internally is because you are using the surplus from a trust fund which surplus can only be used, or rather which funds can only be used, for a specific purpose and not for the general operation of government.

Mr. DALE. That is right.

Senator BYRD. I agree with you if you are looking at it from the broad economic impact.

Mr. DALE. Yes.

Senator BYRD. But it is a little different from the way I was looking at it; from the point of view I was looking at it——

Mr. DALE. Yes; Mr. Chairman.

Senator BYRD. Well, Senator Roth?

Senator ROTH. Mr. Dale, do you feel it would be desirable to impose a 90-day wage-price freeze?

Mr. DALE. A new freeze?

Senator ROTH. Yes, I wonder if you would care to comment.

Mr. DALE. I don't want to sound more convinced or like I had more confidence in this than in fact I have, but my answer is negative. I believe that a freeze at a time of very tight capacity in many industries—in short, excess demand—very probably would be counterproductive. The time a freeze works is when you have slack-as we had in August of 1971. We had plenty of slack then.

This economy is now taut and up against capacity. Even though Senator Proxmire continues to state we are only operating at 80 percent of capacity, the university of Pennsylvania Wharton School, which I believe has a very sophisticated method for measuring of manufacturing capacity utilization, has come up with 94 percent right now and over 100 percent in at least half a dozen industries. With those circumstances, a price freeze is, in my view, not likely to work.

Senator ROTH. Would you explain why?

Mr. DALE. Yes. If I am a paper manufacturer and I am operating flat out and a freeze comes, then I would just simply refuse to serve customers or else I would sell under the table and increase the price and make the guy who can pay the illegal price pay it to get the paper. It is the black market situation, Senator. It is what happened in World War II with meat.

I am not 100 percent sure we would get to that if we imposed a freeze now, but I don't think the risk is worth running. Let me make one more point. I said that because I happen to share the Government's very cautious optimism that the worst of the inflation is now behind us and that the figures will look better for the rest of this year.

Senator ROTH. I noticed in your statement you made some reference to the fact the dollar could go up as well as down. Now, are you talking just generally or are there any specific factors that make you optimistic?

Mr. DALE. Well, yes. The answer is my judgment, based on a guess that the exchange rate of the dollar as established last February and March was about right and, therefore, if the flow of payments generated by that exchange rate balances, the dollar will go up. There will be more demand by German manufacturers for American goods and with the mark at 2.61 yesterday and at 2.82 on May 7, it will self-correct by the flow of transactions if this individual exchange rate was about right.

If, on the other hand, we sit here 6 months from now and the dollar is still at 2.61 marks instead of 2.81, then we will realize a further devaluation is probably appropriate.

Senator ROTH. I guess the thing that is confusing to someone like myself is that we have a number of distinguished economists before us and their answers vary widerly on this issue.

Mr. DALE. Yes.

Senator ROTH. It is hard to know who is right.

Mr. DALE. Senator Roth, I remember, for example, Mr. Rinfret was convinced the dollar's exchange rate would decline further. Maybe I could make a bet with him on that. It is one of those things nobody could be 100 percent sure of. If the new exchange rate of the dollar has made our foreign trade position really massively better, then the normal flow of transactions in the market will push the dollar back up again.

Senator ROTH. I take it that you don't see the international corporations as the badmen in the situation?

Mr. DALE. Yes, sir; that is correct. I hope I made it clear that the old fixed rate system made anybody a fool who did not join the rush and the multinational corporations did join the rush. When, for whatever reason, a big flow of funds began to go into Germany and the mark rose to its old ceiling position, which it now has not got, then anybody who didn't buy marks was out of his mind because it could only move one way, which was up.

Eventually the BundesBank got swamped with $6½ billion on one day and they had no recourse but to close the market and either float or revalue the mark. And if I were the president of a multinational corporation and my treasurer did not buy marks at least for payments he knew he was going to have to make, I would fire him.

Senator ROTH. I wonder, is there any action that you think the Congress should take at this time?

Mr. DALE. Well, I said explicitly, no, with the one exception—and, if I may, let me repeat the cliche—of holding the spending to 269.

Senator ROTH. Do we really provide too much or too little incentive to business to invest abroad?

Mr. DALE. Oh, yes. That is an awfully difficult question. I have read about this a good deal and have read both sides of the issue of taxation of foreign source income. I don't have any firm, clear-cut conclusions with the exception that I am sure that it would be a bad mistake to repeal the tax credit against taxes paid to the foreign governments, which was in the Burke-Hartke bill.

The other issue of taxation of the earnings, as earned, instead of only after they are sent back to this country, is a closer question. I do not regard, however, our tax system as ranking higher than seventh as a cause for the huge explosion of investment abroad by American firms. There are other reasons that are far more important.

Finally, it is interesting to note this—and I think Senator Haskell has had his facts a little wrong on this—the repatriation of earnings is now in excess of $9 billion a year as a plus in our balance of payments. If we were to tax all foreign earnings as earned, the official revenue estimate is only $300 million, so I think maybe it is a bit of a mountain being made out of a mole hill. Of course, the multinationals don't want it at all, but whether they exaggerate the damage to their competitiveness, I don't know. They may be overarguing their case just on the repatriation.

I would just conclude, Senator, by emphasizing that all of the studies that have been done are unanimous in finding that our tax system is not the reason they have gone abroad.

Senator ROTH. And then on the other side, do you see any need to liberalize?

Mr. DALE. No.

Senator ROTH. Then I guess the status quo is pretty satisfactory?

Mr. DALE. Yes; I think so. I would definitely adopt the administration's proposals, modified, to tax the earnings as earned of any plant abroad that ships as much as 25 percent of its goods back to the United States. This is the exceptional situation, though. This is not the rule.

Senator ROTH. That would be exporting jobs, presumably?

Mr. DALE. Yes; in other cases, you normally are not.

Senator ROTH. Well, I want to thank you for appearing here. Your statement is very interesting.

Mr. DALE. Thank you.

Senator ROTH. Thank you, Mr. Chairman.

Senator BYRD. Thank you, Senator Roth.

Mr. Dale, I assume from your overall discussion that you probably do not agree with former Chairman Martin that we are headed for a moderate recession?

Mr. DALE. No; I would amend that, if I may, because I think a moderate recession in 1974 is a 40–60 probability. I tried to make clear in my statement what I don't see and I don't see a calamity with an 8-percent unemployment, but a modest recession in 1974 is possible. Now, the forecasters are divided on this. Serious forecasters in the banks and in the insurance companies and in the universities are more divided than they have ever been in my memory as to the outlook of this economy and whether the GNP will still be growing in 1974 or would show a mild decline. There is no such thing as a standard forecast and this is quite unusual.

Senator BYRD. You are not as pessimistic as Chairman Martin then?

Mr. DALE. No; I think not. I believe that we have a fairly good chance of achieving this miracle called a safe entry or a soft landing, which is to reduce the growth from over 8 percent in the first quarter to around 4; 3 to 4, and stay there. Now, that would be consistent with the unemployment remaining about where it is. I think, frankly, we have practically full employment right now.

Senator BYRD. That is the way it looks to me, as a practical matter. I get around Virginia a great deal and most places I go the complaint is that the plants or the stores, or what have you, need help and they are not able to obtain it.

Let me ask you a question I asked all of the other witnesses, or most of them: I assume that even though we will have reduced our rate of inflation, we will still have inflation. How does the average citizen protect himself or herself?

Mr. DALE. The answer has to depend first on whether we are talking about a world of 8 or 9 percent inflation or a world of 3 to 4 percent inflation. I am, myself, still confident that this Nation has enough discipline to get back to 3 to 4 percent inflation and I imagine you are not totally pessimistic about that possibility. If you have a 3 to 4 percent inflation, you can buy corporate bonds at $7\frac{1}{2}$ percent and come out ahead; if you are at a reasonably good tax bracket, you can buy municipal bonds and get an effective yield of 10 to 12 percent and come out ahead; and even with a savings account you will get 5 percent or a certificate, you will get 6 percent.

And then if you want to play that sophisticated crap game known as the stock market, over a long period of time it has seen growth with the economy of the country. I think this Nation can live all right with 3 to 4 percent inflation although I have to confess if you asked me that question 15 years ago, I would have thought 3 to 4 percent inflation, chronic inflation, as being terrible. Now, I would think it would be rather wonderful.

Let me say, if I may, Senator, in this cluster of differing forecasts nearly all are foreseeing a significant reduction of our recent rate of inflation. There have been a lot of temporary factors in that.

Senator BYRD. I just want to thank you, Mr. Dale, for being here today. I think your oral presentation shows much good common sense. You suggest that the committee consider as one of the alternatives suspending judgment and I think that certainly would be a wise alternative for the committee to consider. I think it is important that the focus, that the attention be focused on the problem which we have here in regard to our fiscal monetary problems. And I am not prepared to say today, however, that we ought to recommend specific steps.

I think the suggestion that you have made has a great deal of merit to it to suspend judgment. It is an immensely complicated and complex problem, even for many of us who are not professional economists.

Mr. DALE. And for me, too.

Senator BYRD. Well, I am glad to hear that. It makes me feel better.

[Whereupon, at 12:15 p.m., the subcommittee recessed, to reconvene subject to the call of the Chair.]

Appendix A

The International Monetary Crisis—Briefing Material Prepared by the Staff for the Use of the Subcommittee on International Finance and Resources

THE INTERNATIONAL MONETARY CRISIS

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THE INTERNATIONAL MONETARY CRISIS

I. Introduction

.Speculation against the dollar has risen to a fever pitch. The price of gold on the Paris Bourse hit $126 an ounce on May 15 and $111 in London on May 16. Currency speculation and the rush to gold may be irrational, but it is having a severe effect on the U.S. stock market and on the balance of payments. Between January 2, 1973 and May 25, the U.S. stock market dropped over 100 points. The bear market cannot be explained by the performance of the U.S. economy which was growing at the extraordinary rate of 14.3 percent in the first quarter. The degree to which market confidence is dependent upon a strong U.S. international position is reflected in the 29 point increase in the Dow-Jones industrial average on May 24 when the U.S. announced a significant improvement in its trade performance which, apparently over shadowed the news that several large banks increased their prime lending rates.

Mainly as a result of speculation against the dollar in January and February, the U.S. balance of payments deficit in the first quarter of 1973 reached the phenomenal height of $10.2 billion. As those figures were published, a new round of speculation against the dollar ensued which will undoubtedly make the second quarter's balance of payments look bad.

There appears to be a broad loss of confidence in the dollar and a rush to gold. The panic buying of gold may be viewed either as an irrational act which should be left alone, or as an attack against the American dollar which should be fought.

In response to the question: "Is there anything that the United States should or could do at the present time to calm the situation in the currency markets?", Under Secretary of the Treasury Paul Volcker recently stated: "The most fundamental thing we can do and the only thing really effective in the long run, is to deal with this inflationary problem at home and to deal with the balance of payments problem. I think we're working as hard as we can on those problems. . . . There is no financial legerdemain that I know of or sleight of hand that solves this problem unless we are dealing with those fundamentals."

Foreign holders of dollars as well as Ameicans are looking for tangible signs that the United States will get a grip on itself and "put its financial house in order." Under these circumstances, it would appear that the benign neglect philosophy in a crisis situation is more risky than a positive action program to fight the speculation.

The United States is not a helpless giant: there are measures we could take unilaterally and in concert with our allies to shore up the confidence in the American dollar which has been severely eroded by two devaluations in 18 months, a continuing large balance of payments deficit and attacks against the American dollar from certain countries and sources.

Thus, some of the key issues which this hearing should illuminate are:

(*1*) *Can the United States afford to stand still and permit the gold price to hit ridiculously high levels, even if the speculation is irrational?*

(*2*) *If so, are we not going to witness a "double mirror effect" on our balance of payments—one large balance of payments deficit caused mainly by speculation will lead to a chain reaction causing other large balance of payments deficits?*

(*3*) *What are the alternatives?*

(*a*) *gold sales by the U.S.?*

(*b*) *a monetary conference?*

(*c*) *fund excess dollars by issuing long-term attractively priced securities?*

(*d*) *a special issue of IMF Special Drawing Rights?*

(*4*) *How long will it take before the two dollar devaluations bring about a significant improvement in the basic U.S. balance of payments deficit? Can we afford to wait?*

(*5*) *Where is the speculation against the dollar coming from—oil producing countries, banks, multinational corporations? Is there sufficient information on this?*

(*6*) *What will be the effect of growing dependence by western countries on Middle East oil as far as the international monetary system is concerned?*

(*7*) *What progress is being made in the long-term reform of the monetary system?*

II. U.S. Balance of Payments Deficits

Unquestionably, fundamental reforms in the institutional arrangements governing monetary and trade affairs between nations are urgently needed. However, no reform will insure international monetary stability unless the balance of payments deficits of the United States come to an end. These deficits have lasted too long, have risen to extraordinary heights, and have undermined confidence, not only in the dollar but also in paper currencies generally.

The first order of business, it would appear, is for a positive program to eliminate U.S. balance of payments deficits. Two devaluations of the dollar in the past 18 months should, over a period of time, significantly improve the balance of payments position. Undoubtedly, the devaluations will increase the price of imports, help make American exports more competitive, attract foreign investment to the United States and make it more expensive to invest abroad. However, it also will increase the cost of imports which are considered inelastic, such as oil, and increase the cost of maintaining military bases and supporting operations in foreign countries. No one can say with any assurance that the two devaluations will restore equilibrium to the U.S. balance of payments and, if so, in what time frame? Given the present speculative fever, can the United States afford to wait until the devaluations have hopefully brought about the kinds of adjustment that are necessary? This is a crucial question.

There is no "scientific way" of assessing a "true value" of any currency; indeed the "true value" will change regularly, which is why some flexibility in exchange rates is needed. Psychology as well as underlying economic realities play a role in setting exchange rates, just as they do in setting stock prices. But can the currency of the largest country of the Western world, which also still serves as the world's reserve currency, be buffeted back and forth by speculators, without creating severe strains on the world's monetary and trading structure?

The dollar still serves as the world's reserve currency. That role will diminish over time through agreement, and if the United States eliminates its balance of payments deficits. The deficits have created international reserves for others. For the U.S. they are reflected in an increase in liquid liabilities to foreigners. At the end of February, 1973, liquid liabilities to all foreigners totaled $87.9 billion; liquid liabilities to foreign official agencies (mainly central banks) were $68.5 billion. Against this, the United States had reserve assets of only $12.9 billion, the gold portion of which $10.5 billion has been nonconvertible since August of 1971. (See tables 1, 2, and 3 in appendix B.)

Our liabilities to foreign official institutions constitute a significant portion of their reserve assets. The European Community held $57.3 billion in international reserves (including gold, Special Drawing Rights, reserve positions in IMF, and foreign exchange), while Japan had $16.5 billion. U.S. liquid and other liabilities to Western European official institutions totaled $40.8 billion in February and $17.9 billion to official institutions in Asia.

It is an inherently unstable situation to have a major portion of the world's international reserves held in a currency which is unstable, and not convertible. This is now the position of the United States dollar.

By history and circumstance, the dollar has been the world's currency, and that makes the United States, in effect, the world's banker. But when the creditors of a bank begin to lose confidence, they withdraw their deposits. Demand deposits of foreigners in U.S. banks have declined from $20.5 billion in 1965 to $7.8 billion in February, 1973. Foreigners have chosen to hold Treasury bills and have, in effect, financed about $31 billion of the Federal budget and balance of payments deficits since 1969 by bill purchases.

The question has arisen whether it would be useful to fund the short-term liabilities of the United States into long term assets—either in the form of attractively priced long-term security issues or special issues of the International Monetary Fund's special drawing rights (SDR's), as a short-term device to sop up excess liquidity abroad. Given the liquidity preference of foreigners this may not be feasible without at least a gold content guarantee. Is it worth it?

Another measure which should be considered seriously is gold sales by the United States in short, quick bursts to fight the speculation against the dollar which may be as much politically motivated as it is economic. The speculators could be burned if the United States either alone, or in concert with other countries, intervened actively in the gold and foreign exchange markets to smash speculation whenever it got out of hand. Up until now, profits have been a fairly sure bet for speculators. It was clear that the deutschemark and the yen would be appreciated and the dollar devalued with the last round of speculation. Only by making speculation a losable proposition can governments effectively deal with it. Among other things flexible exchange rates are needed to increase the risk of loss in speculation.

Beating back the speculators is one thing. Ending the chronic balance of payments deficits is another. For longer term stability we need an equilibrium in our balance of payments problem. But, after 20 years of deficits, equilibrium is obviously an elusive phenomenon. The devaluations should help, but we still have to examine our trade account in detail to determine where we are losing competitiveness, what might be done about it, and how to meet import competition on a sector-by-sector basis. Industry, government and labor will have to come together to develop an industrial strategy to meet foreign competition. It may not be a question of more subsidies but more effort and coordination. There are markets out there! And the two devaluations, the DISC legislation and the investment tax credit are aimed at making U.S. industries competitive in world markets.

All the other accounts will have to be examined in detail, including the government accounts. It seems ludicrous that surplus countries should not pay their fair share of the foreign exchange costs of NATO or other security arrangements. Our aid programs also appear in need of a thorough overhaul. The catch-all euphemism of "less developed countries" is not only denigrating but inaccurate.

Some "less developed countries" like Brazil, Mexico, South Korea, Taiwan, and Hong Kong have had phenomenal growth records. And, the international reserves of "less developed countries" increased from $10.9 billion in 1960 to $35.8 billion in September, 1972, presently accounting for 24 percent of the world's reserve assets compared with 18 percent in 1960. The United States had basic balance of payments deficits with less developed countries of over $2 billion in each of the years 1971 and 1972, with government to government aid programs the largest contributor. The U.S. had a trade deficit with "less developed countries" of $0.9 billion in 1972, which would be much larger if aid-financed exports were excluded. This is not to suggest "less developed countries" are undeserving of aid, but that the catchall description may be inappropriate for policy guidance.

III. Oil and the Monetary Crisis

Some "less developed countries" have enormous raw material resources which will earn for them billions of dollars of foreign exchange reserves over the next decade. Several Arab oil producing countries will earn more money than they can usefully employ for their own development. These countries will certainly have the potential for moving billions of dollars from one money market to another for economic or political reasons.

It has been reported that Arab *governments* did *not* speculate against the dollar last January and February but took a $300 million loss on their dollar holdings, while certain rich Arab individuals, who in some cases are reputed to have more money than their governments, might have made windfall profits. But however reliable the source, this is sheer hearsay. Beyond doubt is the fact that oil producing states, and wealthy individuals within those states, have a vast potential for speculation. By the end of the year four major oil producing states in the Arabian peninsula—Saudi Arabia, Kuwait, the Union of Arab Emirates and Quatar—will have accumulated reserves—mainly dollars—of about $9 billion. It is estimated that by the 1980's the figure could surpass $100 billion.

White House energy specialist James E. Akins estimated in a recent issue of Foreign Affairs the cumulative income of the Arab OPEC countries from 1973 through 1980 at over $210 billion. Assuming a 20 percent compounded growth in their expenditures for the same period, Arab budgetary expenditures would total less than $100 billion, leaving a balance of unspent reserves of over $100 billion by 1980. "What will be done with this money will be a matter of crucial importance to the world." writes Akins. "The first place for its use must certainly be in their own countries; the second must be the Arab world, which will not, as a whole, be capital-rich." [1] The fact is, no one really knows how they will spend their money, or whether they will have so much they will stop or slow down oil production from time to time. In a recent meeting in Kuwait it was suggested that Arabs float their riches from country to country, depending on how each country reacts to Arab problems.

The budgets of many of these states will be in substantial surplus because of the energy needs of the western consuming nations and the rising price of oil. For example, this year the Saudis are unlikely to be able to spend more than 60 percent of their $3.2 billion budget. By 1980, the Saudi monetary reserve position is estimated to be close to $50 billion. The same basic situation exists with respect to Kuwait, Ahu Dhabi and Quatar. The following table presents a range of estimates on projected monetary reserves. They might be conservative as the higher figure represents maximum projected production levels at a price tag (tax plus royalties) of $3.50 a barrel, which may well be too low.

[1] James E. Akins, "The Oil Crisis: This Time The Wolf Is Here" *Foreign Affairs*, April, 1973, p. 481.

PROJECTED STATE MONETARY RESERVES OF THE FOUR MAJOR PRODUCING STATES OF THE ARABIAN PENINSULA

	Billions of dollars	
	1973	1980
Saudi Arabia	5.00	30.0–75.0+
Kuwait	3.50	7.0–10.0+
Abu Dhabi	0.27	5.0– 8.0+
Quatar	0.46	2.0– 2.5+
Totals	9.23	44.0–95.5

The lower figure for 1980 represents the minimum projected production levels sold at the price scales laid down by the 1971 Teheran agreement. The higher figure represents the maximum projected production levels at a price tag (tax plus royalties) of $3.50 a barrel.

Mr. Akins' estimates of oil production and revenues in a large group of Middle East and North African countries are shown on the next page for 1975 and 1980. These data are based on taxes and royalties in effect prior to the dollar devaluation in February, 1973. If the 1972 Geneva agreements on currency revaluation apply, the income figures should be increased by 8.5 percent. The revenue figures are annual and do not represent the cumulative income, which, as stated, Mr. Akins estimates at $210 billion between 1973 and 1980.

ESTIMATED PRODUCTION AND REVENUE, 1975 AND 1980

[Stated in thousands of barrels per day; billions of dollars annually]

	Production		Revenue	
	1975	1980	1975	1980
Middle East:				
Iran	7,300	10,000	4.7	12.8
Saudi Arabia	8,500	20,000	5.4	25.6
Kuwait	3,500	4,000	2.2	5.0
Iraq	1,900	5,000	1.2	6.4
Abu Dhabi	2,300	4,000	1.5	5.0
Other Persian Gulf	1,800	2,000	1.0	3.2
Subtotal	25,300	45,000	16.0	58.0
North Africa:				
Libya	2,200	2,000	2.0	3.1
Algeria	1,200	1,500	1.1	2.3
Subtotal	3,400	3,500	3.1	5.4
Total	28,700	48,500	19.1	63.4

Source: James Akins, op. cit. pp. 479–480.

The Arab governments profess their interest in contributing to international monetary stability. A prominent Kuwaiti banker recently stated:

"It is not in our interests to have currency crises. We know we cannot live without the rest of the world. But we are not going to accept any monetary solution that is short of partnership." [2]

The Committee of Twenty, an IMF group established to work out the reform of the international monetary system, has only one Arab member. The Arab States feel they are under-represented.

[2] The Economist, May 5, 1973, p. 39.

A key figure in the world petroleum scene is Saudi Arabian Petroleum Minister Sheikh Almad Zaki Yamani, one of his country's most influential leaders. Sheikh Yamani has suggested that Saudi Arabia, by far the world's largest oil reservoir, may be willing to increase production to 20 million barrels a day by 1980 (from 7.2 million today) *but only if the United States creates "the right political atmosphere."* However, he has also stated that Saudi Arabia is already getting more money from oil than its small economy can absorb. "*If we consider only local interests,*" *he said*, "*then we shouldn't produce more, maybe even less.*" [3]

Oil as a weapon

What it all adds up to is that there is a sellers market for oil and, at this time in history, oil producing states are in a very strong bargaining position with the West, whose dependency on Middle East oil is growing daily. There have already been limited export boycotts. If the West is concerned about the extent of Arab oil producing states with respect to how they will use their money, it is understandable in the light of vitriolic anti-American press which keeps talking about using "*oil as a weapon*" in the battle against imperialism. Several Arab leaders have expressed their view. Kuwaiti ruler Shaykh Sabah as-Salim as Sabah has declared that "*his country will use oil as an effective weapon in the battle when the zero hour comes.*" Cairo newspaper Al-Jumhuryah recently called for "*using the huge Arab funds deposited in European and U.S. banks as an effective weapon in the battle of the Arab destiny.*" The use of these deposits, it said, "would be as effective as the oil weapon."

The United States has a number of policy dilemmas it must face up to in this area, which are not a proper subject of this paper. But the key point is that unless cooperative solutions are found reasonably soon with respect to the reform of the international monetary system and to the Middle East boiling pot, the United States and the Western world may not only find themselves with an energy shortage, but with continuous monetary crises.

Before discussing the postwar evolution of the monetary system it appears useful to review some of the lessons of history which are quite relevant to the present situation.

IV. The Lessons of History

In the system as it has evolved, gold has become a pillar of stability and faith in the dollar is on the wane. There are some voices who would have us return to a gold standard. This is unfortunate as the "disciplines" of the gold standard could never be appreciated by the workingman who must undergo most of the disciplining. Historically, gold has been used as money, either for trading purposes or as a reserve asset. The United States wants to move away from gold as the core of the international monetary system based on reserves and par values. But it is extremely difficult to convince

[3] Washington Post, April 19, 1973, p. 26.

creditors that another structure should be built based on managed currencies or SDR's, when the "managers" are mismanaging.

Some foreign countries, such as France, are insisting that the United States restore convertibility into gold before beginning serious trade negotiations. They perhaps do not appreciate that "disciplining" the United States by gold purchases is unacceptable to the American people if it means growing unemployment. There is no magic alchemy in gold. Under the gold standard as it existed before 1914, countries in deficit were forced to deflate, while surplus countries were not under the same compulsion to inflate. It was a brutal way to achieve international balance.

Disquieting Similarities.—In a widely discussed commencement address at Columbia University on June 1, 1965, The Honorable William McChesney Martin, then Chairman of the Board of Governors of the Federal Reserve System, spoke of "disquieting similarities" between today's monetary crisis and those of the twenties and thirties. The entire speech is worth rereading and is reprinted as Appendix A.

Viewing the twenties from today's vantage point, one can see that drastic measures would have had to be taken to avert disaster. At the time, this was not evident to anyone. In the buoyant twenties depressions were considered a thing of the past. Speculation was rampant. Surplus countries (at that time the United States was in surplus) did not allow the expansion of income and prices but pursued a monetary restraint program and tariff increases which caused gold to pour in. The payments surplus countries, mainly the United States and France, tended to hoard gold and forced severe adjustments on countries like England where unemployment ranged from 10 to 17 percent throughout the twenties. In France, gold was largely sterilized in the Central Bank, and in the United States credit expansion was restrained by the Federal Reserve maintenance of a level of gold reserves approximately twice the legal limit.

Today, the U.S. balance of payments crisis revolves around the growth of short-term liabilities relative to U.S. gold reserves. The immediate problem is how to get rid of the overhang of indebtedness. In the critical early thirties, European central banks were holding, as today, large balances of foreign exchange which had accumulated over a considerable period. The total of short-term international indebtedness had reached about $10 billion by the end of 1930. But under the impact of the depression, sweeping withdrawals of short-term credits put terrific pressure upon the central banks. There was no IMF upon which central banks could fall back upon for credit. Large holders of foreign exchange were converting their balances into gold. Central banks sought emergency credits from the Bank for International Settlements (BIS). Although its resources were insufficient, certain credits were arranged with a gold-exchange guarantee.

1931 was a fateful year in the history of international finances. In May of that year, the Austrian Credit-Anstalt collapsed. In June President Hoover called for a one-year moratorium on intergovernmental debt payments. In July an international conference was called which met in London, but the acute financial crisis could not be stayed. In September, 1931, sterling fell and this led almost immediately to the suspension of gold. By the end of 1931, sixteen countries had either abandoned gold or introduced rigorous exchange controls. Foreign exchange was allocated for the necessary imports of raw materials and import quotas were imposed on specific goods. Countries made bilateral clearing arrangements to help balance trade between two countries.

Private hoarding of gold became widespread. Central banks also intensified their hoardings. In the first six months of 1932, European central banks converted $700 million of their dollar holdings into gold. The third Annual Report of the BIS in 1933 said:

> *"Central banks should combat any conception that gold is properly employable as a store of wealth, or that its primary object is to assure internal convertibility of notes so that all who will may hoard gold coin on demand, to the detriment of the public good and the general economic welfare."*

That statement would fit perfectly in an annual report of the International Monetary Fund for 1973.

Foreign exchange holdings declined drastically after the fall of sterling. In 1929–30 aggregate official foreign exchange holdings amounted to about $11 billion. By the end of 1932, they had dwindled to about $1 billion, while the aggregate gold stock was nearly $12 billion.

By the end of 1931, only eight countries were still on the gold standard, ten were operating on a controlled flexible exchange rate basis and the rest introduced exchange controls.

The United States abandoned gold in April, 1933, but under the Gold Reserve Act of 1934, the dollar was again linked to gold and devalued. In July, 1933, the "gold bloc" was formed with six countries—France, Belgium, Holland, Italy, Poland and Switzerland—declaring firm adherence to the gold standard. The world was then fragmented into blocs. The players were different then, but the effect was the same. Shortly thereafter, the British Commonwealth countries issued a declaration calling for international action to reduce interest rates, undertake capital expenditures and raise wholesale prices.

In July, 1933, the famous London Monetary and Economic Conference was held with 64 countries represented. The Conference report contained five resolutions calling for:

(1) Currency stabilization;

(2) Gold to be re-established as *the* means of exchange value;

(3) Economy of gold by keeping gold out of circulation and reducing gold minimum ratios to 25 percent;

(4) Central banks collaboration, and

(5) International cooperation to stabilize cyclical fluctuations.

Should a monetary conference be held in 1973, one would expect points, (1), (2), and (5) to be agreeable to the United States and most other countries with an emphasis on a reduced role of gold, and paper currency reserves and increased use of SDR's and IMF credit facilities. But the London Conference did not end the crisis nor did it end the "blocism" that had developed.

The gold bloc countries suffered gold losses intermittently beginning in 1933, and by 1936 they devalued. The French devaluation was welcomed by the United States and the United Kingdom and both countries agreed beforehand that they would take no countermeasures. The three countries declared they would support the exchanges so as to forestall any speculative short-term capital flows. The other countries joined this tripartite monetary agreement and, six countries (France, the United States, United Kingdom, Belgium, Holland and Switzerland) cooperated to support the new rate structure. This close collaboration in monetary policy represents a highly significant development, but not all the players joined.

Germany became the leading proponent of bilateral bargaining and clearing agreements. The "Schachtian bilateral system," named after the German Finance Minister Dr. H. Schacht was aimed at achieving balance. However, it led to a most complicated system of exchange controls. Germany's economy however grew stronger while its neighbors, still laboring under the discipline of the gold exchange standard, continued to stagnate in depression.

Lessons from the Thirties.—During the thirties, countries were basically in retreat. They were attempting to protect their gold holdings by various restrictive devices. They were distrustful of foreign exchange, and attempted to get out from under their short-term liabilities. Surplus countries protected their surpluses while deficit countries, fighting deficits and inflation, failed to inflate their economies through expansionary-measures. The result as we all know was economic misery on a world-wide scale.

History should not repeat itself. There is a commitment to full employment and a knowledge of how to get the economies off dead center. The more difficult problem appears to be controlling inflationary pressures in advanced countries and achieving steady, even growth. The danger of severe recession or depression appears remote for the United States, but less remote for countries who depend more heavily on foreign trade in an environment in which currencies are gyrating. It was this latter concern which motivated the founding fathers of Bretton Woods to opt for a fixed exchange rate system.

V. The Post-War Monetary System

Fixed exchange rates provide certainty and stability so that international traders and investors will know in advance just what a transaction will be worth. However, there are serious disadvantages in such a system which will be discussed.

Bretton Woods System.—The international monetary system which evolved after the Bretton Woods Conference in 1944, was essentially a par value, reserve oriented system, with the dollar playing a crucial role as the center of the system. The main features of the system were:

(1) Fixed par values, adjustable only when absolutely necessary or forced by speculation;

(2) The use of currencies, particularly the dollar as reserve assets;

(3) Convertibility of official dollar holdings into gold.

Gold was the common denominator of all currencies, although they were directly tied to the U.S. dollar.

There was a bias in the Bretton Woods system against letting the exchange rates adjust in small but frequent quantities. Deficit countries were faced with an inordinate degree of responsibility to eliminate deficits while surplus countries were under no such compulsion. The United States dollar was so central to the system that this country felt a moral obligation not to devalue the dollar. Thus, we were put in the intolerable dilemma of having to correct a balance of payments deficit without devaluing the dollar or deflating the economy, while maintaining a "leadership" position in world affairs. Adjustment was a one-sided affair. Treasury Secretary Shultz said in his September, 1972, IMF speech:

> "*Resistance of surplus countries to loss of their surpluses defeats the objective of monetary order as surely as failure of deficit countries to attack the sources of their deficits. Any effort to develop a balanced and equitable monetary system must recognize that simple fact: effective and symmetrical incentives for adjustment are essential to a lasting system.*"

The President's International Economic Report of March, 1973, pointed out that:

> "*One of the ironies of the Bretton Woods system is that the exchange rigidities which were built into the system to avoid the political and economic problems encountered in the postwar period created political and economic problems of their own.*"

Domestic deflationary policies for balance of payments reasons, and a loss of competitiveness in industries in countries maintaining an overvalued currency, were among the serious economic and political problems resulting from the biases of the Bretton Woods system.

New Economic Program.—The rules of the game under the Bretton Woods system were changed when President Nixon announced his New Economic Program on August 15, 1971.

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The President's program had two interrelated objectives in mind: (1) to correct the overvaluation of the dollar to reestablish the competitiveness of U.S. products in world markets, and (2) to reform the international monetary system to ease the continuing burdens on the United States and to serve better the economic needs of the entire world.

In order to obtain these objectives, the President:

(1) Suspended the convertibility of the dollar into gold, special drawing rights, or other reserve assets and allowed the dollar to "float" in exchange markets;

(2) Imposed a 10 percent import surcharge on all dutiable imports;

(3) Excluded foreign capital equipment from the proposed tax credit for investment;

(4) Proposed the Domestic International Sales Corporation (DISC) to stimulate U.S. exports;

(5) Asked Congress to reduce foreign aid appropriations by 10 percent.

VI. Reform of the International Monetary System

Since August 15, 1971, we have had two official dollar devaluations, currencies are still floating and dollar-gold convertibility remains "suspended."

The world is now on a floating dollar standard. Currencies are still tied to the dollar but in a more flexible way.

The key issue now is "where do we go from here"? At present there are no internationally-agreed upon ground rules. The Group of Twenty experts are trying to establish a new framework. Clearly we cannot return to the Bretton Woods system. As a practical matter we probably could not maintain rigidly fixed exchange rates even if we wanted to, with all the speculative capital crossing national frontiers. It has been estimated that multinational corporations hold many billions of short-term dollar assets, as do foreign branches of U.S. banks. The Arab oil producing countries, as noted, are also large dollar holders and are capable of triggering off massive speculation.

In a very real sense the international monetary system (and the trading system) is at a critical juncture. There are, as previously stated, no agreed-upon rules governing the world's finances. There is no longer a dominating central power keeping the system afloat. Confidence, that precious commodity that can only be achieved through proven performance, is lacking. The performance of major countries in the system does not engender confidence.

Restoring Confidence.—It would appear that the first priority for monetary authorities is to act boldly and decisively to restore confidence in paper currencies. An agreement by major countries to commit themselves to eliminate entrenched deficits and surpluses may be called for. Cooperative measures to intervene in the exchange markets and to fight gold speculators may also be helpful. Controlling and attacking the underlying causes of domestic inflation is obviously of paramount importance in restoring confidence in a nation's ability to discipline itself. In that respect, the United States seems to be going downhill in 1973 as the wholesale price index in the first quarter increased by the phenomenal annual rate of 21.1 percent!

Governments must also commit themselves to long-term reform of the international monetary system. More flexibility in the exchange rates between currencies and a gradual increase in the role of Special Drawing Rights are key ingredients as well as reformed trading rules to assist in the balance of payments adjustment process are needed. Surplus countries must surely recognize that persistent surpluses will certainly contribute to a collapse of the monetary system as will persistent deficits. It is in their self interest to avoid this by unilateral liberalization of imports if necessary. A trade negotiation cannot be divorced from the goals of the monetary system.

If the United States succeeds in eliminating its chronic balance of payments deficits confidence in the dollar will improve as will the prospect for lasting reform in the monetary system. In the meantime, however, some funding of short-term U.S. liquid liabilities may be in order.

There is a general consensus among private experts on the broad outlines of international monetary reform. The impasse appears to exist at the government level. The U.S. has made a proposal (See Appendix C). Europe however appears to be concentrating on its own "monetary union" and Japan on trade and investment issues. There is a possibility that all major economic issues—trade, investment and monetary—may be combined in a major negotiation. Such a negotiation may prove unwieldy at best unless the three major world centers—the U.S., the European Community, and Japan agree beforehand on general principles.

Principles of a New International Monetary Order: The Economist's View.—Private experts from these countries met in Washington to consider long-range issues. The report [4] suggested the following guidelines:

A reconstruction of the system should provide for adjustments in par values in smaller and more frequent steps and in accordance with agreed rules. These rules, whatever form they take, should bear equally on surplus countries in upvaluing their currency and on deficit countries in devaluing theirs. The rules should be framed so as to make clear beyond all doubt that the level of employment—that is, the number of jobs available—must be governed by domestic economic policy and not by the manipulation of exchange rates.

The reconstructed system would provide for a resumption of convertibility of the dollar and would deal with the problem of the existing overhang of dollars. If this were not done, there could be no guarantee that exchange rate adjustments could take place in small steps. Par values would be established in terms of IMF units, no matter how convertibility of the dollar and other currencies was assured.

[4] *Reshaping the International Economic Order:* A tripartite Report by twelve economists from North America, the European Community and Japan, Washington, The Brookings Institution, 1972.

Provision should be made for the funding of the existing holdings of reserve currencies, including sterling. There are several ways in which this could be done, all of them involving exchange for claims against the IMF or reserve positions with the Fund. There might, for example, be a fresh issue of SDRs to the depositors of reserve currencies with the Fund. Another method would be an exchange into deposit liabilities with the Fund. Under this arrangement, the deposits of dollars by the monetary authorities would create deposit liabilities of the Fund expressed in IMF units. The Fund would exchange the received liquid dollars into long-term obligations of the United States, also expressed in Fund units. The deposits with the Fund would carry interest at a rate similar to that provided for the SDRs (which, however, might be increased above the present 1.5 percent a year); and the U.S. obligations held by the Fund would carry interest close to the current market rate.

One further question to be decided is whether conversion should be voluntary or mandatory. It may be preferable to remove the dollars with one clean sweep; on the other hand, freedom of choice is not a bad principle if it can be upheld without danger. But any dollars from existing official balances that are not funded when the opportunity is offered may have to remain inconvertible and without exchange-value guarantee.

For the appropriate degree of flexibility of exchange rates, a variety of techniques may be used. The main principle is that exchange rates are matters of international concern, and that such concern may relate not only to proposed changes in par values but also to failures of countries to make adjustments when they may be internationally helpful. This implies that the initiative for adjustments of par values may sometimes have to come from trading partners and from international organizations and that there should be a presumption of slow and orderly change rather than of prolonged rigidity.

APPENDIX A

DOES MONETARY HISTORY REPEAT ITSELF?

Address of Wm. McC. Martin, Jr.
Chairman, Board of Governors of the Federal Reserve System,

Before the

Commencement Day Luncheon
of the Alumni Federation of Columbia University

June 1, 1965

DOES MONETARY HISTORY REPEAT ITSELF?

Address of Wm. McC. Martin, Jr., Chairman, Board of Governors of the Federal Reserve System

When economic prospects are at their brightest, the dangers of complacency and recklessness are greatest. As our prosperity proceeds on its record-breaking path, it behooves every one of us to scan the horizon of our national and international economy for danger signals so as to be ready for any storm.

Some eminent observers have recently compared the present with the period preceding the breakdown of the interwar economy, and have warned us of the threats of another Great Depression. We should take these warnings seriously enough to inquire into their merits and to try to profit in the future from the lessons of the past.

And indeed, we find disquieting similarities between our present prosperity and the fabulous twenties.

Then, as now, there had been virtually uninterrupted progress for seven years. And if we disregard some relatively short though severe fluctuations, expansion had been underway for more than a generation—the two longest stretches of that kind since the advent of the industrial age; and each period had been distorted in its passage by an inflationary war and postwar boom.

Then, as now, prosperity had been concentrated in the fully developed countries, and within most of these countries, in the industrialized sectors of the economy.

Then, as now, there was a large increase in private domestic debt; in fact, the expansion in consumer debt arising out of both residential mortgages and installment purchases has recently been much faster than in the twenties.

Then, as now, the supply of money and bank credit and the turnover of demand deposits had been continuously growing; and while in the late twenties this growth had occurred with little overall change in gold reserves, this time monetary expansion has been superimposed upon a dwindling gold reserve.

Then, as now, the Federal Reserve had been accused of lack of flexibility in its monetary policy: of insufficient ease in times of economic weakness and of insufficient firmness in times of economic strength.

Then, as now, the world had recovered from the wartime disruption of international trade and finance, and convertibility of the major world currencies at fixed par values had been restored for a number of years.

Then, as now, international indebtedness had risen as fast as domestic debt; recently, in fact, American bank credits to foreigners and foreign holdings of short-term dollar assets have increased faster than in the closing years of the earlier period.

Then, as now, the payments position of the main reserve center—Britain then and the United States now—was uneasy, to say the least; but again, our recent cumulative payments deficits have far exceeded Britain's deficits of the late twenties.

Then, as now, some countries had large and persistent payments surpluses and used their net receipts to increase their short-term reserves rather than to invest in foreign countries.

Then, as now, the most important surplus country, France, had just decided to convert its official holdings of foreign exchange into gold, regardless of the effects of its actions on international liquidity.

Then, as now, there were serious doubts about the appropriate levels of some existing exchange rate relationships, leading periodically to speculative movements of volatile short-term funds.

And most importantly, then as now, many government officials, scholars, and businessmen were convinced that a new economic era had opened, an era in which business fluctuations had become a thing of the past, in which poverty was about to be abolished, and in which perennial economic progress and expansion were assured.

If some of these likenesses seem menacing, we may take comfort in important differences between the present and the interwar situation.

The distribution of our national income now shows less disparity than in the earlier period; in particular, personal incomes, and especially wages and salaries, have kept pace with corporate profits, and this has reduced the danger of investment expanding in excess of consumption needs.

Perhaps related to that better balance, the increase in stock market credit now has been much smaller.

Instead of a gradual decline in wholesale prices and stability in consumer prices, there has now been stability in wholesale prices though consumer prices have been creeping up.

The worst defects in the structure of commercial and investment banking and of business seem to have been corrected—although we are time and again reminded of our failure to eliminate all abuses.

The potentialities of monetary and fiscal policies are, we hope, better understood—although the rise in government expenditures even in times of advancing prosperity threatens to make it difficult to be still more expansionary should a serious decline in private business activity require it.

In spite of the rise in the international flow of public and private credit and investment, business abroad appears in general to be less dependent upon American funds. The recent restraint on the outflow of U.S. capital has had little effect on business activity abroad, in contrast to the paralyzing effect of the cessation of U.S. capital outflows in the late twenties.

While the cold war makes for sources of friction absent in the twenties, we are no longer suffering from the cancer of reparations and war debts.

We have learned the lessons taught by the failure of trade and exchange restrictions, and of beggar-my-neighbor policies in general, although the temptation to backslide is ever present.

We have become aware of our responsibility for helping those less developed countries that seem willing and able to develop their economies—although the poor countries still are not becoming rich as fast as the rich countries are becoming richer.

The International Monetary Fund has proved to be a valuable aid to a better working of the international payments system.

A network of international, regional, and bilateral institutions and arrangements has reduced the danger of lack of international financial communication.

And finally, the experience of the twenties has strengthened the resolution of all responsible leaders, businessmen and statesmen alike, never again to permit a repetition of the disasters of the Great Depression.

But while the spirit is willing, the flesh, in the form of concrete policies, has remained weak. With the best intentions, some experts seem resolved to ignore the lessons of the past.

Economic and political scientists still argue about the factors that converted a stock-exchange crash into the worst depression in our history. But on one point they are agreed: the disastrous impact of the destruction of the international payments-system that followed the British decision to devalue sterling in September 1931. At that time, sterling was the kingpin of the world payments system, exactly as the dollar is today. While changes in the par values of other peripheral currencies affected mainly or solely the devaluing countries themselves, the fate of sterling shook the entire world.

This is not wisdom of hindsight. Only a few weeks before the fateful decision was taken, the most eminent economist of the day stated that "for a country in the special circumstances of Great Britain the disadvantages (of devaluation) would greatly outweigh the advantages" and he concurred with his colleagues in rejecting the idea. His name was John Maynard Keynes.

And soon afterwards, another great British economist, Lionel Robbins, declared that "no really impartial observer of world events can do other than regard the abandonment of the Gold Standard by Great Britain as a catastrophe of the first order of magnitude." This was long before the final consequences of that step had become apparent—the political weakening of the West which followed its economic breakdown and which contributed to the success of the Nazi revolution in Germany, and thus eventually to the outbreak of the Second World War and to the emergence of Communism as an imminent threat to world order.

As if neither Keynes, the founder of the anti-classical school of economics, nor Robbins, the leader of the neo-classical school, ever had spoken, some Keynesian and neo-classicist economists—fortunately with little support at home but with encouragement from a few foreign observers—are urging us to follow the British example of 1931 and to act once more in a way that would destroy a payments system based on the fixed gold value of the world's leading currency. In doing so, they not only show that they have not learned from monetary history; they also impute to our generation even less wisdom than was shown in the interwar period.

The British Government in 1931, and the U.S. Administration in 1933, can rightly be accused of underestimating the adverse international effects of the devaluation of the pound and the dollar. But at least they had some plausible domestic grounds for their actions. They were confronted with a degree of unemployment that has hardly ever been experienced either before or after. They were confronted with disastrously falling prices, which made all fixed-interest obligations an intolerable burden on domestic and international commerce. They were confronted with a decline in international liquidity, which seemed to make recovery impossible.

Neither Keynes nor Robbins have denied that, from a purely domestic point of view, there was some sense in devaluation. In the United States of 1933, one worker out of four was unemployed; industrial production was little more than half of normal; farm prices had fallen to less than half of their 1929 level; exports and imports stood at one-third of their 1929 value; capital issues had practically ceased. In such a situation, any remedy, however questionable, seemed better than inaction.

In the Britain of 1931, things were not quite as bleak as in the United States of 1933; but fundamentally, the economic problems were similar. Ever since 1925, the British economy had failed to grow, and by 1931, one out of five workers had become unemployed, exports—far more important for the British economy than for our own—had declined by nearly one-half, and most observers believed that over-valuation of the British pound was largely responsible for all these ills. Can anybody in good faith find any similarity between our position of today and our position of 1933, or even the British position of 1931?

In 1931 and 1933, an increase in the price of gold was recommended in order to raise commodity prices. Today, a gold price increase is recommended as a means to provide the monetary support for world price stability. In 1931 and 1933, an increase in the price of gold was recommended in order to combat deflation; today it is recommended in effect as a means to combat inflation. In 1931 and 1933, an increase in the price of gold was recommended as a desperate cure for national ills regardless of its disintegrating effect on world commerce; today it is recommended as a means to improve integration of international trade and finance. Can there be worse confusion?

True, most advocates of an increase in the price of gold today would prefer action by some international agency or conference to unilateral action of individual countries. But no international agency or conference could prevent gold hoarders from getting windfall profits; could prevent those who hold a devalued currency from suffering corresponding losses; could prevent central banks from feeling defrauded if they had trusted in the repeated declarations of the President of the United States and of the spokesmen of U.S. monetary authorities and kept their reserves in dollars rather than in gold. To this day, the French, Belgian, and Netherlands central banks have not forgotten that the 1931 devaluation of sterling wiped out their capital; and much of the antagonism of those countries against the use of the dollar as an international reserve asset should be traced to the experience of 1931 rather than to anti-American feelings or mere adherence to outdated monetary theories.

But most importantly, no international agency or conference could prevent a sudden large increase in the gold price from having inflationary consequences for those countries that hoarded gold, and deflationary consequences for those that did not. And the gold holding countries are precisely those whose economies are least in need of an inflationary stimulus since they are most prosperous—not prosperous because they are holding gold, but holding gold because they are prosperous; in contrast, those that do not hold gold are most in need of further expansion. Hence the inflationary and deflationary effects of an increase in the price of gold would be most inequitably and most uneconomically distributed among nations.

If we were to accept another sort of advice given by some experts, we might repeat not the mistakes of 1931–33 but those of earlier years. We are told that a repetition of the disaster of the Great Depression could be averted only, or at least best, by returning to the principles of the so-called classical gold standard. Not only should all settlements in international transactions between central banks be made in gold; but also the domestic monetary policy of central banks should be oriented exclusively to the payments balance, which means to changes in gold reserves. Whenever gold flows out, monetary policy should be tightened; whenever it flows in, it should be eased.

This is not the place to discuss whether this pure form of gold standard theory has ever been translated into practice. I doubt that any central bank has ever completely neglected domestic considerations in its monetary policy. And conversely, we do not need to adhere to an idealized version of the gold standard in order to agree that considerations of international payments balance need to play a large role in monetary policy decisions. But even strict adherence to gold standard principles would not guarantee international payments equilibrium. As a great American economist, John H. Williams, put it in 1937:

"For capital movements, the gold standard is not a reliable corrective mechanism. . . . With capital the most volatile item in the balance of payments, it is apt to dominate and to nullify any corrective effects which might otherwise result from the gold standard process of adjustment. . . . It is surely not a coincidence that most booms and depressions, in the nineteenth century as well as in the twentieth, had international capital movements as one of their most prominent features."

Even countries that advocate a return to gold standard practices do not practice what they preach. Gold reserves of some Continental European countries have been rising strongly and continuously for many years, and according to the rules, these countries should follow a clearly expansionary policy. But in order to offset inflationary pressures, they have done exactly the opposite—and who is there to blame a country that wishes to assure domestic financial stability even at the expense of endangering equilibrium in international payments?

But obviously, if we permit one country to violate the rules of the gold standard in order to avert domestic inflation, we must also permit another country to violate those rules in order to avert domestic deflation and unemployment. In other words, we must agree that a country may be justified in avoiding or at least modifying a tightening of monetary policy even though its gold reserves are declining, if otherwise it were to risk precipitating or magnifying a business recession.

True, this deviation from gold-standard rules could be carried too far. Domestic developments might be taken as a pretext to avoid an unpopular monetary move, although the payments situation would seem to demand it and although the action would be unlikely to be damaging to the domestic economy. But the possibility of abuse and error is inherent in all human decision, and just as no sane observer would ascribe infallibility to the decisions of central bankers, neither should he ascribe infallibility to a set of rules. Few experts today would want to argue that it was right for the German Reichsbank in 1931, in the middle of the greatest depression that ever hit Germany, to follow the gold standard rules by raising its discount rate to 7 percent merely in order to stem an outflow of gold; or that it was right for our own Federal Reserve to take similar restrictive action for the same reason, in the fall of 1931.

And just as the success of monetary policy cannot be guaranteed by an abdication of discretion in favor of preconceived gold-standard rules, it cannot be guaranteed by following the advice of those who would shift the focus of policy from national agencies to an international institution. Surely, international cooperation should be encouraged and improved whenever possible. And the functions of the International Monetary Fund might well be enlarged so as to reinforce its ability to act as an international lender of last resort and as an arbiter of international good behavior.

But no institutional change can exclude the possibility of conflicts between national and international interests in specific circumstances. Moreover, there is no reason to believe that such conflicts would necessarily be resolved more wisely, more speedily, and with less rancor and dissent if they were fought out in the governing body of some supra-national bank of issue rather than by discussion and negotiation among national authorities.

It is true that such discussion and negotiation may prove fruitless and that inconsistent decisions may be taken on the national level. But similarly, lack of consensus within a supra-national agency may result in a paralysis of its functions, and the effects of such paralysis could well be worse than those of inconsistent national actions.

If then we doubt the wisdom of the three most fashionable recent proposals—to increase the dollar price of gold, to return to pure gold-standard principles, or to delegate monetary policy to an international agency—what should be our position? And what is the outlook for solving present and future difficulties in international monetary relations, and thus for avoiding a repetition of the disasters of 1929–33?

In my judgment, it is less fruitful to look for institutional changes or for a semi-automatic mechanism that would guarantee perennial prosperity than to draw from interwar experience some simple lessons that could save us from repeating our worst mistakes.

First, most observers agree that to a large extent the disaster of 1929–33 was a consequence of maladjustments born of the boom of the twenties. Hence, we must continuously be on the alert to prevent a recurrence of maladjustments—even at the risk of being falsely accused of failing to realize the benefits of unbounded expansion. Actually, those of us who warn against speculative and inflationary dangers should return the charge: our common goals of maximum production, employment, and purchasing power can be realized only if we are willing and able to prevent orderly expansion from turning into disorderly boom.

Second, most observers agree that the severity of the Great Depression was largely due to the absence of prompt antirecession measures. In part, the necessary tools for this were not then available nor were their potentialities fully understood. Today it is easy to understand where observers went wrong 35 years ago. But it is less easy to avoid a repetition of the same mistake; we always prefer to believe what we want to be true rather than what we should know to be true. Here again, we need most of all eternal vigilance. But we must also be ready to admit errors in past judgments and forecasts, and have the courage to express dissenting even though unpopular views, and to advocate necessary remedies.

Third, and most importantly, most observers agree that the severity of the Great Depression was due largely to the lack of understanding of the international implications of national events and policies. Even today, we are more apt to judge and condemn the worldwide implications of nationalistic actions taken by others than to apply the same criteria to our own decisions.

Recognition of the close ties among the individual economies of the free world leads to recognition of the need to maintain freedom of international commerce. This means not only that we must avoid the direct controls of trade and exchange that were characteristic of the time of the Great Depression. It means also that we must avoid any impairment of the value and status of the dollar, which today acts—just as sterling did until its devaluation in 1931—as a universal means of international payment between central banks as well as among individual merchants, bankers, and investors.

If the dollar is to continue to play its role in international commerce, world confidence in its stability must be fully maintained; the world must be convinced that we are resolved to eliminate the long-persistent deficit in our balance of international payments. The measures taken in accordance with the President's program of February 10, 1965, have so far been highly successful. But some of these measures are of a temporary character, and these include the efforts of the financial community to restrain voluntarily the expansion of credit to foreigners. We should not permit the initial success of these efforts to blind us against the need for permanent cure.

Some observers believe that our responsibility for maintaining the international function of the dollar puts an intolerably heavy burden on our monetary policy; that this responsibility prevents us from taking monetary measures which might be considered appropriate for solving domestic problems. I happen to disagree with that view. I believe that the interests of our national economy are in harmony with those of the international community. A stable dollar is indeed the keystone of international trade and finance; but it is also, in my judgment, the keystone of economic growth and prosperity at home.

Yet even if I were wrong in this judgment, and if indeed an occasion arose when we could preserve the international role of the dollar only at the expense of modifying our favored domestic policies—even then we would need to pay attention to the international repercussions of our actions. We must consider these international effects not because of devotion to the ideal of human brotherhood, not because we value the well-being of our neighbors more than our own. We must do so because any harm that would come to international commerce and hence to the rest of the world as a result of the displacement of the dollar would fall back on our own heads. In the present stage of economic development we could not preserve our own prosperity if the rest of the world were caught in the web of depression. Recognition of this inter-dependence gave rise to the Marshall Plan—in my judgment the greatest achievement of our postwar economic policy.

It should not have taken the Great Depression to bring these simple truths home to us. Today, as we approach the goal of the "Great Society"—to make each of our citizens a self-reliant and productive member of a healthy and progressive economic system—we can disregard these truths even less than we could a generation ago. By heeding them instead, we will have a good chance to avoid another such disaster. If monetary history were to repeat itself, it would be nobody's fault but our own.

APPENDIX B

STATISTICAL MATERIAL

INTERNATIONAL STATISTICS

TABLE 1.—U.S. BALANCE OF PAYMENTS, 1946–72

[Millions of dollars]

Year or quarter	Merchandise [1,2]			Military transactions			Net investment income		Net travel and transportation expenditures	Other services, net	Balance on goods and services [4]	Remittances, pensions, and other unilateral transfers [4]	Balance on current account
	Exports	Imports	Net balance	Direct expenditures	Sales	Net balance	Private [3]	U.S. Government					
1946	11,764	−5,067	6,697	−493	(5)	−493	750	6	733	114	7,807	−2,922	4,885
1947	16,097	−5,973	10,124	−455	(5)	−455	997	50	946	−45	11,617	−2,625	8,992
1948	13,265	−7,557	5,708	−799	(5)	−799	1,177	85	374	−27	6,518	−4,525	1,993
1949	12,213	−6,874	5,339	−621	(5)	−621	1,200	73	230	−3	6,218	−5,638	580
1950	10,203	−9,081	1,122	−576	(5)	−576	1,382	78	−120	6	1,892	−4,017	−2,125
1951	14,243	−11,176	3,067	−1,270	(5)	−1,270	1,569	151	298	2	3,817	−3,515	302
1952	13,449	−10,838	2,611	−2,054	(5)	−2,054	1,535	140	83	41	2,356	−2,531	−175
1953	12,412	−10,975	1,437	−2,615	192	−2,423	1,566	166	−238	24	532	−2,481	−1,949
1954	12,929	−10,353	2,576	−2,642	182	−2,460	1,899	213	−269	0	1,959	−2,280	−321
1955	14,424	−11,527	2,897	−2,901	200	−2,701	2,117	180	−297	−43	2,153	−2,498	−345
1956	17,556	−12,803	4,753	−2,949	161	−2,788	2,454	40	−361	47	4,145	−2,423	1,722

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1957	19,562	−13,291	6,271	−3,216	375	−2,841	2,584	4	−189	72	5,901	−2,345	3,556
1958	16,414	−12,952	3,462	−3,435	300	−3,135	2,416	168	−633	78	2,356	−2,361	−5
1959	16,458	−15,310	1,148	−3,107	302	−2,805	2,658	68	−821	62	310	−2,448	−2,138
1960	19,650	−14,744	4,906	−3,087	335	−2,752	2,825	16	−964	77	4,107	−2,292	1,815
1961	20,107	−14,519	5,588	−2,998	402	−2,596	3,451	103	−978	30	5,599	−2,513	3,086
1962	20,779	−16,218	4,561	−3,105	656	−2,449	3,920	132	−1,155	115	5,126	−2,631	2,495
1863	22,252	−17,011	5,241	−2,961	657	−2,304	4,056	97	−1,312	178	5,957	−2,742	3,215
1964	25,478	−18,647	6,831	−2,880	747	−2,133	4,872	3	−1,149	142	8,568	−2,754	5,814
1965	26,438	−21,496	4,942	−2,952	830	−2,122	5,274	21	−1,318	301	7,098	−2,835	4,263
1966	29,287	−25,463	3,824	−3,764	829	−2,935	5,331	44	−1,380	286	5,170	−2,890	2,280
1967	30,638	−26,821	3,817	−4,378	1,240	−3,138	5,847	40	−1,763	334	5,136	−3,081	2,055
1968	33,576	−32,964	612	−4,535	1,392	−3,143	6,157	63	−1,565	302	2,425	−2,909	−484
1969	36,417	−35,796	621	−4,856	1,512	−3,344	5,820	155	−1,784	442	1,911	−2,946	−1,035
1970	41,963	−39,799	2,164	−4,852	1,478	−3,374	6,376	−115	−2,061	574	3,563	−3,208	356
1971	42,770	−45,459	−2,689	−4,816	1,922	−2,894	8,952	−957	−2,432	748	727	−3,574	−2,847
1972 [12]	47,391	−54,355	−6,964	−4,716	1,153	−3,563	9,211	−1,803	−2,589	795	−4,913	−3,737	−8,651

See footnotes at end of table.

TABLE 1.—U.S. BALANCE OF PAYMENTS, 1946-72 Continued

Year or quarter	Long-term capital flows, net: U.S. Government[4]	Long-term capital flows, net: Private[5]	Balance on current account and long-term capital	Nonliquid short-term private capital flows, net[5]	Allocations of special drawing rights	Errors and omissions, net	Net liquidity balance	Liquid private flows, net[5]	Official reserve transactions balance	Changes in liabilities to foreign official agencies, net[6]	Changes in U.S. official reserve assets, net[7]	U.S. official reserve assets, net (end of) period
1946				−253		155					−623	20,706
1947				−236		861					−3,315	24,021
1948				−131		1,115					−1,736	25,758
1949				158		717					−266	26,024
1950				75		−124					1,758	24,265
1951				−227		354					−33	24,299
1952				−41		497					−415	24,714
1953				183		220					1,256	23,458
1954				−556		60					480	22,978
1955				−328		371					182	22,797
1956				−479		390					−869	23,666
1957				−174		1,012					−1,165	24,832
1958				−145		361					2,292	22,540
1959				−89		260					1,035	21,504
1960	−889	−2,100	−1,174	[9] −1,405		−1,098	[9] −3,676	[9] 273	−3,403	1,258	2,145	19,359
1961	−901	−2,181	4	[9] −1,200		−1,054	[9] −2,251	[9] 903	−1,348	742	606	18,753
1962	−892	−2,607	−1,003	[9] −657		−1,206	[9] −2,864	[9] 214	−2,650	1,117	1,533	17,220
1963	−1,150	−3,357	−1,292	[9] −968		−455	[9] −2,713	[9] 779	−1,934	1,557	377	16,843
1964	−1,349	−4,470	−4	−1,642		−1,048	−2,696	1,162	−1,534	1,363	171	16,672

1965	−1,532	−4,577	−1,846	−154	...	−476	−2,477	1,188	−1,289	67	1,222	15,450
1966	−1,469	−2,555	−1,744	−104	...	−302	−2,151	2,370	219	−787	568	14,882
1967	−2,424	−2,912	−3,280	−522	...	−881	−4,683	1,265	−3,418	3,366	52	14,830
1968	−2,159	1,198	−1,444	230	...	−399	−1,610	3,251	1,641	−761	−880	15,710
1969	−1,926	−50	−3,011	−640	...	−2,470	−6,122	8,224	2,702	−1,515	−1,187	[10] 16,964
1970	−2,018	−1,398	−3,059	−482	867	−1,174	−3,851	−5,988	−9,839	7,362	2,477	14,487
1971	−2,378	−4,079	−9,304	−2,386	717	−11,031	−22,002	−7,763	−29,765	27,417	2,348	[11] 12,167
1972 [12]	−959	−632	−10,243	−611	710	−2,951	−13,093	1,461	−11,632	11,441	191	13,150

[1] Excludes military grants.
[2] Adjusted from Census data for differences in timing and coverage.
[3] Includes fees and royalties from U.S. direct investments abroad or from foreign direct investments in the United States.
[4] Excludes liabilities to foreign official reserve agencies.
[5] Private foreigners exclude the International Monetary Fund (IMF), but include other international and regional organizations.
[6] Includes liabilities to foreign official agencies reported by U.S. Government and U.S. banks and U.S. liabilities to the IMF arising from reversible gold sales to, and gold deposits with, the United States.
[7] Official reserve assets include gold, special drawing rights, convertible currencies, and the U.S. gold tranche position in the IMF.
[8] Not available separately.
[9] Coverage of liquid banking claims for 1960–63 and of nonliquid nonbanking claims for 1960–62 is limited to foreign currency deposits only; other liquid items are not available separately and are included with nonliquid claims.
[10] Includes gain of $67 million resulting from revaluation of the German mark in October 1969.
[11] Includes $28 million increase in dollar value of foreign currencies revalued to reflect market exchange rates as of December 31, 1971.
[12] First 3 quarters on a seasonally adjusted annual rates basis (except reserve assets are end of December).
[13] Includes increase of $1,016 million resulting from change in par value of the U.S. dollar on May 8, 1972.

Sources: Department of Commerce (Bureau of Economic Analysis) and Treasury Department.

TABLE 2.—U.S. RESERVE ASSETS, 1946–72

[Millions of dollars]

End of year or month	Total reserve assets	Gold stock [1]		Special drawing rights [3]	Convertible foreign currencies [4]	Reserve position in International Monetary Fund [5]
		Total [2]	Treasury			
1946	20,706	20,706	20,529			
1947	24,021	22,868	22,754			1,153
1948	25,758	24,399	24,244			1,359
1949	26,024	24,563	24,427			1,461
1950	24,265	22,820	22,706			1,445
1951	24,299	22,873	22,695			1,426
1952	24,714	23,252	23,187			1,462
1953	23,458	22,091	22,030			1,367
1954	22,978	21,793	21,713			1,185
1955	22,797	21,753	21,690			1,044
1956	23,666	22,058	21,949			1,608
1957	24,832	22,857	22,781			1,975
1958	22,540	20,582	20,534			1,958
1959	21,504	19,507	19,456			1,997
1960	19,359	17,804	17,767			1,555
1961	18,753	16,947	16,889		116	1,690
1962	17,220	16,057	15,978		99	1,064
1963	16,843	15,596	15,513		212	1,035
1964	16,672	15,471	15,388		432	769
1965	15,450	[6] 13,806	[6] 13,733		781	[6] 863
1966	14,882	13,235	13,159		1,321	326
1967	14,830	12,065	11,982		2,345	420
1968	15,710	10,892	10,367		3,528	1,290
1969	[7] 16,964	11,859	10,367		[7] 2,781	2,324
1970	14,487	11,072	10,732	851	629	1,935
1971	[8] 12,167	10,206	10,132	1,100	[8] 276	585
1972	13,150	10,487	10,410	1,958	241	464

[1] From 1956 through January 1972, includes gold sold to the United States by the International Monetary Fund (IMF) with the right of repurchase, and beginning 1965 also includes gold deposited by the IMF to mitigate the impact on the U.S. gold stock of purchases by foreign countries for gold subscriptions on increased IMF quotas.
[2] Includes gold in Exchange Stabilization Fund.
[3] Includes initial allocation on January 1, 1970 of $867 million, second allocation on January 1, 1971 of $717 million, and third allocation on January 1, 1972 of $710 million of special drawing rights (SDR) in the Special Drawing Account in the IMF, plus or minus transactions in SDR.
[4] Includes holdings of Treasury and Federal Reserve System.
[5] The United States has the right to purchase foreign currencies equivalent to its reserve position in the Fund automatically if needed. Under appropriate conditions the United States could purchase additional amounts equal to the United States quota.
[6] Reserve position includes, and gold stock excludes, $259 million gold subscription to the Fund in June 1965 for a U.S. quota increase which became effective on February 23, 1966. In figures published by the Fund from June 1965 through January 1966, this gold subscription was included in the U.S. gold stock and excluded from the reserve position.
[7] Includes gain of $67 million resulting from revaluation of German mark in October 1969, of which $13 million represents gain on mark holdings at time of revaluation.
[8] Includes $28 million increase in dollar value of foreign currencies revalued to reflect market exchange rates as of December 31, 1971.

Note.—Gold held under earmark at Federal Reserve Banks for foreign and international accounts is not included in the gold stock of the United States.

Sources: Treasury Department and Board of Governors of the Federal Reserve System.

TABLE 3.—U.S. LIQUID AND OTHER LIABILITIES TO FOREIGN OFFICIAL INSTITUTIONS, AND LIQUID LIABILITIES TO ALL OTHER FOREIGNERS

(In millions of dollars)

			Liabilities to foreign countries										
			Official institutions [2]							Liquid liabilities to other foreigners			
			Liquid										
End of period	Total	Liquid liabilities to IMF arising from gold transactions [1]	Total	Short-term liabilities reported by banks in United States	Marketable U.S. Treasury bonds and notes [3]	Nonmarketable, convertible U.S. Treasury bonds and notes	Nonmarketable, nonconvertible U.S. Treasury bonds and notes [4]	Other readily marketable liabilities [5]	Liquid liabilities to commercial banks abroad [6]	Total	Short-term liabilities reported by banks in United States	Marketable U.S. Treasury bonds and notes [3] [7]	Liquid liabilities to nonmonetary international and regional organizations [8]
1959	19,428	500	10,120	9,154	966				4,678	2,940	2,399	541	1,190
1960 [9]	20,994	800	11,078	10,212	866				4,818	2,773	2,230	543	1,525
	21,027	800	11,088	10,212	876				4,818	2,780	2,230	550	1,541
1961 [9]	22,853	800	11,830	10,940	890				5,404	2,871	2,355	516	1,948
	22,936	800	11,830	10,940	890				5,484	2,873	2,357	516	1,949
1962 [9]	24,268	800	12,948	11,997	751		200		5,346	3,013	2,565	448	2,161
	24,268	800	12,914	11,963	751		200		5,346	3,013	2,565	448	2,195
1963 [9]	26,433	800	14,459	12,467	1,217	703	63	9	5,817	3,397	3,046	351	1,960
	26,394	800	14,425	12,467	1,183	703	63	9	5,817	3,387	3,046	341	1,965
1964 [9]	29,313	800	15,790	13,224	1,125	1,079	204	158	7,271	3,730	3,354	376	1,722
	29,364	800	15,786	13,220	1,125	1,079	204	158	7,303	3,753	3,377	376	1,722
1965	29,569	834	15,826	13,066	1,105	1,201	334	120	7,419	4,059	3,587	472	1,431

See footnotes at end of table.

TABLE 3.—U.S. LIQUID AND OTHER LIABILITIES TO FOREIGN OFFICIAL INSTITUTIONS, AND LIQUID LIABILITIES TO ALL OTHER FOREIGNERS—Continued

(In millions of dollars)

End of period	Total	Liquid liabilities to IMF arising from gold transactions [1]	Liabilities to foreign countries: Official institutions [2]: Total	Official institutions: Liquid: Short-term liabilities reported by banks in United States	Official institutions: Liquid: Marketable U.S. Treasury bonds and notes [3]	Official institutions: Liquid: Nonmarketable, convertible U.S. Treasury bonds and notes	Official institutions: Nonmarketable, nonconvertible U.S. Treasury bonds and notes [4]	Official institutions: Other readily marketable liabilities [5]	Liquid liabilities to commercial banks abroad [6]	Liquid liabilities to other foreigners: Total	Liquid liabilities to other foreigners: Short-term liabilities reported by banks in United States	Liquid liabilities to other foreigners: Marketable U.S. Treasury bonds and notes [3] [7]	Liquid liabilities to nonmonetary international and regional organizations [8]
1966 [9]	31,145	1,011	14,841	12,484	860	256	328	913	10,116	4,271	3,743	528	906
	31,020	1,011	14,896	12,539	860	256	328	913	9,936	4,272	3,744	528	905
1967 [9]	35,819	1,033	18,201	14,034	908	711	741	1,807	11,209	4,685	4,127	558	691
	35,667	1,033	18,194	14,027	908	711	741	1,807	11,085	4,678	4,120	558	677
1968 [9]	38,687	1,030	17,407	11,318	529	701	2,518	2,341	14,472	5,053	4,444	609	725
	38,473	1,030	17,340	11,318	462	701	2,518	2,341	14,472	4,909	4,444	465	722
1969 [9]	45,755	1,019	15,975	11,054	346	[10] 555	[10] 2,515	1,505	23,638	4,464	3,939	525	659
	45,914	1,019	15,998	11,077	346	555	2,515	1,505	23,645	4,589	4,064	525	663
1970—Dec. [9]	47,009	566	23,786	19,333	306	429	3,023	695	17,137	4,676	4,029	647	844
	46,960	566	23,775	19,333	295	429	3,023	695	17,169	4,604	4,039	565	846
1971—Dec. [11]	67,681	544	51,209	39,679	1,955	6,060	3,371	144	10,262	4,138	3,691	447	1,528
	67,810	544	50,651	39,018	1,955	6,093	3,441	144	10,950	4,141	3,694	447	1,524

1972—Feb.	69,998		52,799	40,679	2,399	6,094	3,441	186	11,373	4,204	3,812	392	1,622
Mar.	71,013		53,806	40,980	2,644	6,094	3,723	365	11,464	4,194	3,818	376	1,549
Apr.	72,215		54,093	38,723	2,668	8,594	3,723	385	12,433	4,242	3,853	389	1,447
May[r]	72,115		53,579	37,850	3,018	8,594	3,723	394	12,822	4,285	3,890	395	1,429
June[r]	74,001		54,604	38,603	3,292	8,594	3,723	392	13,444	4,475	4,103	372	1,478
July[r]	77,465		59,416	39,777	3,516	12,094	3,647	382	12,128	4,493	4,123	370	1,428
Aug.[r]	79,454		60,601	40,611	3,881	12,094	3,647	368	12,911	4,419	4,041	378	1,523
Sept.	79,731		60,070	39,628	4,117	12,095	3,804	426	13,585	4,630	4,241	389	1,446
Oct.	81,422		60,926	40,261	4,457	12,097	3,651	460	14,180	4,823	4,417	406	1,493
Nov.	82,373		61,122	40,040	4,834	12,098	3,651	499	14,781	4,745	4,322	423	1,725
Dec.	82,902		61,503	39,976	5,236	12,108	3,639	544	14,821	4,951	4,526	425	1,627
1973—Jan.[p]	82,093		60,779	38,516	5,798	12,110	3,780	575	14,824	4,897	4,472	425	1,593
Feb.[p]	87,873		68,455	45,395	6,377	12,110	3,627	946	12,791	5,006	4,634	372	1,621

[1] Includes (a) liability on gold deposited by the IMF to mitigate the impact on the U.S. gold stock of foreign purchases for gold subscriptions to the IMF under quota increases, and (b) U.S. Treasury obligations at cost value and funds awaiting investment obtained from proceeds of sales of gold by the IMF to the United States to acquire income-earning assets.

[2] Includes BIS and European Fund.

[3] Derived by applying reported transactions to benchmark data; breakdown of transactions by type of holder estimated 1959–63.

[4] Excludes notes issued to foreign official nonreserve agencies.

[5] Includes long-term liabilities reported by banks in the United States and debt securities of U.S. federally sponsored agencies and U.S. corporations.

[6] Includes short-term liabilities payable in dollars to commercial banks abroad and short-term liabilities payable in foreign currencies to commercial banks abroad and to "other foreigners."

[7] Includes marketable U.S. Treasury bonds and notes held by commercial banks abroad.

[8] Principally the International Bank for Reconstruction and Development and the Inter-American and Asian Development Banks. From December 1957 through January 1972 includes difference between cost value and face value of securities in IMF gold investment account.

[9] Data on the two lines shown for this date differ because of changes in reporting coverage. Figures on first line are comparable with those shown for the preceding date; figures on second line are comparable with those shown for the following date.

[10] Includes $101 million increase in dollar value of foreign currency liabilities resulting from revaluation of the German mark in October 1969 as follows: liquid, $17 million, and nonliquid, $84 million.

[11] Data on the second line differ from those on first line because certain accounts previously classified as "official institutions" are included with "banks"; a number of reporting banks are included in the series for the first time; and U.S. Treasury securities payable in foreign currencies issued to official institutions of foreign countries have been increased in value to reflect market exchange rates as of December 31, 1971.

Note: Based on Treasury Department data and on data reported to the Treasury Department by banks and brokers in the United States. Data correspond generally to statistics following in this section, except for the exclusion of nonmarketable, nonconvertible U.S. Treasury notes issued to foreign official nonreserve agencies, the inclusion of investments by foreign official reserve agencies in debt securities of U.S. federally sponsored agencies and U.S. corporations, and minor rounding differences. Table excludes IMF "holdings of dollars," and holdings of U.S. Treasury letters of credit and nonnegotiable, non-interest-bearing special U.S. notes held by other international and regional organizations.

TABLE 4.—GOLD PRODUCTION

(In millions of dollars; valued at $35 per fine ounce through 1971 and at $38 per fine ounce thereafter)

Period	World production [1]	Africa			North and South America					Asia			Other	
		South Africa	Ghana	Zaire	United States	Canada	Mexico	Nicaragua	Colombia	India	Japan	Philippines	Australia	All other [1]
1966	1,445.0	1,080.8	24.0	5.6	63.1	114.6	7.5	5.2	9.8	4.2	19.4	15.8	32.1	62.9
1967	1,410.0	1,068.7	26.7	5.4	53.4	103.7	5.8	5.2	9.0	3.4	23.7	17.2	28.4	59.4
1968	1,420.0	1,088.0	25.4	5.9	53.9	94.1	6.2	4.9	8.4	4.0	21.5	18.5	27.6	61.6
1969	1,420.0	1,090.7	24.8	6.0	60.1	89.1	6.3	3.7	7.7	3.4	23.7	20.0	24.5	60.0
1970	1,450.0	1,128.0	24.6	6.2	63.5	84.3	6.9	4.0	7.1	3.7	24.8	21.1	21.7	54.1
1971 [p]		1,098.7	24.4	6.0	52.3	79.1	5.3	3.7	6.6	4.1	27.0	22.2	23.5	
1972 [p]		1,109.8			54.3	77.2								
1972—January		95.3				6.5	.4		.7	.4	2.6		3.3	
February		88.2				6.4	.4		.6	.3	2.5		2.5	
March		91.8		[2] 1.2		6.6	.5		.5	.3	2.6		2.0	
April		93.2				7.5			.6	.3	2.4		2.4	

May	94.4		6.8	.6	.4	2.4	2.3
June	94.3	[2] 1.0	6.2	.7	.3	2.5	2.5
July	94.4		6.4	.5	.4	2.8	2.6
August	94.1		5.9	.6	.3	2.8	
September	93.9		6.3	.6	.3		
October	94.2		6.3	.5			
November	91.5		6.0				
December	84.3		6.3				
1973—January	82.2		6.2				

[1] Estimated; excludes U.S.S.R., other Eastern European countries, China Mainland, and North Korea.

[2] Quarterly data.

Table 5. – London Gold Price at P.M. Fixing, Jan.–May, 1973, Biweekly

(In U.S dollars)

Jan. 2	65.10
Jan. 15	65.10
Feb. 1	66.60
Feb. 15	73.65
Mar. 1	85.70
Mar. 15	82.75
Apr. 2	89.25
Apr. 16	89.30
May 1	90.70
May 15	110.00

Source: Board of Governors of the Federal Reserve System.

TABLE 6.—APPROXIMATE PRIVATE GOLD SALES IN ALL INTERNATIONAL MARKETS

[In millions of U.S. paper dollars at end of month]

	1963	1964	1965	1966	1967	1968	1969	1970	1971
January	$165	$240	$510	$380	$380	$485	$520	$170	$415
February	200	220	525	350	345	425	310	220	440
March	240	300	490	290	390	1,975	290	240	425
April	210	365	370	310	375	1,350	230	265	450
May	220	325	325	280	445	1,565	275	315	625
June	260	290	315	260	510	675	205	270	430
July	275	235	475	360	445	690	340	230	550
August	255	260	380	390	410	615	325	320	710
September	300	310	290	420	370	635	310	360	985
October	285	340	375	405	420	675	330	475	480
November	325	400	315	375	650	825	280	460	510
December	310	415	325	410	985	885	215	425	560
Total	3,045	3,700	4,695	4,230	5,725	10,800	3,630	3,730	6,580

TABLE 7.—COMPARISON OF FEDERAL BUDGET ESTIMATES ORIGINALLY SUBMITTED TO CONGRESS AND FINAL RESULTS, UNDER THE KENNEDY, JOHNSON, AND NIXON ADMINISTRATIONS—WITH PERCENT CHANGES IN PRICE INDEXES

[Dollars in billions]

Fiscal year	Administration original budget estimates submitted			Actual budget results			Calendar year	Percent changes in Consumer Price Indexes (all items)	Percent changes in Wholesale Price Indexes (all commodities)
	Receipts	Outlays	Surplus or deficit (—)	Receipts	Outlays	Surplus or deficit (—)			
Administrative budget:									
1963—Kennedy	$93.0	$92.5	$0.5	$86.4	$92.6	—$6.2	1963	1.6	—0.1
1964—Kennedy	86.9	98.8	—11.9	89.5	97.7	—8.2	1964	1.2	.4
1965—Johnson	93.0	97.9	—4.9	93.1	96.5	—3.4	1965	1.9	3.4
1966—Johnson	94.4	99.7	—5.3	104.7	107.0	—2.3	1966	3.4	1.7
1967—Johnson	111.0	112.8	—1.8	115.8	125.7	—9.9	1967	3.0	1.0
1968—Johnson	126.9	135.0	—8.1	114.7	143.1	—28.4	1968	4.7	2.8

Federal funds budget:									
1969—Johnson	135.6	147.4	−11.8	143.3	148.8	−5.5	1969	6.1	4.8
1970—Johnson	147.8	154.7	−6.8	143.2	156.3	−13.1	1970	5.5	2.2
1971—Nixon	147.6	154.9	−7.3	133.8	163.7	−29.9	1971	3.4	4.0
1972—Nixon	153.7	176.9	−23.1	148.8	178.0	−29.1	1972	3.4	6.5
1973—Nixon	150.6	186.8	−36 2	154.3	188.4	−34.1	1973	[1] 8.8	[1] 21.1
1974—Nixon	171.3	199.1	−27.8	NA	NA	NA	1974	NA	NA
Total recommended budget deficts, compared to actual results:									
Kennedy administration, fiscal year 1963-64			−11.4			−14.4			
Average yearly			−5.7			−7.2			
Johnson administration, fiscal year 1965-70.			−38.7			−62.6			
Average yearly			−6.5			−10.4			
Nixon administration, fiscal year 1971-74.			−94.4			[2] −93.3			
Average yearly			−23.6			[2] −31.0			

[1] First quarter seasonally adjusted, annualized rate of increase.
[2] Fiscal year 1971-73.

Source: Report of the Joint Study Committee on Budget Control Table 1; Economic Report of the President, Tables C-50, C-51.

TABLE 8.—CONSUMER PRICE INDEXES IN THE UNITED STATES AND OTHER MAJOR INDUSTRIAL COUNTRIES, 1957-72

[1963=100]

Period	United States	Canada	Japan	France	Germany	Italy	Netherlands	United Kingdom
1957	91.9	91.7	79.3	69.6	88.1	83.2	88.0	86.9
1958	94.4	94.1	78.9	80.1	90.0	85.5	90.0	89.5
1959	95.2	95.1	79.8	85.0	90.9	85.1	91.0	90.0
1960	96.7	96.2	82.6	88.1	92.[illegible]	87.1	93.0	90.9
1961	97.7	97.1	87.0	91.0	94.3	88.9	95.0	94.0
1962	98.8	98.3	93.0	95.4	97.1	93.1	97.0	98.0
1963	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1964	101.3	101.8	103.9	103.4	102.3	105.9	106.0	103.3
1965	103.1	104.3	110.7	106.0	105.8	110.7	111.0	108.2
1966	106.0	108.2	116.4	108.9	109.5	113.3	117.4	112.4
1967	109.1	112.0	121.0	111.8	111.1	116.9	121.4	115.2
1968	113.6	116.6	127.5	116.9	113.1	118.5	125.9	120.6
1969	119.7	122.0	134.1	124.4	116.1	121.6	135.3	127.2
1970	126.8	126.0	144.5	131.2	120.5	127.6	141.3	135.3
1971	132.3	129.6	153.3	138.6	126.7	133.9	152.0	148.0
1972[1]	136.6	135.2	159.6	145.8	133.3	140.6	162.9	157.5

[1] For United States, 12-month average; for all other countries, January-October average.

Sources: Department of Labor and Organization for Economic Cooperation and Development.

TABLE 9.—PERCENT APPRECIATION (+) OR DEPRECIATION (—) AGAINST THE DOLLAR [1]

	Apr. 30, 1971 to Dec. 18, 1971 [2]	Pre-February 1973 to May 18, 1973 [3]	Apr. 30, 1971 to May 18, 1973
Currency of—			
Australia	+8.6	+11.0	+26.3
Austria	+11.6	+12.8	+25.8
Belgium-Luxembourg	+11.6	+14.4	+27.7
Canada	+.8	−.1	+.8
Denmark	+7.5	+11.8	+20.1
Finland	+2.4	+5.7	+8.2
France	+8.6	+15.2	+25.0
Germany	+13.6	+15.9	+31.6
Greece	0	0	0
Iceland	0	+8.3	−3.3
Ireland	+8.6	+8.6	+6.4
Italy	+7.5	−1.2	+6.2
Japan	+16.9	+16.5	+36.2
Netherlands	+11.6	+12.7	+25.7
Norway	+7.5	+12.7	+21.1
Portugal	+5.5	+7.9	+13.84
Spain	+8.6	+10.9	+20.4
Sweden	+7.5	+6.7	+14.7
Switzerland	+13.9	+21.9	+38.8
Turkey	+7.1	0	+7.1
United Kingdom	+8.6	+8.6	+6.4

See notes to table 10.

TABLE 10.—WEIGHTED AVERAGE APPRECIATION AGAINST THE DOLLAR [1]

	Apr. 30, 1971, to Dec. 18, 1971 [2]	Pre-February 1973 to May 18, 1973 [3]	Apr. 30, 1971, to May 18, 1973 [4]
OECD currencies	8.0	8.2	16.5
OECD currencies excluding Canada	11.9	12.7	25.0

[1] Calculated on basis of U.S. cents per foreign currency unit. Averages are weighted on basis of U.S. bilateral trade pattern in 1970.

[2] Calculated on basis of Apr. 30, 1971, par values and, for Dec. 18, 1971, new par values or central rates following Smithsonian agreement. Market rates on Apr. 30 and Dec. 24, 1971, were used for Canada, whose currency was floating.

[3] Base rates are par values or central rates prevailing in early February 1973, except for Canada and the U.K., for which base rates of U.S. $1=C$1 and $2.35=1£, respectively, were taken as an approximate average of rates prevailing in the weeks preceding the February market disturbances. Rates for May 18, 1973, are market rates for most countries, and par values or central rates for a few of the smaller countries whose rates are not available regularly.

[4] Apr. 30, 1971, base rates and May 18, 1973, rates are as described in the preceding footnotes.

TABLE 11.—GLOBAL BALANCE OF TRADE AND PAYMENTS OF THE EUROPEAN COMMUNITY AND JAPAN, 1972

[In millions of dollars]

Country	Merchandise trade balance	Current account	Official settlements [1]
France	1,357	760	1,600
Germany	8,414	543	4,790
Italy	923	2,714	–900
Netherlands	0	1,086	800
Belgium-Luxembourg	944	1,439	400
United Kingdom	–1,720	63	–3,690
Denmark	–716	–109	(2)
Ireland	–470	(2)	(2)
Japan	8,997	6,656	2,760
Subtotal, EC–6	11,638	6,542	6,690
Subtotal, EC–6+United Kingdom	9,918	6,605	3,000
Total, 9 countries	8,733	(2)	(2)

[1] Not strictly comparable with U.S. definition.
[2] Not available.

Note: Preliminary. Partly estimated by OECD and national authorities. Converted from SDR at central rates or par values prevailing in 1972.

Source: Treasury Department, May 9, 1973.

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APPENDIX C

THE SECRETARY'S STATEMENT

Needed: A New Balance in International Economic Affairs

by the

Hon. George C. Shultz, Secretary of the Treasury

Before the

Boards of Governors of the IMF and the IBRD,

September 26, 1972

THE SECRETARY'S STATEMENT

Statement by the Honorable George P. Shultz
The Secretary of the Treasury
of the United States of America
at the
1972 Annual Meetings
of the
Boards of Governors
of the
International Monetary Fund
and the
International Bank for Reconstruction and Development
and Affiliates
Tuesday, September 26, 1972

NEEDED: A NEW BALANCE IN INTERNATIONAL ECONOMIC AFFAIRS

Mr. Chairman, Mr. Managing Director, Mr. President, Fellow Governors, Distinguished Guests:

The nations gathered here have it in their power to strike a new balance in international economic affairs.

The new balance of which I speak does not confine itself to the concepts of a balance of trade or a balance of payments.

The world needs a new balance between flexibility and stability in its basic approach to doing business.

The world needs a new balance between a unity of purpose and a diversity of execution that will permit nations to cooperate closely without losing their individuality or sovereignty.

We lack that balance today. Success in the negotiations in which we are engaged will be measured in terms of how well we are able to achieve that balance in the future.

I anticipate working closely and intensively with you to that end, shaping and reshaping the best of our thinking as we proceed in full recognition that the legitimate requirements of each nation must be meshed into a harmonious whole.

In that spirit, President Nixon has asked me to put certain ideas before you.

In so doing, I must necessarily concentrate my remarks today on monetary matters. However, I am deeply conscious that, in approaching this great task of monetary reform, we cannot neglect the needs of economic development. I am also conscious that the success of our development efforts will ultimately rest, in large measure, on our ability to achieve and maintain a monetary and trading environment in which all nations can prosper and profit from the flows of goods, services and investment among us.

The formation of the Committee of Twenty, representing the entire membership of the Fund, properly reflects and symbolizes the fact that we are dealing with issues of deep interest to all members, and in particular that the concerns of developing countries will be fully reflected in discussions of the reform of the monetary system.

As we enter into negotiations in that group, we have before us the useful Report of the Executive Directors, identifying and clarifying some of the basic issues which need to be resolved.

We also look forward to participation by other international organizations, with each contributing where it is most qualified to help. The challenge before us calls for substantial modification of the institutions and practices over the entire range of international economic cooperation.

There have already been stimulating contributions to our thinking from a wide variety of other sources—public and private. I have examined with particular care the statements made over the past few months by other Governors individually and the eight points which emerged from the deliberations of the Finance Ministers of the European Community.

Drawing from this interchange of views, and building upon the Smithsonian Agreement, we can now seek a firm consensus for new monetary arrangements that will serve us all in the decades ahead Indeed, I believe certain principles underlying monetary reform already command widespread support.

First is our mutual interest in encouraging freer trade in goods and services and the flow of capital to the places where it can contribute most to economic growth. We must avoid a breakup of the world into antagonistic blocs We must not seek a refuge from our problems behind walls of protectionism

The pursuit of the common welfare through more open trade is threatened by an ancient and recurring fallacy. Surpluses in payments are too often regarded as a symbol of success and of good management rather than as a measure of the goods and services provided from a nation's output without current return

We must recognize, of course, that freer trade must be reconciled with the need for each country to avoid abrupt change involving serious disruptions of production and employment We must aim to expand productive employment in all countries—and not at one another's expense.

A second fundamental is the need to develop a common code of conduct to protect and strengthen the fabric of a free and open international economic order

Such basic rules as "no competitive devaluation" and "most-favored nation treatment" have served us well, but they and others need to be reaffirmed, supplemented and made applicable to today's conditions Without such rules to guide us, close and fruitful cooperation on a day-to-day basis would not be possible

Third, in shaping these rules we must recognize the need for clear disciplines and standards of behavior to guide the international adjustment process—a crucial gap in the Bretton Woods system Amid the debate about the contributing causes of past imbalances and the responsibility for initiative toward correction, sight has too often been lost of the fact that adjusment is inherently a two-sided process—that for the world as a whole, every surplus is matched by a deficit.

Resistance of surplus countries to loss of their surpluses defeats the objective of monetary order as surely as failure of deficit countries to attack the source of their deficits. Any effort to develop a balanced and equitable monetary system must recognize that simple fact, effective and symmetrical incentives for adjustment are essential to a lasting system.

Fourth, while insisting on the need for adjustment, we can and should leave considerable flexibility to national governments in their choice among adjustment instruments. In a diverse world, equal responsibility and equal opportunity need not mean rigid uniformity in particular practices But they do mean a common commitment to agreed international objectives. The belief is widespread—and we share it—that the exchange rate system must be more flexible. However, important as they are, exchange rates are not the only instrument of adjustment policy available; nor, in specific instances, will they necessarily be the most desirable.

Fifth, our monetary and trading systems are an interrelated complex. As we seek to reform monetary rules, we must at the same time seek to build in incentives for trade liberalization. Certainly, as we look ahead, ways must be found to integrate better the work of the GATT and the IMF. Simultaneously we should insure that there are pressures which move use toward adequate development assistance and away from controls which stifle the free flow of investment.

Finally, and perhaps most fundamental, any stable and well functioning international monetary system must rest upon sound policies to promote domestic growth and price stability in the major countries. These are imperative national goals for my government—and for yours. And no matter how well we design an international system, its prospects for survival will be doubtful without effective discharge of those responsibilities.

Today is not the occasion for presenting a detailed blueprint for monetary reform. However, I do want to supplement these general principles with certain specific and interrelated ideas as to how to embody these principles in a workable international agreement.

These suggestions are designed to provide stability without rigidity. They take as a point of departure that most countries will want to operate within the framework of specified exchange rates. They would encourage these rates to be maintained within specified ranges so long as this is accomplished without distorting the fabric of trade and payments or domestic economic management. We aim to encourage freer flows of trade and capital while minimizing distortions from destabilizing flows of mobile capital. We would strengthen the voice of the international community operating through the IMF

I shall organize these ideas under six headings, recognizing that much work remains to be done to determine the best techniques in each area:

The Exchange Rate Regime
The Reserve Mechanism
The Balance of Payments Adjustment Process
Capital and Other Balance of Payments Controls
Related Negotiations
Institutional Implications

1. The Exchange Rate Regime

We recognize that most countries want to maintain a fixed point of reference for their currencies —in other words, a "central" or "par" value. The corollary is a willingness to maintain and support these values by assuring convertibility of their currencies into other international assets.

A margin for fluctuation for market exchange rates around such central values will need to be provided sufficiently wide to dampen incentives for short-term capital movements and, when changes in central values are desirable, to ease the transition. The Smithsonian Agreement took a major step in that direction. Building on that approach in the context of a symmetrical system, the permissible outer limits of these margins of fluctuation for all currencies—including the dollar—might be set in the same range as now permitted for non-dollar currencies trading against each other.

We also visualize, for example, that countries in the process of forming a monetary union—with the higher degree of political and economic integration that that implies—may want to maintain narrower bands among themselves, and should be allowed to do so. In addition, an individual nation, particularly in the developing world, may wish to seek the agreement of a principal trading partner to maintain a narrower range of exchange rate fluctuation between them.

Provision needs also to be made for countries which decide to float their currencies. However, a country that refrains from setting a central value, particularly beyond a brief transitional period, should be required to observe more stringent standards of behavior in other respects to assure the consistency of its actions with the basic requirements of a cooperative order

2. The Reserve Mechanism

We contemplate that the SDR would increase in importance and become the formal numeraire of the system. To facilitate its role, that instrument should be freed of those encumbrances of reconstitution obligations, designation procedures, and holding limits which would be unnecessary in a reformed system. Changes in the amount of SDR in the system as a whole will be required periodically to meet the aggregate need for reserves.

A "central value system" implies some fluctuation in official reserve holdings of individual countries to meet temporary disturbances in their balance of payments positions In addition, countries should ordinarily remain free to borrow or lend, bilaterally or multilaterally, through the IMF or otherwise.

At the same time, official foreign currency holdings need be neither generally banned nor encouraged. Some countries may find holdings of foreign currencies provide a useful margin of flexibility in reserve management, and fluctuations in such holdings can provide some elasticity for the system as a whole in meeting sudden flows of volatile capital. However, careful study should be given to proposals for exchanging part of existing reserve currency holdings into a special issue of SDR, at the option of the holder.

The suggested provisions for central values and convertibility do not imply restoration of a gold-based system. The rigidities of such a system, subject to the uncertainties of gold production, speculation, and demand for industrial uses, cannot meet the needs of today.

I do not expect governmental holdings of gold to disappear overnight. I do believe orderly procedures are available to facilitate a diminishing role of gold in international monetary affairs in the future.

3. The Balance of Payments Adjustment Process

In a system of convertibility and central values, an effective balance of payments adjustment process is inextricably linked to appropriate criteria for changes in central values and the appropriate level, trend, and distribution of reserves. Agreement on these matters, and on other elements of an effective and timely adjustment process, is essential to make a system both practical and durable.

There is, of course, usually a very close relationship between imbalances in payments and fluctuations in reserve positions. Countries experiencing large deterioration in their reserve positions generally have had to devalue their currencies or take other measures to strengthen their balance of payments. Surplus countries with disproportionate reserve gains have, however, been under much less pressure to revalue their currencies upward or to take other policy actions with a similar balance of payments effect. If the adjustment process is to be more effective and efficient in a reformed system, this asymmetry will need to be corrected.

I believe the most promising approach would be to insure that a surfeit of reserves indicates, and produces pressure for, adjustment on the surplus side as losses of reserves already do for the deficit side Supplementary guides and several technical approaches may be feasible and should be examined Important transitional difficulties will need to be overcome. But, in essence, I believe disproportionate gains or losses in reserves may be the most equitable and effective single indicator we have to guide the adjustment process.

As I have already indicated, a variety of policy responses to affect the balance of payments can be contemplated. An individual country finding its reserves falling disproportionately would be expected to initiate corrective actions For example, small devaluations would be freely permitted such a country. Under appropriate international surveillance, at some point a country would have a prima facie case for a larger devaluation.

While we must frankly face up to limitation on the use of domestic monetary, fiscal, or other internal policies in promoting international adjustments in some circumstances, we should also recognize that the country in deficit might well prefer—and be in a position to apply—stricter internal financial disciplines rather than devalue its currency. Only in exceptional circumstances and for a limited period, should a country be permitted direct restraints and these should be general and nondiscriminatory. Persistent refusal to take fundamental adjustment measures could result in withdrawal or borrowing, SDR allocation, or other privileges.

Conversely, a country permitting its reserves to rise disproportionately could lose its right to demand conversion, unless it undertook at least limited revaluation or other acceptable measures of adjustment. If reserves nonetheless continued to rise and were maintained at those higher levels over an extended period, then more forceful adjustment measures would be indicated.

For a surplus as for a deficit country, a change in the exchange rate need not be the only measure contemplated. Increasing the provision of concessionary aid on an untied basis, reduction of tariffs and other trade barriers, and elimination of obstacles to outward investment could, in specific circumstances at the option of the nation concerned, provided supplementary or alternative means. But, in the absence of a truly effective combination of corrective measures, other countries should ultimately be free to protect their interests by a surcharge on the imports from the chronic surplus country.

For countries moving toward a monetary union, the guidelines might be applied on a collective basis, provided the countries were willing to speak with one voice and to be treated as a unit for purposes of applying the basic rules of the international monetary and trading system.

4. Capital and Other Balance of Payments Controls

It is implicit in what I have said that I believe that the adjustment process should be directed toward encouraging freer trade and open capital markets. If trade controls are permitted temporarily in extreme cases on balance of payments grounds, they should be in the form of surcharges or across-the-board taxes. Controls on capital flows should not be allowed to become a means of maintaining a chronically undervalued currency. No country should be forced to use controls in lieu of other, more basic, adjustment measures.

5. Related Negotiations

We ~~welcome~~ the commitments which major nations have already made to start detailed trade negotiations under the GATT in the coming year. These negotiations, dealing with specific products and specific restraints need not wait on monetary reform, nor need monetary reform await the results of specific trade negotiations.

Those negotiations, and the development of rules of good behavior in the strictly monetary area, need to be supplemented by negotiations to achieve greater equity and uniformity with respect to the use of subsidies, and fiscal or administrative pressures on trade and investment transactions. Improper practices in these areas distort trade and investment relationships as surely as do trade barriers and currency disequilibrium. In some instances, such as the use of tariff surcharges or capital controls for balance of payments purposes, the linkage is so close that the Committee of Twenty must deal with the matter directly. As a supplement to its work, that group can help launch serious efforts in other bodies to harmonize countries' practices with respect to the taxation of international trade and investment, the granting of export credit, and the subsidization of international investment flows.

6. Institutional Implications

As I look to the future, it seems to me that there are several clear-cut institutional requirements of a sensible reform of the monetary and trading system.

Several times today, I have stressed the need for a comprehensive new set of monetary rules. Those rules will need to be placed under guardianship of the IMF, which must be prepared to assume an even more critical role in the world economy.

Given the interrelationships between trade and payments, that role will not be effectively discharged without harmonizing the rules of the IMF and the GATT and achieving a close working relationship.

Finally, we need to recognize that we are inevitably dealing with matters of essential and sensitive national interest to specific countries. International decision-making will not be credible or effective unless it is carried out by representatives who clearly carry a high stature and influence in the councils of their own governments. Our international institutions will need to reflect that reality, so that in the years ahead national governments will be intensively and continuously involved in their deliberations and processes. Without a commitment by national governments to make a new system work in this way, all our other labors may come to naught.

I am fully aware that the United States as well as other countries cannot leap into new monetary and trading arrangements without a transitional period. I can state, however, that after such transitional period the United States would be prepared to undertake an obligation to convert official foreign dollar holdings into other reserve assets as a part of a satisfactory system such as I have suggested—a system assuring effective and equitable operation of the adjustment process. That decision will, of course, need to rest on our reaching a demonstrated capacity during the transitional period to meet the obligation in terms of our reserve and balance of payments position.

We fully recognize that we have not yet reached the strength we need in our external accounts. In the end, there can be no substitute for such strength in providing the underpinning for a stable dollar and a stable monetary system.

An acceptable monetary system requires a willingness on the part of all of us to contribute to the common goal of full international equilibrium. Lacking such equilibrium no system will work. The equilibrium cannot be achieved by any one country acting alone.

We engage in discussions on trade and financial matters with a full realization of the necessity to continue our own efforts on a broad front to restore our balance of payments. I must add, in all candor, that our efforts to improve our position have, in more than one instance, been thwarted by the reluctance of others to give up an unjustified preferential and highly protected market position. Yet, without success in our endeavor, we cannot maintain our desired share in the provision of aid, and reduce our official debt to foreign monetary authorities.

We take considerable pride in our progress toward price stability, improved productivity and more rapid growth during the past year Sustained into the future, as it must be, that record will be the best possible medicine not only for our domestic prosperity but for the effective functioning of the international financial system.

My remarks today reflect the large agenda before us. I have raised difficult, complicated, and controversial issues. I did not shrink from so doing for a simple reason: I know that you, as we, want to move ahead on the great task before us.

Let us see if, in Nairobi next year, we can say that a new balance is in prospect and that the main outlines of a new system are agreed. We owe ourselves and each other that effort.

Appendix B

Communication Received by the Subcommittee in Response to Questions Raised by the Subcommittee on International Finance and Resources

HOWARD S. PIQUET,
Washington, D.C., June 10, 1973.

Hon. HARRY F. BYRD,
Chairman, Subcommittee on International Finance and Resources, Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: In response to your announcement of May 23, 1973, I submit herewith answers to your five questions for incorporation in the record of your proceedings on "The International Financial Crisis." I submit these views, not because of any personal self-interest, but from the point of view of the broad national interest.

I might identify myself by pointing out that for over 22 years (1946–69) I was the Senior Specialist in International Economics of the (then) Legislative Reference Service of the Library of Congress. In that capacity I advised committees and Members of both Houses of Congress on matters pertaining to international trade, the balance of payments, and other international economic matters. Previously, I had been Chief of the Economics Division of the U.S. Tariff Commission for over 6 years.

Yours sincerely,

HOWARD S. PIQUET.

ANSWERS TO QUESTIONS ASKED BY THE SUBCOMMITTEE ON INTERNATIONAL FINANCE AND RESOURCES

1. What immediate steps can the United States and other major trading nations take to strengthen the dollar?

Assurances by Government officials that the dollar will not again be devalued in terms of gold will fall on deaf ears. If a country devalues its currency once, there is a strong chance that it will do it again, and even again.

The external value of a currency and its internal value (purchasing power) tend to equal each other. To strengthen the external value of the dollar it is necessary to preserve its purchasing power *within* the United States. This means that we must apply strong brakes to inflation by—

1. Stabilizing the supply of money and credit.
2. Moving toward a balanced Federal budget.
3. Increasing taxes enough to show our firm determination to put the U.S. Government on an honest pay-as-you-go basis.

As evidence that we mean business, we should invoke a comprehensive *wage-price freeze*, to last at least 90 days without any assurance as to when it will be lifted. It should apply to *all* prices and to *all* wages and salaries, without exception, including Federal Government salaries and built-in escalators, such as the 6.1-percent increase scheduled for Government pensions on August 1, 1973. It should also apply to escalation provisions in private wage contracts (existing as well as future). *It should be a genuine freeze and not a system of controls.*

If the President is unwilling to do this promptly it should be legislated by Congress.

II. What can be done to cut the deficit in the U.S. balance of payments?

As such, the deficit in the U.S. balance of payments is of minor importance. Like a thermometer, which records room temperature, it merely *reflects* existing conditions. We should transfer our attention from the thermometer to a search for the causes of the heat which have made the temperature rise.

Again, inflation (decline in the value of the dollar primarily because of over-issue) is the major cause. Rising prices cause imports to increase and exports to decline.

Also, interest rates must be allowed to rise to a level necessary to bring savings into line with the demand for real capital. When we keep interest rates too low, relative to interest rates abroad, we create an incentive for funds to leave the country.

Because rising prices result in an inflationary psychology, inducing people to rush to buy goods in anticipation of further price increases, even in the absence of a marked increase in the quantity of money, it is necessary to take dramatic steps to convince the public that the government means business in putting a halt to inflation. This reinforces the need for invoking an across-the-board *wage-price freeze.*

III. How can speculation in the international money markets be reduced?

We should abandon the idea of returning to a system of fixed exchange rates. Fixed exchange rates represent one of the worst kinds of price-fixing. They breed speculation of a kind that results in recurrent crises and instability.

Not all speculation is bad. Speculators who take large risks often perform a useful economic function by lifting risks from the shoulders of producers or others performing useful economic services. Speculation in the grain market, for example, through the process of hedging on the part of millers and bakers, transfers the risk from changes in the price of grain to professional risk takers, thereby allowing millers to operate on the basis of costs and prices that will not change during the period of manufacture.

Under a system of freely-fluctuating exchange rates speculators buy and sell currencies in accordance with changes which they think will occur. The net result is a tendency for greater stability in the foreign exchanges than would otherwise obtain because the speculators would pit their judgments against each other.

However, under a system of fixed exchange rates, when it is known that a certain currency is weakening and is probably going to be devalued to a lower level, there is great incentive for speculators to move in the same direction at the same time. Instead of bringing about stability, such activity aggravates instability and uncertainty.

As far as possible, we should strive to achieve a system of truly flexible exchange rates. The present "float" of the dollar is proving to be more workable than most bankers and finance ministers thought possible.

Even if we do insist on returning to a system of fixed exchange rates there should be adequate provision for frequent adjustments in exchange parities. Although this was provided for in the Bretton Woods Agreements of 1944 it was not adequately implemented by the International Monetary Fund.

IV. Should the short-term liabilities of the United States be funded by issuing long-term securities, or by other means?

This does not impress me as being a question of major importance, but I can see some advantages in issuing U.S. Government bonds in exchange for some of the dollars being held by foreigners because it might increase confidence in the strength of the dollar.

It might even be advantageous to issue short-term government securities bearing a low rate of interest and ear-marked for the specific purpose of purchasing U.S. merchandise exports. This might involve the disadvantage of bearing the stigma of "export subsidy" and necessitate discussions with other Contracting Parties to the General Agreement on Tariffs and Trade.

V. Is a new monetary conference, similar to Bretton Woods, needed to reshape the international economic order?

The danger of convening a new monetary conference, similar to the Bretton Woods Conference, is that we might return too quickly to a system of rigid exchange rates, with inadequate provision for flexibility over short periods of time.

The hope would be that the conference would provide for strengthening the IMF, moving it at least one step farther toward being, in fact, a world central bank. It would be a landmark in international monetary history if such a conference were to provide for issuance of an international currency along the lines originally proposed at Bretton Woods for creation of an international currency to be known as either the "bancor" (as proposed by Lord Keynes) or the "unitas" (as proposed by some Americans).

Whether such a conference would succeed in doing this would depend upon careful preliminary work on the part of the major powers in advance of the conference.

HOWARD S. PIQUET.

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