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FOLDER TITLE (2) Balance of Payments [Jan '69 - Feb. 72]

RESTRICTION CODES

- A. Release would violate a Federal statute or Agency Policy.
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Memos and Misc

A

THE WHITE HOUSE

WASHINGTON

Treasury

Negotiations with Canada have not been brought to a successful conclusion; the U.S. will seek appropriate means of reducing imbalances in trade agreements with Canada.

State

Negotiations with Canada are continuing.

A
2/5/72

Draft Transmittal Letter

Dear Mr. Speaker:

There is transmitted herewith a draft bill "To provide for a modification in the par value of the dollar in the International Monetary Fund, and for other purposes." There are also enclosed background and statistical information on this proposed legislation as well as a status report on progress in negotiations on short-term trade problems with Canada, the Common Market, and Japan.

On August 15, 1971, President Nixon announced a "New Economic Policy for the United States" to fight unemployment and inflation at home and to strengthen our international economic position. The program was unique in its comprehensiveness, combining fiscal stimulus to create jobs, and mandatory restraints on prices and wages as well as cuts in spending to halt inflation. In the international field, the President directed a suspension of convertibility of the dollar into reserve assets, and a temporary 10 percent surcharge on dutiable imports to assure that American products would not be at a disadvantage because of unfair exchange rates.

The domestic program is proceeding well. It is now up to business, labor and government to join together to assure continued noninflationary growth.

The legislation being submitted today to authorize a change in the par value of the dollar deals with one aspect of the international program. The suspension of convertibility and the imposition of the

10 percent surcharge were the beginning of a major effort to achieve fair and equitable monetary and trading arrangements. Exchange rates were out of line and trading practices had developed that are not in the interest of fair trade. To remedy these defects, the United States began a series of intensive multilateral and bilateral negotiations aimed at achieving a better balance in international economic relationships. In the international monetary field, a significant breakthrough was achieved on a multilateral realignment of currencies agreed in the Group of Ten at the Smithsonian Institution in Washington on December 18, 1971. The major industrial countries, after intensive negotiations, succeeded in reaching difficult decisions on the appropriate relationship in the values of their currencies. The result of this joint effort is an overall weighted average realignment of approximately 12 percent in the currencies of other industrial countries (excluding Canada). Because it will take some time for the full impact of the adjustment to be felt, the beneficial effects of the realignment should begin to be realized during 1973 in terms of an improvement in the United States balance of payments position. Since the import surcharge was linked to the exchange rate disadvantages suffered by our trade, with the agreement on realignment the President terminated it on December 19, 1971.

As part of this realignment and to facilitate agreement, the United States agreed to propose legislation to Congress to devalue the dollar by 8.57 percent as soon as the progress in negotiations on short-term trade proposals was available for Congressional scrutiny.

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Agreements have now been reached with Japan which will result in a significant increase in United States trade, particularly agricultural trade, with that country. Some results have been achieved in discussions with the Common Market and negotiations are continuing. Moreover, Japan and the Common Market have joined with us in a commitment, subject to Congressional authorization, to negotiate the mutual reduction of nontariff barriers in 1973 and the resolution of more immediate problems within the context of the GATT during 1972. Although no

agreements have been reached with Canada, the United States is proposing to take action to protect its trade interests in areas where an imbalance exists. The enclosed status report on these trade negotiations explains in full the scope of the agreements reached.

Accordingly, legislation is now being submitted which would have the effect of authorizing a modification in the United States dollar par value in the International Monetary Fund. The Bretton Woods Agreements Act prohibits a change in the par value of the dollar without prior Congressional approval and the proposed legislation would grant this approval.

The 8.57 percent change in the par value of the dollar will increase by an equal percentage the value of the United States gold stock and certain other assets. This par value change will also have the consequence of requiring the United States to add 8.57 percent to its dollar subscriptions to the international financial and lending

Rider Y

institutions in order to maintain the value of these subscriptions in terms of gold. The maintenance of value provision works equitably on all members and assures that contributions from all countries maintain their original worth despite changes in relationships among currencies. It also assures that we do not lose out through devaluation in our share of the assets and voting power of these institutions. In addition, certain other gains and costs reflecting foreign exchange obligations will result from the change in par value. The enclosed background material contains full details on all aspects of the increases in assets and liabilities resulting from the change in par value.

The proposed legislation will make a significant contribution to better balanced international economic relationships and to international monetary stability. I urge prompt and favorable consideration of this proposed legislation by the Congress.

AN ACT To provide for a modification in the par value of the dollar in the International Monetary Fund, and for other purposes.

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

SECTION 1. This Act may be cited as "The Act to Modify the Par Value of the Dollar in the International Monetary Fund."

SEC. 2. The Secretary of the Treasury is hereby authorized and directed to take the steps necessary to establish a new par value of the dollar in the International Monetary Fund of one dollar equals 0.618513 gram of fine gold. Such par value when established as provided in this section shall define the relationship of the dollar to gold for the purpose of issuing gold certificates.

SEC. 3. The Secretary of the Treasury is authorized and directed to maintain the value in terms of gold of the holdings of United States dollars of the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the International Development Association and the Asian Development Bank to the extent provided in the Articles of Agreement of such institutions. There is hereby authorized to be appropriated, to remain available until expended, such amounts as may be necessary to provide for such maintenance of value.

SEC. 4. The \$830 million increase in the value of the gold held by the United States (including the gold held as security for gold

certificates) resulting from the change in the par value of the dollar authorized by Section 2 hereof shall be covered into the Treasury as a miscellaneous receipt.

AN ACT To provide for a modification in the par value of the dollar in the International Monetary Fund, and for other purposes.

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

SECTION 1. This Act may be cited as "An Act to Modify the Par Value of the Dollar in the International Monetary Fund."

SEC. 2. The Secretary of the Treasury is hereby authorized and directed to take the steps necessary to establish a new par value of the dollar in the International Monetary Fund of one dollar equals 0.818513 gram of fine gold. Such par value when established as provided in this section shall define the relationship of the dollar to gold for the purpose of issuing gold certificates.

SEC. 3. The Secretary of the Treasury is authorized to maintain the value in terms of gold of the holdings of United States dollars of the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the International Development Association and the Asian Development Bank to the extent provided in the Articles of Agreement of such institutions. To carry out these purposes the Secretary may (1) issue letters of credit to the International Monetary Fund and deposit drawings thereon in the International Monetary Fund as an exchange of assets, and (2) use the resources of the fund established by Section 20 of the Gold Reserve Act of 1934 (31 U.S.C. 822a).

SEC. 4. The increase in the value of the gold held by the United States (including the gold held as security for gold certificates), resulting from the change in the par value of the dollar authorized by Section 2 hereof shall be covered into the fund established by Section 10 of the Gold Reserve Act of 1934 (31 U.S.C. 822a).

2/5/72

Analysis of Draft Gold Bill

Section 1. -- Short Title

This section provides that the bill may be cited as "An Act to Modify the Par Value of the Dollar in the International Monetary Fund.

Section 2. -- Devaluation Authorization

Section 5(b) of the Bretton Woods Agreements Act requires that Congress must give prior approval to any change in the par value of the dollar. Section 2 gives this approval by authorizing and directing the Secretary to take the necessary steps to establish a new par value for the dollar of one dollar equals 0.818513 gram of fine gold. The Secretary can establish this new par value by communicating it to the Fund. Under Article IV, Section 5, of the Fund Articles a change in par value may be made only on the proposal of a member and only after consultation with the Fund. While the Fund has a right to object to in certain circumstances to a proposed change, it may not do so if the proposed change does not exceed 10 percent of the initial par value. Since the proposed change in the U.S. par value is less than 10 percent of the initial U.S. par, the Fund must accept the par value change as provided in Section 2 of the bill.

Section 2 uses the par value of the dollar in the Fund to establish the dollar's relationship to gold for international purposes. It does not establish a gold dollar as defined in Section 15 of the Gold Reserve Act of 1934 (31 U.S.C. 444). The old superseded gold dollar which was relevant before par values were established in the Fund was 15 and 5/21 grams of gold nine tenths fine.

There is one domestic purpose for which it is necessary to define a fixed relationship between the dollar and gold. Section 14(c) of the Gold Reserve Act of 1934 (31 U.S.C. 405b) provides that the amount of gold certificates issued and outstanding shall at no time exceed the value, at the legal standard, of the gold so held against gold certificates. In order to provide a legal standard for the issuance of gold certificates, Section 2 provides that the new par value when established in the International Monetary Fund shall define the relationship of the dollar to gold for the purpose of issuing gold certificates. Thus, gold certificates may be issued on the basis of \$38 per ounce of gold instead of on the basis of the old par value of the dollar of \$35 per ounce of gold.

Section 3 of the bill authorizes the Secretary of the Treasury to maintain the value in terms of gold of the holdings of United States dollars of the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the International Development Association and the Asian Development Bank to the extent provided in the Articles of Agreement of such institutions. Each of the Articles of Agreement establishing the foregoing international financial institutions contains a provision requiring members whose par value is reduced to maintain the value in terms of gold of the institutions' holdings of dollars. The

provisions do differ in detail but basically involve the obligation to pay an amount equal to the reduction in par value on the institutions' holdings of the members' currency. The details of the amount that must be paid in with respect to each institution is contained in Section III of this background paper.

Section 3 also authorizes the Secretary of the Treasury to issue letters of credit to the International Monetary Fund and deposit dollars thereon in the Fund as an exchange of assets. Since the United States receives an asset in the Fund equal to any drawings on the letters of credit no appropriation is required in order to issue these letters of credit.

Section 3 also authorized the use of the resources of the Exchange Stabilization Fund to make maintenance of value payments. This authorization is similar to the authorization contained in ~~Section 10 of the Bretton Woods Agreements Act~~ Section 10 of the Bretton Woods Agreements Act which authorized the ~~Secretary~~ Secretary of the Treasury to utilize the resources of the Exchange Stabilization Fund for repayment of drawings from the International Monetary Fund. It is proposed that the Fund would use its resources to issue letters of credit and make payments thereon in connection with its assumption of the maintenance of value obligations on paid-in and callable subscription to the International Development lending institutions. The details of this proposal are also contained in Section III of this paper.

Section 4 of the bill provides that the increase in value of gold held by the United States, including the gold held as security for gold certificates, resulting from the change in par value authorized by Section 2 of this bill would be covered into the Exchange Stabilization Fund. Section 7 of the Gold Reserve Act of 1934 (31 U.S.C. 408b) provides that in the case of any decrease in the weight of the gold dollar the resulting increase in value of gold would be covered into the Treasury as miscellaneous receipts. This statute is inapplicable for two reasons, one technical and one substantive. One is that there has been no reduction in the weight of the gold dollar but, instead, a creation of a new par value. The substantive reason is that the Exchange Stabilization Fund which was established to deal with the consequences of exchange rate fluctuations is the appropriate place for both handling the increases in the value of assets and the increases in the value of liabilities resulting from a change in the par value of the dollar. In fact, the proceeds from the increase in the value of gold were transferred to the Exchange Stabilization Fund in 1934. As explained in Section III, the Exchange Stabilization Fund would assume the liabilities resulting from maintenance of value in the international development lending institutions and would need the partially offsetting increase in assets in order to meet these

liabilities. In fact, liabilities would exceed assets by \$239 million although it is anticipated that through earnings on investments the Fund would accumulate the resources needed to meet in full all of these liabilities when and if they fall due.

2/5/72

Modification of Par Value of the Dollar -- Increase
in Value of Assets and Liabilities

The currency realignment will increase the value of certain United States international reserve and other assets. Our gold assets and those with a fixed relationship to gold such as the gold tranche in the International Monetary Fund and Special Drawing Rights will increase in value by 8.75 percent -- the amount of the reduction in the par value of the dollar. Foreign exchange assets will increase by the amount of dollar devaluation plus any revaluations of the currency held.

The par value change will also result in an increase of 8.57 percent in the value of our dollar subscriptions to international financial institutions. This increase in the value of dollar subscriptions stem from a requirement that subscriptions be maintained in value in terms of gold. The purpose of this requirement is to assure that the contributions of all members do not lose value in relation to each other despite changes in values of currencies. It also assures that our share in the assets and voting rights in these institutions is not impaired by devaluation of our currency.

Currency realignment will also mean increased dollar costs on repayment of certain foreign currency borrowings.

The increases in value of assets in some cases exceed the increases in related liabilities and in others assets and liabilities almost offset each other. In most cases the increases in value of assets and liabilities are the direct result of the privileges and obligations of membership in international financial institutions. [No appropriations will be required as a consequence of currency realignment.]

With respect to liquid assets, there is an increase of \$828 million in the value of United States gold holdings, an increase of \$155 million in United States holdings of Special Drawing Rights; an increase of \$344 million in the United States gold tranche in the International Monetary Fund; and, finally, an increase of \$27 million in the value of United States foreign exchange holdings. These increments in value total \$1.1 billion.

The calculated increment on the U.S. gold stock of \$828 million is based on the assumption that the IMF will, prior to the change of the dollar parity, repurchase or withdraw from the Treasury amounts of gold on which it has a claim on the U.S. These claims amount to \$544 million. We have proposed that the IMF do so. There are no financial benefits to either party whether these reversals take place prior to or following the U.S. parity change. The Treasury believes, however, that a clearer presentation of the effects of the parity change on the U.S. gold stock may be made if these transactions are now reversed and, in any event, there no longer appears to be any useful purpose served by their continuation.

The increments in value of assets must be viewed against increases in value of three classes of liabilities; those resulting from (1) participation in the International Monetary Fund, (2) participation in the international development lending institutions, and (3) increased costs of repaying certain foreign currency borrowing.

International Monetary Fund

A. Additional letters of credit will be issued in the following amounts representing the 8.57% increase in:

(i) amount of U.S. dollar subscription (3/4 of quota)	431	
(ii) outstanding drawings by U.S.	<u>94</u>	525

B. The value of our subscription will increase by: 575
(The net increase of \$50 million over the additional letters of credit issued represents the portion of our quota paid in gold and undrawn.)

The consequences of our relationships with the International Monetary Fund will result in a \$50 million increase in our assets. First, because the dollar portion of \$5025 million of our Fund subscription is denominated in dollars of a fixed weight and fineness of gold, this subscription will increase in current dollar value by 8.57 percent or \$431 million. Against the increased value of this asset, the United States will incur an equal liability derived from the requirement of maintenance of value of the dollar portion of our subscription in terms of gold. In order to effect this exchange of assets, the Treasury will issue a letter of credit to the Fund in the amount of \$431 million.

There will also be an 8.57 percent increase equal to \$144 million in the United States gold tranche of \$1675 million in the International Monetary Fund. Because this asset represents gold paid to the Fund in partial fulfillment of U.S. subscription obligations, there is no offsetting maintenance of value obligation. However, the increase in value of this asset will be partially offset by the requirement of maintaining the value in terms of gold of a United States drawing from the Fund of \$1,105 million, resulting in an increased obligation of \$94 million. A letter of credit would be issued to the Fund in this amount as part of the normal process of issuing such letters of credit in connection with U.S. drawings.

Thus, in the Fund, as a result of a change in the par value of the dollar the total increase in assets equals \$575 million and the increase in liabilities amounts to \$525 million. The \$525 million in letters of credit that are to be issued to the Fund will not result in budgetary expenditures even when drawn upon since transactions with the Fund represent exchanges of assets that are outside the budget. [Moreover, since only exchanges of assets are involved no appropriation is required.] [However, in order to issue these letters of credit an appropriation of approximately \$525 million will be requested. The amount of appropriation to be requested can only be approximate since the exact amount of the Fund's holdings of dollars will vary by small amounts from day to day and the exact amount of the letters of credit to be issued to the Fund can only be determined as the day when the United States par value is formally modified.]

International Development Lending Institutions

The maintenance of value obligations incurred for the multilateral development lending institutions are as follows and total approximately:

1,069

	<u>Callable</u>	<u>To be paid in</u>
IBRD	509	51
IDA	-	122
IDB OC	146	25
FSO	-	199
ADB	9	9
	<u>663</u>	<u>406</u>

A. Callable Capital

In the World Bank, the Inter-American Development Bank (IDB) and the Asian Development Bank (ADB) -- our subscription of callable or "guarantee" capital is denominated in dollars of a fixed weight and fineness and the change in the par value of the dollar will mean an increase of 8.57 percent in our callable capital obligation. The U.S. callable capital in the World Bank is \$5,715 million, in the IDB it is \$1700 million, and in the ADB it is \$100 million. The total increase in the current dollar amount of these callable capital subscriptions, plus those authorized by Congress but not yet subscribed, amounts to \$663 million.

This callable capital is a highly contingent liability. It has never been called in the past and it is highly unlikely that these subscriptions will be called in the future considering the size of already existing callable capital and the reserves which the international banks have built up. [Nevertheless, funds must be available

to meet these obligations if they are ever called and an appropriation will be requested. This appropriation will back up borrowing in private capital markets but will not result in budgetary expenditures unless it is called.]

B. Paid-in Subscriptions

There is a substantial maintenance of value obligation with respect to the paid-in subscriptions to the development lending institutions -- the multilateral banks mentioned above plus the International Development Association. As a maximum this will total \$343 million on both subscriptions previously authorized and those now in the authorization process. The total obligation can only be definitively determined on the basis of dollar holdings as of the day on which the par value is changed. In addition, the IDB is studying the question of maintenance of value and particularly its application to the pending \$1 billion Fund for Special Operations subscription.

The maintenance of value obligation would be paid in letters of credit that would be drawn down only after a period of several years as the development lending institutions need the funds for disbursements. No disbursements on these funds is anticipated in fiscal years 1972 or 1973 and it is expected that draw downs would be fairly evenly spread over fiscal years 1974-1976. In addition, in the World Bank and in the Fund for Special Operations of the Inter-American Development Bank there are loans outstanding which, when repaid over the next 5 to 10 years, would result in a maintenance of value obligation of \$63 million

Foreign Currency Bonds and SDRs

Exchange guarantees on foreign currency-denominated securities estimated at:	\$172	
Offset from gains on foreign exchange of	<u>27</u>	\$145

Also the value of both SDR held by and allocated to the ESF will be written up. Since the U.S. is a net user of SDR there will be a net book loss, realizable only on dissolution of the SDR system, of: 42

The United States will incur a liability of \$172 million on its foreign currency denominated securities. In other words, the cost of buying foreign currencies to repay these securities will increase by \$172 million over what it would have been prior to the realignment. The Exchange Stabilization Fund, as the organ of the Treasury which has responsibility for exchange stabilization operations, assumes the foreign exchange risk of United States borrowing in foreign currencies. Thus, the Fund would assume the liability of purchasing the additional foreign currencies to pay these obligations. This obligation will be partially offset by the increase of \$27 million in the value of the foreign exchange holdings of the Fund. In addition, the Fund would incur an increased contingent liability of \$194 million on allocations to date of Special Drawing Rights to the United States but only in the remote event of liquidation of the SDR account in the IMF. This liability is offset by an increase, noted above, of \$155 million in the value of current United States holding of SDRs. No appropriations are necessary with respect to these transactions and no budgetary expenditures will result.

Revaluation of Assets and Obligations
 Arising from Devaluation of Dollar
 With Respect to Gold
 (In millions of \$)

Gold revaluation results in increment of 8.57% of U.S. gold stock \$828

Maintenance of Value Obligations (MOVs) in International
 Financial Institutions

The value of our subscriptions and capital stock, in accordance with the Articles of Agreement to which we have subscribed, must be revalued in terms of dollars to maintain their initial gold value. This entails the acceptance of liabilities with varying degrees of contingency. These are:

International Monetary Fund

A. Additional letters of credit will be issued in the following amounts representing the 8.57% increase in:

(i) amount of U.S. dollar subscription (3/4 of quota)	431	
(ii) outstanding drawings by U. S.	94	525

B. The value of our subscription will increase by: 575

(The net increase of \$50 million over the additional letters of credit issued represents the portion of our quota paid in gold and undrawn.)

The IMF transaction represents an exchange of assets and is not a budgetary expense.

International Banks

The maintenance of value obligations incurred for the development institutions may be broken down as follows and total approximately: 1,069

	To be paid in	Callable
IBRD	51	509
IDA	122	-
IDB OC	25	146
FSO	199	-
ADB	9	9
	406	663

The paid in amount reflects that portion of our subscription already paid in or for which letters of credit are outstanding, plus amounts to be paid in under subscriptions to which we are committed and are now in the authorization process. Budgetary expenditures will take place only as payments are made under letters of credit and will be spread over a number of years (see below).

The callable capital represents a highly contingent liability. The likelihood of it being called and becoming an expenditure at any time is remote.

The dollar value of our subscription and capital stock in these institutions will increase commensurately with our MOV obligations.

Estimated Budgetary Impact

IMF: None

International Banks:

Paid in Capital

FY1972 and 1973 - None

FY1974 through FY 1976 - representing MOV on capital now paid in and held by institutions, or to be paid in under authorizations in process

\$343

FY1977 to FY1986 - representing MOV on paid in capital now out on loan by institutions for which letters of credit will be issued and payment made as loans are repaid and new disbursements made:

63

Callable Capital: None expected.

Note: The precise amount of maintenance of value obligations will have to be determined on the date the parity change becomes effective. The above figures are therefore subject to moderate change. Also, the IDB has under consideration the relationship of MOV to pending subscriptions to the FSO.

2/5/72

Exchange Stabilization Fund (ESF)

In addition to MOVs in the international financial institutions certain liabilities will be incurred by the ESF.

These arise from exchange guarantees on foreign currency denominated securities estimated at: \$172

Against which there is an offset from gains on foreign exchange of 27 \$145

Also the value of both SDR held by and allocated to the ESF will be written up. Since the U. S. is a net user of SDR there will be a net book loss, realizable only on dissolution of the SDR system, of: 42

The exchange transactions of the ESF are not budgetary expenditures.

2/5/72

B

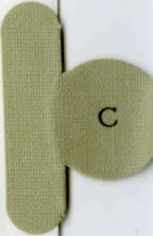
MEMORANDUM

THE WHITE HOUSE

WASHINGTON

Although no agreements have been reached with Canada, we will continue our negotiations with that country with a view toward prompt settlement of outstanding trade issues,

these are untrading imbalances



Background Material

U.S. Treasury Department
February 1972

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Proposed Modification of Par Value of Dollar
Background Material

I. Introduction

The Administration has proposed legislation authorizing and directing the Secretary of the Treasury to take the steps necessary to modify the par value of the dollar in the International Monetary Fund by 8.57 percent to \$38.00 per fine Troy ounce as agreed provisionally in the Smithsonian Agreement of the Group of Ten on December 18, 1971. (This modification is equivalent to a change of approximately 7.89 percent in the par value of the dollar in terms of grams of gold per dollar, from .888671 grams to .818513 grams.) Legislation has also been proposed to authorize the United States Government to fulfill maintenance of value obligations to international financial institutions, and to effect increases in the dollar value of the U.S. Government's subscriptions in those institutions and otherwise. These changes are a necessary consequence of the proposed modification in the par value of the dollar. The text and a technical explanation of the proposed legislation appear in Annexes 1 and 2.

This report describes the Smithsonian Agreement and the status of negotiations on related issues, and the increases in U.S. assets and liabilities which will result from the change in the dollar's par value. It also discusses briefly international monetary developments in 1971 and points out several issues for discussion in the area of monetary reform over the longer-term.

II. The Smithsonian Agreement and Related Negotiations on Trade and Defense

The Smithsonian Agreement of the Group of Ten followed a period of international monetary adjustment, involving a generalized system of floating (but not freely floating) exchange rates, during 1971. It consisted of an interrelated series of measures designed to help resolve balance of payments problems to restore more settled conditions to the exchange markets, and to provide a framework from which longer term reform could evolve. It was also agreed that discussions should be promptly undertaken measures for reform of the monetary system over the longer term, and several areas of reform to which attention should be directed were identified.^{1/}

- a new pattern of basic exchange rate relationships among the countries concerned;
- provisional arrangements to permit up to 2-1/4 percent margins of exchange rate fluctuation above and below the new exchange rates;
- recognition that trade arrangements are a relevant factor in assuring lasting equilibrium in the international economy;
- agreement by the United States to propose to the Congress a suitable means for devaluing the dollar in terms of gold as soon as a related set of short-term trade expansion measures is available for Congressional scrutiny; and
- agreement by the United States to immediately suppress the 10 percent import surcharge and related provisions of the Job Development Credit.

^{1/} The text of the Communique issued at the conclusion of the Smithsonian Agreement appears at Annex 3.

A. Exchange Rate Realignment

During the week following the Agreement, the Group of Ten participants individually announced the exchange rates and exchange rate policies to which they had agreed. The Government of Canada announced that it would not immediately set a new fixed rate for the Canadian dollar, but instead would maintain temporarily a floating exchange rate and would permit fundamental market forces to establish the exchange rate without intervention except as required to maintain orderly conditions. The changes and the new pattern of exchange rates for the U.S. dollar, are summarized in the table below. Annex 4 provides several alternative calculations of the average appreciation of foreign currencies vis a vis the dollar.

Table 1

Country	Type of Rate	Wider Margins	Percent Change from IMF Parity of May 1, 1971	Percent Appreciation Against U.S. Dollar	Currency Unit Per Dollar	
			3.6/	5.6/	Old	New
Belgium	Central ^{1/}	Yes	+2.76	+11.57	50.00BF	44.8BF
Canada	Float	*	*	*	*	*
France	Par	Yes	0.0	+8.57	5.55FF	5.12FF
Germany	Central	Yes	+4.61	+13.57	3.66DM	3.22DM
Italy	Central	Yes	-1.00	+7.48	625L	581.5L
Japan	Central	Yes	+7.66	+16.88	360Y	308Y
Netherlands	Central	Yes	+2.76	+11.57	3.62G	3.24G
Norway	Central	Yes	-1.00	+7.48	5.17K	4.81K
Switzerland	Par ^{2/}	Yes	+4.89	+13.88	4.37SF	3.84SF
United Kingdom	Par	Yes	0.00	+8.57	.42L	.38L
United States	Par	*	-7.89 ^{4/}	0.00	*	*

* Not applicable.

^{1/} "Central rates" have been established in some cases, in lieu of new par values as the effective rates about which currency values will be maintained pending formal par value changes.

^{2/} Switzerland is not a member of the IMF.

^{3/} Expressed as percent change in grams of gold per currency unit.

^{4/} If approved by the Congress.

^{5/} Expressed as percent change in U.S. cents per foreign currency unit.

^{6/} All changes are computed on basis of par values of April 30, 1971.

The Group of Ten participants recognized that their agreement would trigger decisions on exchange rates by most other countries and indicated their view that it was particularly important that no country seek improper competitive advantage through its exchange rate policies. Changes in parities could be justified only on the basis of an objective appraisal which established a position of disequilibrium. As of January 20, the IMF had received indications from all but five of its members of their decisions on their exchange rate systems. All proposed exchange rate changes have been examined by the IMF in accordance with the principle outlined above and in accordance with the Fund's own Articles of Agreement, and the Fund has taken such formal action as was appropriate in each case to enable the rates concerned to be implemented.^{1/}

^{1/} Changes and new rate patterns for each member country are listed in Annex 5.

B.

The Smithsonian Agreement noted that urgent negotiations were under way between the United States and the Commission of the European Community, Japan and Canada "to resolve pending short-term issues at the earliest possible date" . . . and "to establish an appropriate agenda for considering more basic issues in a framework of mutual cooperation in the course of 1972 and beyond." The result of these talks has been a series of practical steps to remove trade obstacles and an agreement to work toward improvement in the framework for the conduct of international trade.

These negotiations have addressed themselves both to major trade issues, including issues which the United States considers of critical importance, and to a series of intrinsically less important issues that have become an irritant in trade relationships. These issues have by no means been fully resolved, but a beginning has been made. The Japanese Government has announced a series of trade liberalization steps of immediate value to the United States. The European Communities have also agreed to some limited measures. Both trading partners have agreed to join with the United States in efforts during 1972 within GATT toward the removal of some trade barriers leading to comprehensive trade negotiations in 1973. In short, a broad understanding has been reached for future negotiations in a time frame that takes into account the fact that international trade is undergoing an adjustment

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process initiated by recent comprehensive and substantial currency realignments. In the case of Canada, the parallel short-term negotiations, dealing mainly with certain bilateral agreements and understandings that no longer fit the facts of our economic relationship, have not been brought to a successful conclusion. A continuing absence of such agreement will necessarily require a review of other approaches toward achieving the necessary balance and equity in our trading relationship.

The United States for its part intends to focus these future negotiations on issues such as: non-tariff barriers; barriers to trade in agricultural products; the erosion of the "most-favored-nation" principle through the proliferation of preferential trading arrangements; the trade effects of the enlargement of the European Communities; the continued maintenance by some developed countries of quantitative restrictions not sanctioned by the GATT; and the need for new or modified institutions for the conduct of trade.

The immediate reduction of some tariff and non-tariff barriers demonstrates the commitment of these countries to minimize economic friction and expand trade. These unilateral commitments do not completely fulfill U.S. desires, but together with the commitment to negotiate reductions in trade barriers over the longer term they do constitute recognition that changes must be made in the trading system.

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Short-Term Measures

The greatest progress toward liberalization in the immediate future with tangible benefits for the United States will be made by Japan. For several years there has been a large and growing deficit in our trade with Japan, partially as a result of the now inappropriate trade barriers the Japanese continue to maintain. While many important restrictions remain, the actions, supplementing the yen appreciation of 16.8 percent, represent a useful contribution towards bringing the United States-Japan trade imbalance into reasonable adjustment. They are also a welcome sign that Japan wishes to participate more fully in international efforts to reduce barriers. Japan will [unilaterally] alter a number of tariff and non-tariff barriers over a broad spectrum of trade.

With respect to agricultural products, Japan will increase the quantity of imports permitted under quota of fresh oranges, orange and grapefruit juice, quality beef, and several other products. The duty on soybeans will be eliminated and the duties on Turkey meat, tallow, soybean meal, vegetable oils and some 10 other products will be reduced. A duty-free tariff quota will be established for feeder cattle. The effective date for these changes will be April 1, 1972, the beginning of the Japanese fiscal year.

On industrial products, Japan will reduce tariffs on April 1, 1972 on automobiles, computers, computer peripheral equipment, machine tools, color film, X-ray film and some 30 other industrial products. The internal excise tax on large

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and medium sized automobiles will be significantly reduced. As of February 1, Japan is removing import quota restrictions on light aircraft and light aircraft parts, computer peripheral equipment (not including memory or terminal devices), light and heavy oil, and sulfur. Technical consultations will be held later this year when a U.S. team is to visit Japan to discuss liberalization of restrictions on imports of computers and computer equipment. Japan will in addition grant more liberal treatment to the establishment by U.S. firms of wholly-owned subsidiary sales and service outlets in Japan. Some actions are also being taken to reduce other Japanese non-tariff barriers.

Part of Japan's hesitance to further liberalize its international trading practices in response to U.S. desires is the result of the continuing restrictions on Japanese goods entering the European Common Market. Therefore, the agreement by both Japan and the Common Market countries to multilateral negotiations is of key importance to reaching the President's objective of a reduction in trade barriers.

The European Communities have agreed to add 1.5 million metric tons to their normal carry-over stocks of wheat as part of an effort with the U.S. to prevent a depression in world markets due to surplus production in '71-'72. The EC will also make an effort to stock grains in the next crop year and will endeavor to operate its export payments system for grains for this year so as not to cause trade diversions in favor of the EC. The EC has further declared that the

harmonization of its manufactured tobacco tax system will be neutral in its effects on trade, and has agreed to consult with the United States at the appropriate time. The Communities have announced that for the coming two years the 15 percent common external tariff (CET) on oranges from non-preferential suppliers will be reduced to 5 percent during part of the U.S. export season (June 1 - September 30). The CET on non-preferential imports of grapefruit will be reduced from 6 percent to 4 percent for the coming two years. The EC has agreed to immediate discussions in the GATT of the accession treaty between the EC and the four applicant states. Formal tariff renegotiations under the relevant procedures of the GATT will begin immediately after ratification by the parties concerned, which is envisaged for December 31, 1972, at the latest.

The nominal short-term effects of the agreements with the European Communities reflect the reluctance of the Community, despite its strong external position, to accept fully the responsibilities for leadership in external liberalization, at least during a period when it is preoccupied with internal expansion. The cumbersome decision-making machinery within the EC is itself a handicap. Further negotiations on the key issues for the longer term, such as appropriate means of reducing the impact on third countries of the highly protectionist Common Agricultural Policy, will be long and difficult. Nevertheless, we believe the EC has shown a new political will to join with us in an attempt to find mutually

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satisfactory solutions both bilaterally and within the GATT to outstanding problems. As part of this agreement the U.S. and the EC have both accepted the principle of reciprocity and mutual advantage as the basis for solving pending issues.

For its part, the United States has announced the U.S. domestic farm program will be administered so as to carry over 10 percent of the production of wheat and feed grains from '71-'72. For the coming year, 20 million acres will be removed from corn production and 6 million from wheat production. The U.S. has agreed to participate in bilateral anti-dumping discussions with the Japanese at the technical level. The United States has agreed to consider steps necessary for the elimination of the "Final List" (Section 402(a) of the Tariff Act) and "American Selling Price" methods of customs valuation, both of these actions to be contingent upon fulfillment of reciprocal commitments previously made by other countries. The United States may moderate its inspection measures of Japanese canned tuna as determined by the effectiveness of Japanese measures in meeting U.S. laws and regulations concerning decomposed canned tuna.

Discussions were held with Canada on the issues of the Automotive Agreement, defense production sharing, and tourist allowances, as current arrangements in these areas are no longer justified by the economic relations which exist between our two countries. While it was not possible to reach agreement in these areas, the U.S. will continue efforts to achieve

LIMITED OFFICIAL USE

balanced and equitable arrangements with Canada. It is possible that such new arrangements will prove unobtainable. Thus, the U.S. is reviewing other approaches which would achieve a U.S.-Canadian trade relationship more in keeping with the current payments balances of both countries.

Conclusion

These negotiations have by no means settled the major issues outstanding in the field of international trade. Nevertheless a good beginning has been made. Japan in particular has, by its actions in the trade field, supplemented the effects of the monetary realignment in contributing to an improvement in the United States balance of payments. Certainly, there is greater recognition today of both the need for further progress and the dangers implicit in failure to achieve that progress. We are encouraged that major trading nations have agreed to join with us in seeking future steps to revitalize the world trading system.

Side X

The United States has been concerned that certain trading arrangements with Canada no longer fairly reflect the economic circumstances surrounding economic relationships between our two countries. While it has not yet been possible to achieve appropriate balance in these arrangements, the United States will seek appropriate means of reducing imbalances in trade agreements with that country.

C. Defense Financing Arrangements

The President's announcement of August 15, 1971, included the statement:

"Now that other nations are economically strong, the time has come for them to bear their fair share of the burden of defending freedom around the world."

The implication was that the persistent U.S. payments problems were caused partly by the high level of U.S. defense expenditures abroad. If some of those defense burdens could be borne by other countries, the shift required in other U.S. accounts, including trade, would be smaller.

Some reduction of defense expenditures overseas could be expected as we withdrew from Vietnam. However, these savings could be dissipated by rising prices and the increased cost of foreign currencies. It seemed desirable that Europe and Japan be asked to carry a larger share of the defense burden, which would mean some increase in their defense responsibilities, greater contributions to the cost of maintaining U.S. forces in their areas, or a combination of both.

The U.S. wants to maintain fully the strength of the alliance. Unilateral reductions in U.S. forces might be followed by reductions in the forces of our allies rather

than a compensating increase. Reductions should be the subject of negotiation with Warsaw Pact powers, not the result of unilateral action. The U.S. view was that forces of our European allies needed to be strengthened. Thus, a number of conflicting objectives had to be reconciled.

The result so far has been the signing of a new agreement for partially offsetting the cost of U.S. forces in Germany and announcement by our European allies that they intend to increase expenditures on their own defense forces by more than \$1 billion in 1972. These agreements are steps toward maintaining the strength of our common defense with a less proportionate burden on the U.S. However, the increased expenditure by our European allies on their own defense forces, except as it may involve procurement from the U.S., will not directly reduce our payments deficit. Nor will the share of European gross national products spent on defense be larger than in previous years.

Consequently, this area will need further examination and action in the year ahead when the adjustment needed in the international payments balance will have to be achieved almost entirely in the trade sector of the balance of payments.

III. Modification of Par Value of Dollar

This section reviews the considerations that led the United States negotiators to agree to propose legislation to the Congress to change the par value of the dollar. It also sets forth information on the changes in the dollar value of certain assets and obligations that result, under existing international agreements, when the par value of the dollar is increased in terms of gold.

A. Need for Change in the United States Official Gold Price as Part of Exchange Rate Realignment

The United States entered the negotiations that followed the August 15 announcement of the New Economic Policy with a strong view that it would be preferable to achieve a realignment of exchange rates without changing the official price of gold in terms of dollars.

This view was based upon several considerations:

- (a) A change in the official monetary price of gold did not have any economic significance in itself. The exchange rate of the dollar in terms of other currencies was the substantive economic question, and the official dollar price of gold was relevant only if it affected those exchange rate relationships.
- (b) If other countries also raised their official gold prices along with the United States, then no realignment of exchange rates would occur. Such a uniform change in par values would therefore

accomplish nothing useful and might stimulate a rise in prices in the private market for gold. This would attract more funds into gold hoarding and speculation in anticipation of still further changes in the official prices for gold sometime in the future. Such speculative gold hoarding could draw funds from any country, weakening all currencies in comparison to gold. In order to avoid a general rise in official gold prices, therefore, it was necessary to obtain prior agreement on a pattern of exchange rates for major currencies. This was instrumental in getting the agreement.

- (c) Furthermore, the Executive Branch of the United States believes that the monetary role of gold should continue to diminish. With the advent of Special Drawing Rights in the Fund, the world now has a basic reserve-asset which is not held in private hands and hence is free from the private hoarding and speculation which has arisen in connection with gold. Moreover, in contrast to gold, the volume of Special Drawing Rights can be expanded when needed without changing the official price of SDRs, and there is no need to raise the

official gold price merely to increase world reserves. Hence it is sensible to de-emphasize gold, and ~~gradually replace its monetary functions~~ with Special Drawing Rights.

On the other hand, there was a political issue involved in the gold price question. In some quarters in Europe it was strongly held that the United States must "participate" in the realignment by changing its official gold price. Without such participation, the exchange adjustment that appeared negotiable was unsatisfactory. With it, a substantial realignment appeared possible.

There was one other aspect of realignment that gave rise to resistance to an adjustment in exchange rates solely by appreciation of foreign currencies. This was the fact that a country which appreciates its currency has to reduce the value of its reserves and other foreign assets measured in terms of its own currency.

In September, at the Annual Meeting of the Fund in Washington, the United States proposed elimination of the temporary import surcharge if tangible progress could be made on trade liberalization and if foreign governments would allow fundamental market forces freely to determine the exchange rates of their currencies for a transitional period. This suggestion was not accepted -- underlining the strength of foreign views that the U.S. should

"participate" and indicating more strongly than ever the deep-seated resistance of many governments to truly floating rates themselves.

As time passed after August 15, business pressures for a return to stable rates strengthened both here and abroad. In addition, European economic growth was widely expected to slow somewhat, for cyclical reasons unrelated to the international monetary situation. If this expectation were correct, further appreciations would become even more difficult as foreign business conditions slackened. There was even some danger that the quite significant appreciations already produced by the period of temporary floating would be eroded.

Thus an early settlement of the realignment question appeared in late November and early December to be advantageous, if the realignment offered reasonable prospects for a substantial improvement in the U.S. position, and if it were accompanied by such short-term trade expansion measures -- and agreement to negotiate over the longer term on trade liberalization -- as could reasonably be negotiated to help ensure the success of the realignment.

Because of these factors and the firm foreign attitude with respect to "participation" by the United States, the United States negotiators agreed in December to a change in the official gold price, to facilitate and expedite an agreed realign-

ment of exchange rates. However, it became clear that foreign countries were even more basically concerned with their exchange rates than with their demand that the United States participate. In effect, they did not wish the dollar to be devalued too much, because this would affect their export and other internationally competitive industries. This placed a limit to the extent to which they would agree to a change in our gold price without themselves matching and hence neutralizing such a change.

In terms of dollars, the proposed rise in the United States official gold price amounts to 8.57 percent. In terms of some other major currencies, the official price of gold will be lower than before, because of an appreciation of these currencies in terms of gold. On a weighted average calculation, the price of gold in terms of the currencies of the Group of Ten (excluding Canada) will rise only by about 1- $\frac{1}{2}$ percent.^{1/}

It is the view of the Executive Branch that this agreed change in the official gold price should not be allowed to disturb the trend toward de-emphasis of gold in the international monetary system. It will be one major task of those examining the long-term improvement in the international monetary system to counter any tendency toward a relapse. Gold is becoming more

^{1/} Weighted by official gold holdings on November 30, 1971.

useful as a non-monetary commodity and less satisfactory as
a monetary reserve. All nations should recognize this fact,
and adapt the monetary system accordingly.

D

MEMORANDUM

NATIONAL SECURITY COUNCIL

1934
T.H. 11/16
URGENT ACTION

February 4, 1972

MEMORANDUM FOR: DR. KISSINGER ✓
FROM: HELMUT SONNENFELDT%
ROBERT HORMATS DH
SUBJECT: Tough Treasury Position on Canada --
A Pointless Crisis

Treasury has rejected the latest Canadian offer on trade. It feels that the "trade package" is inadequate and has threatened to take a public hard line against Canada when we submit the "gold bill" to the Congress in the middle of next week. And, Treasury has raised the possibility of suspending the U.S. - Canadian Auto Agreement and the Defense Production Sharing Arrangement with Canada. Canada, however, believes that it has gone as far as it can go and that to give any more would lead the Government to fall in the next election. The Canadians feel that they are being asked to commit political suicide by Treasury for the sake of concessions that could scarcely make that much difference to the U.S. This memo is to alert you to the problem and to the urgent need to moderate Connally before an unnecessary foreign policy crisis with adverse domestic implications arises.

The major issues are:

Unclear
-- Canada wants to declare "inoperative" the first two safeguards of the Canadian-American Auto Agreement by legally eliminating them through an order-in-council (which the Ministers feel would involve unacceptable domestic political consequences). Treasury wants formal elimination. The issue here is more political than economic, since these two safeguards have not actually been adhered to or affected our trade in the last several years.

-- With regard to the third safeguard, which limits the duty free import of autos into Canada to manufacturers alone, i. e., no private Canadian citizens can import duty free automobiles from the U.S. Canada has indicated that for both political and economic reasons it cannot give any concessions on this, although it has proposed the establishment of a committee to examine this problem. Treasury's position is that individual Canadians should be able to import automobiles duty free since Americans can now import automobiles duty free from Canada (although because Canadian prices are higher no Americans have done so).

In addition, Canada will remove the ten percent ("buy Canadian") differential on defense purchases under the Defense Production Sharing Arrangement, and will allow duty free entry for prime contracts valued at \$150,000 or more as opposed to the current \$250,000. Treasury's position is that because most contracts are not "prime", but "subcontracts", this is of little help to us. (Treasury is probably right.)

-- Canada has also offered to increase tourist allowances, which is calculated to increase U.S. earnings by about \$40 million per year. And Canada has indicated that it would eliminate its present five percent duty on citrus juices, although it admits this is unlikely to affect the level of U.S. exports to Canada.

-- Canada also points out that the U.S. has done nothing which has the appearance of a reciprocal concession.

Although admittedly Canada has made limited concessions to the U.S., it would serve little good at this time to publicly denounce Canada or to threaten to revoke the Auto Agreement or the Defense Production Sharing Arrangement. Indeed, it might encourage members of the Congress to tack on punitive amendments to the gold bill, and strengthen protectionist pressures.

The foreign policy consequences would be that anti-Americanism will become the major Canadian election issue with the parties outbidding each other. In addition, the Canadians are not incapable of economic retaliation with adverse effects on interests and communities in this country which should be of some concern to the President. Needless to say, any notion of a Presidential trip in these circumstances would be absurd and, as has been previously pointed out to you, the cancellation of the trip will merely add to the momentum of deteriorating relations. (Incidentally, there is evidence that Treasury, either on its own or with White House blessing, has already threatened the Canadians with cancellation of the trip as part of the economic bargaining.) Instead, the trip ought to be used as a means to keep the negotiations open until the Canadian election, after which Trudeau will be able to make concessions which now would kill him politically.

RECOMMENDATION:

It is essential that you talk to Secretary Connally on this matter before Treasury freezes the position and goes public.

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

INFORMATION

May 5, 1971

CONFIDENTIAL

THE PRESIDENT HAS SEEN... *A*

MEMORANDUM FOR: THE PRESIDENT

FROM: HENRY A. KISSINGER *H. Kissinger*

SUBJECT: International Monetary Developments

Germany, Switzerland, The Netherlands, Belgium and Austria today suspended the dollar operations of their central banks. They did so because of a tremendous inflow of dollars which reached \$1 billion in Germany yesterday. It now appears that the dollar operation will continue suspended at least through this weekend.

The huge capital flows are due mainly to speculation that the German mark, and perhaps other European currencies, will be raised in value against the dollar. The German Economic Minister and five influential German research institutes have advocated such a move to help fight inflation in Germany. Their public comments are in fact the dominant cause of the immediate problem.

The German Cabinet will meet on Friday to decide the course of action. Their most likely decision is to let the mark float freely for a temporary period, perhaps via the technical step of widening the margins around the present exchange rate within which the currency can fluctuate. This is the preferred course of most German economic officials, but it faces strong opposition from France which wants no exchange rate movements within the Common Market. The theoretical possible alternative of a joint move by the Common Market countries is also firmly opposed by France.

The Germans could try to block dollar inflows directly rather than let the exchange rate move, as they have done in earlier speculative situations. They could also simply make a firm declaration that no exchange rate change was planned, a move which has succeeded at least temporarily in past crises.

The smaller countries will undoubtedly await a German decision and take their cue from it. Most of them would, however, probably have to emulate a German float or else they would then be swamped with capital themselves.

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The situation could develop important political overtones in Europe. Germany and France take opposite views on how European monetary integration should proceed, on whether individual EC countries should be permitted to change their exchange rates, and perhaps even on whether we should be pressured to at least contribute to whatever action is needed to resolve the crisis. The French might even seek to use their veto over British entry to get German acquiescence on French monetary views.

However, no policy decisions are required on our part at this time. The sharp disparity between U.S. and European interest rates has been a major cause of the large short term capital flows from the U.S. to Europe, but are obviously essential to pursue our domestic economic objectives. There is also concern that we do not attach much importance to our balance of payments situation and that, since a dollar devaluation is technically impossible, other currencies are bound to move up in value at some point in the future. However, the immediate situation has been stirred up by German rhetoric and there is nothing much we could do about it anyway short of fundamental changes in our international financial policy.

Treasury issued a statement last night indicating that we see no need for any exchange rate changes, and indicating our continued willingness to cooperate in dealing with the situation. At present, we need only watch the situation carefully and await word on what the Europeans plan to do.

CONFIDENTIAL

28228

May 5, 1971

MEMO FOR GENERAL HAIG

Attached is the memorandum
for the President on the inter-
national monetary developments
which we just discussed.

C. Fred Bergsten

CONFIDENTIAL

NSC CORRESPONDENCE PROFILE

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SUBJECT: *Situation Report on International Monetary Developments*

REFERENCE: S/S _____ OTHER _____ NOT XEROXED _____

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MEMORANDUM

THE WHITE HOUSE
WASHINGTON

Via Harry
INFORMATION

SECRET

December 3, 1970

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten *CFB*

SUBJECT: The Absurdity of Possible Reductions in U.S. Forces Overseas for Balance of Payments Reasons

AMEN!
I agree
HK

I was shocked to learn that Paul McCracken and Peter Flanigan had seriously raised with you the possibility of U.S. troop cuts abroad for balance of payments reasons.

I take no stand on whether our overseas troop levels are correct. I do take the firmest possible stand that we should never reduce them for balance of payments reasons.

The last Administration had a major hangup over the balance of payments. It did everything from implementing mandatory capital controls, to proposing a tax on foreign travel by American citizens, to requiring the Defense Department to pay 50% higher prices to purchase U.S. commodities, to bringing down Erhard over the offset issue, to the additionality requirements on foreign aid. Even it, however, never reduced U.S. troops abroad for balance of payments reasons -- though it considered the possibility repeatedly throughout its eight-year life.

The arithmetic demonstrates why. It is true that our foreign expenditures for military purposes are high. However, drastic reductions in our military capabilities would be required to produce small net gains for our balance of payments. When our deficit is running in the \$3-\$5 billion range, as it has for twelve years with temporary aberrations on either side of the range, the saving of a few hundred million dollars gets lost in the shuffle -- and even a saving of that relatively small magnitude would require major shifts in troop deployments.

In view of the difficult decisions already made to maintain our troop levels in Europe, Vietnamize as rapidly as possible, and pull out of Korea at a pace which already causes major foreign policy problems, I do not see how we could seriously consider additional withdrawals for balance of payments reasons.

SECRET

What would be the signal to the Soviets if we were to do so? It could only be that the U. S. had become so pitifully weak on the economic and financial front that we could no longer make any pretense of maintaining our defense posture around the world.

It is bad enough to make overseas troop decisions on budgetary grounds, but this at least involves real resources and alternative uses of money. To do so for balance of payments reasons, in order to juggle the statistics marginally and enable us to tell the European financial officials "that we are doing something about our problem", would be criminal.

The underlying problem, as always, is the failure to properly perceive our balance of payments situation -- and I deliberately do not say "balance of payments problem". An effort to clarify perceptions on this issue will be the first task of the new International Economic Policy Committee, as worked out yesterday at George Shultz's meeting on the subject in which I participated. Hopefully, that exercise will dash any notions of troop cuts or other changes in serious policies for balance of payments purposes.

In addition, however, I urge you to stand firm against any such nonsense. I assume you will need little urging in this direction, but wanted to restate the case to you because of the absurdity of the proposal.

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DOC DATE: 12/03 Beyette

SUBJECT: Possible Reductions in US Forces Overseas For Balance of Payments reasons

ENCLOSURES: (_____) (_____) NOT XEROXED FOR SUSPENSE FILE _____

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MEMO TO PRESIDENT (_____)

REPLY FOR HAK SIGNATURE (_____)

REPLY FOR PRES SIGNATURE (_____)

MEMO _____ TO _____ (_____)

RECOMMENDATIONS (_____)

JOINT MEMO (_____)

APPROPRIATE ACTION (_____)

ANY ACTION NECESSARY (_____)

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MEMORANDUM FOR:

Mr. Richard Moose
National Security
Council Staff

File ⁶¹⁹
Cooper

The attached paper fulfills a phoned request from Mr. Richard Cooper to Ed Allen, the Director of our Office of Economic Research.

Because of the potential sensitivity of this paper, there is but one file copy.



27 February 1969

Attachment

(DATE)

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(47)

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E.O. 12958, as amended, Sect 3.5
NW 04-06/1 per sec. 6.2(c) Htr. JUL 2 2007
By *[Signature]* NARA, Date 16 Oct 07

[p. 1 of 11]

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OCI- 1111 -69

WESTERN EUROPEAN ATTITUDES TOWARD A CHANGE
IN THE OFFICIAL PRICE OF GOLD

I. Introduction

1. If there is a European gold lobby favoring an increase in the price of monetary gold, it is heterogeneous and scattered among various groups of officials and private persons. Motivations among its members vary from ideology to profit. A few academic and governmental monetary authorities have been the most outspoken and influential supporters of a price increase -- outspoken because their claims can be tinted with the respectability of participating in the debate over improving the international monetary system, influential because they have been close to or involved in the policy-making machinery of Europe.

II. Official Attitudes to Proposals for a Gold Price Increase
France

2. France is the only country to take a stand officially and publicly in support of gold revaluation. President DeGaulle has been the leading official champion in Europe, indeed in the world, for the case of returning to the gold standard. He and his supporters reason that the additional gold reserves gained through a rise in the official price of gold could be used by the United States and United Kingdom to pay off existing dollar and sterling liabilities, thus terminating the gold-exchange standard and permitting a return to the pure gold standard of pre-World War I vintage. DeGaulle has found this view well suited to his underlying political goal of

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reducing the worldwide monetary influence exercised by the US.

3. There is considerable difference of opinion on the gold price issue between the French government and the French central bank. M. Brunet, Governor of the Banque de France, is known to be opposed to Gaullist views on gold. However, the opposition of the Bank is of little consequence in French politics; in matters of monetary policy, the French central bank is completely captive to the Ministry of the Economy and Finance and hence to General DeGaulle.

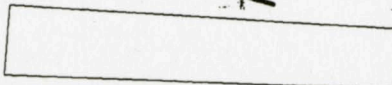
The United Kingdom

4. Hardly in a position to do otherwise because of its enormous political and financial debt to the US, the British government's policy on international monetary questions mirrors that of the US. The situation is somewhat different in the Bank of England, however. Its governor, Sir Leslie O'Brien, is an outspoken proponent of a gold price increase, on the grounds that it would benefit the international monetary system as a whole and the UK in particular. Sir Leslie feels that such a price increase would permit accelerated growth (and attendant inflation) in the UK without immediately calling forth the balance of payments constraint.

West Germany

5. Both government and central bank in West Germany are solidly opposed to any suggestion of a gold price increase. The German view on this issue is expounded with nearly one voice by Karl Schiller

-2-



[NIN 04-06/1:3]

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[REDACTED]

funds that might accompany a worldwide gold price increase. Moreover, they reason that the net effect of a price increase would be the destabilization of the international monetary system as a whole.

Belgium

8. The Belgian central bank is opposed to a price increase, but for a rather curious reason. With nearly 70% of its reserves in gold (see Table 1), the National Bank of Belgium would reap a substantial profit from a price increase -- but the officials of the bank are morally certain that their government will find a way to use this windfall to finance an inflationary fiscal policy. This fear outweighs the profit motive. The central bank position has a counterpart in a considerably more lukewarm attitude on the part of the Belgian government, which nevertheless does not publicly support a price increase.

The Netherlands

9. The Dutch government is opposed, for the same reasons as are the German and Italian governments. In the central bank, however, some ambivalence is developing. The Bank's head, Dr. Zijlstra, has had a long association with the Bank for International Settlements (BIS) in Basle. As Chairman of its Board of Directors, he has been heavily influenced by the long-standing BIS policy of favoring a gold price rise. He is regarded by other Western central bankers

-4-

[NLN 04 - 06 / 1:5]

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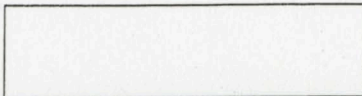
as a man who tends toward maverick behavior in any case and who is especially to be watched on the gold price issue.

Other

10. All of the Scandinavian central banks and governments are solidly opposed to a gold price increase. Most of the other European governments and central banks also are unsympathetic to plans for revaluing gold. However, Spain and Portugal may favor a price increase for monetary gold because of a considerable share of gold within their reserve holdings.

The Bank for International Settlements

11. Based in Basle, this quasi-official international institution is well known as supporting a gold price increase. The chief intellectual force behind this support is Dr. Milton Gilbert, who is the BIS staff economist and is highly regarded throughout the West for his wide ranging work. The chief protagonist -- indeed, propagandist -- on the BIS staff for a gold price increase is a bank officer named MacDonald (a British citizen), who is ardently anti-US. He lobbies extensively, both in the US and in Europe, and wields considerable influence within the US-European financial community. On evidence gained from other intelligence sources, we believe him to be an active and strong opponent of the present US policy on gold.



[NLN 04 - 06/1:6]

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Summary of Official Attitudes

12. Despite the prevailing feeling among European monetary officials that gold must continue to serve a vital function in the international monetary system for some years to come, most -- excepting the French government, the Bank of England, possibly the Netherlands Bank, and the BIS -- agree that an increase in the price of gold would be undesirable and should be avoided. Fear of inflation is prevalent among them, and the thoughts that an increase in the price of gold could lend greater instability to the international monetary system in the future also lurks in the backs of their minds. Most officials prefer to maintain the existing international monetary machinery with necessary increments to world liquidity to be furnished by the new SDR's and -- perhaps -- by official purchases of South Africa's newly mined gold at \$35 an ounce. They see the principal hope for the future of the international monetary system in closer international cooperation under the old rules. They also generally believe that a basic weakness in the system now is the chronic US balance-of-payments deficit.

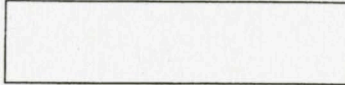
III. Attitudes in the Private Sector

13. The great majority of Europe's scholars, journalists, bankers, and businessmen view with disapproval any potential shift toward gold revaluation. Nevertheless, a few eminent economists have been outspoken in support of a gold price increase. They include

[NLN 04 - 06/1:7]

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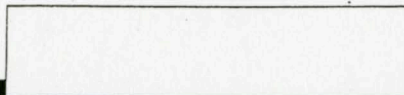
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such well-known names as professors Roy Harrod of the UK, Michael Heilperin of Switzerland (actually a naturalized US citizen residing in Switzerland), and Jacques Rueff of France. Rueff is considered the high priest of the gold school. Perhaps the most active proponent today outside France for a rise in the official gold price is Dr. Franz Aschinger, former editor of the Neue Zürcher Zeitung and presently economic advisor to the Swiss Bank Corporation in Zurich. He has been a prominent figure among an informal group of economists and private bankers which meets periodically in Geneva to massage common views on gold.

14. Few important European financial journals are consistently outspoken in favor of a gold price increase. British journalist C. Gordon Tether, who writes for the Financial Times, is perhaps the UK's most prolific protagonist for an increase. It cannot be said, however, that a gold price increase forms an element of editorial policy for this publication. The influential London Economist has made some comment favorable to price revision but has focused its discussion of international monetary problems on the need for floating exchange rates. Der Volkswirt in West Germany echoes the views of the German government in firm opposition to a gold price increase. Most major European newspapers have not taken a stand regarding gold revaluation, although the French Le Monde and Figaro have reflected a favorable attitude.

-7-



[NW 04-06/1:8]

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15. The views of private European banks, firms, and citizens on the question of gold revaluation are mixed. Some private companies and banks in Switzerland and France have invested heavily in gold. The three large Swiss commercial banks comprising the Zurich gold market -- the Union Bank of Switzerland, the Swiss Banking Corporation, and the Swiss Credit Bank -- are (not remarkably) known to favor a revaluation of gold. These banks also have been maneuvering successfully into position as South Africa's principal gold marketing agents. The majority of private banks and companies throughout the remainder of Europe do not wish a price increase for gold. Both Dr. Othmar Emminger of the Bundesbank and Dr. Kurt Richebacher, deputy manager of the Dresdner Bank explain that most private bankers oppose an increase in the official price of gold because it would be inflationary and would allow the Americans to postpone the day when they will reduce their deficit and strengthen international confidence in the dollar.

16. Popular sentiment favoring an increase in the price of official gold appears to be strong only in France. French citizens, who cannot easily forget the many Franc devaluations of the past, are believed to be hoarding about \$4 billion of gold. The middle class, which represents both the main group of gold hoarders and the biggest backers of Gaullism, has been a major source of political pressure to raise the price of gold.

[NLN 04-06/1:9]

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[REDACTED]

17. With the exception of a few ideologues, a large portion of the French bourgeoisie, and the few banks and businesses that have gambled heavily on a gold price increase, European private-sector opinion roughly parallels official opinion in viewing the idea of a gold price increase as on balance a poor one. The larger international banks and business firms of Western Europe hold highly sophisticated economic views. Like the majority of their counterparts in the US, they tend to form "internationalist" opinions on international monetary questions. In general, they eschew any precipitous alterations in the present system. At the same time, they favor expanding and developing the techniques of international cooperation to correct faults in the system in unspectacular steps. Nevertheless, some have swung towards less conservative proposals. While opinion is almost unanimous against a change to fully flexible exchange rates, for example, some important European bankers have publicly supported the proposal for widening the bands within which exchange rates would be allowed to fluctuate around parity. Others place great faith in SDR's. The entire group's generally skeptical attitude towards the notion of a gold price increase is, like the attitude of Karl Blessing, based primarily on a deep-seated fear of its possible inflationary consequences.

OER/CIA
26 February 1969

-9-

[REDACTED]

[NW 04-06/1:10]

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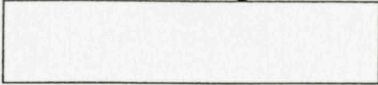
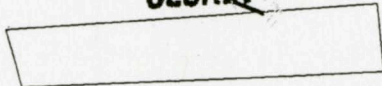


Table 1

INTERNATIONAL RESERVE HOLDINGS
AT THE END OF 1968

	<u>Total Reserves</u>	<u>(Billions of US\$ and Percentage)</u>	
		<u>Gold</u>	<u>Percent</u>
France	4.20	3.88	92
Spain	1.06	.79	75
Netherlands	2.46	1.70	69
Belgium	2.19	1.52	69
Switzerland	3.93	2.62	67
Portugal	1.36	.86	63
United Kingdom	2.42	1.49	62
Italy	5.34	2.92	55
Austria	1.51	.71	47
West Germany	9.93	4.54	46
Sweden	.82	.23	28
Denmark	.45	.11	24
Norway	.61	.02	3

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[NW 04-06/1:11]

MEMORANDUM

THE WHITE HOUSE
WASHINGTON

ACTION

Acton 5320

December 9, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

OK - Let's take Burns opinion

SUBJECT: Urgent Need for Presidential Decision on Balance of Payments Program for 1970

DEC 11 1969

Issue

The President approved two contradictory options for the 1970 investment control program (Tab A). The issue is now quite urgent because the hundreds of companies covered by the program are already making their plans for next year; Commerce and Treasury are both agitating daily for a decision. I urge you to take up the matter orally with the President as soon as possible to reconcile the inconsistencies.

Option 1 (your recommendation in Tab A)

1. Increase level of foreign investment exempted from control for each firm from \$1 million to \$3 million.

2. Exempt from control up to an additional \$2 million per firm for investment in LDCs, on a case-by-case basis. (This would meet the President's pledge to modify the controls to facilitate private investment in the LDCs, which he made in the Latin America speech.)

3. Recommended by Secretary Kennedy, with the concurrence or acquiescence of all relevant parties. The Secretary worked this out as a compromise between Secretary Stans' desire for greater liberalization and Arthur Burns' desire for no liberalization at this time.

Option 2 (cited as "fully acceptable" to you in Tab A).

1. Increase level of foreign investment exempted from control from \$1 million to \$5 million for investment in LDCs only, as a general rule (not case-by-case).

2. Pros:

-- Would redeem President's pledge to promote investment in LDCs more than Option 1.

-- Would hurt U. S. balance of payments less.

3. Con: less popular with U.S. business community, which expects liberalization of investment to all areas.

4. Strongly supported by Arthur Burns and Peter Flanigan. (Tab B)

Evaluation

Either approach is fully acceptable from a foreign policy standpoint. Option 2 is more clearly directed toward the LDCs. It also runs less risk of later problems with the Europeans, if our balance of payments turns sour and requires drastic U.S. action, because it will hurt our balance of payments less; we would then be less susceptible to charges of having induced a crisis ourselves.

The main virtue of Option 1 is bureaucratic: Secretary Kennedy worked it out in a series of lengthy sessions with Stans and Burns. You favored it in your earlier memo. And Stans will be even more unhappy if Option 2 is chosen.

RECOMMENDATION:

That you recommend to the President that he choose Option 2 -- the Burns proposal, strongly supported by Flanigan, that we liberalize for investment in LDCs only.

A

CONFIDENTIAL

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *HK*

SUBJECT: Balance of Payments Program for 1970

At Tab A are recommendations from Secretary Kennedy for next year's balance of payments control programs on foreign investment by U. S. companies and banks. An early announcement is needed to permit the companies and banks to develop their own plans in light of the new program. I have checked this memorandum with Arthur Burns.

Level of Restraint

Secretary Kennedy, with the concurrence or acquiescence of all relevant parties, recommends a modest liberalization of the present controls on foreign investment by U. S. firms:

1. An increase in the level of foreign investment for each firm exempted from the controls, from \$1 million to \$3 million.
2. Exemption from control of an additional \$2 million per firm for investment in LDCs.

These steps represent a compromise between the preferences of some for more liberalization and the preferences of others for less. They would:

- Be a next move toward implementing your April 4 call for "ultimate dismantling of the network of direct controls."
- Eliminate about 350 companies from coverage by the Commerce program, which would be popular politically.
- Risk an increase in capital outflows of up to \$600 million. (The net effect on our balance of payments would be decidedly smaller because any additional capital outflows would generate additional U. S. exports.)
- Risk foreign policy problems, if our balance of payments turns sour enough next year to require us to take tough unilateral actions -- such

CONFIDENTIAL

suspension of the gold convertibility of the dollar --- since we might be blamed for creating the problem ourselves by relaxing our defensive measures.

Other options were considered:

Tightening of the controls (This would signal a new policy direction for the Administration, contrary to our basic philosophy of freer trade payments.)

No change from 1969. [This would disappoint some businessmen but would reduce the risks cited above. It was initially preferred by the Budget Bureau and the Federal Reserve. It is strongly opposed by CEA (Tab B).]

3. Liberalization on investment in LDCs only. (This is strongly supported by Arthur Burns, who would increase the level of investment exempt from control to \$5 million for LDCs only.)

4. Slightly greater liberalization than finally proposed by Secretary Kennedy, by eliminating the present program's preferential treatment from LDCs in addition to the two steps proposed by Secretary Kennedy. (Its gross payments effect of up to \$900 million would run greater real and psychological risks but would be better received by some businessmen. It is preferred by Secretary Stans.)

5. A large reduction or complete elimination of the controls. (This was deemed by all as too risky in view of next year's unfavorable balance of payments outlook.)

Treatment of LDCs, including Latin America

In your speech on Latin America, you said that, "We are examining ways to modify our direct investment controls in order to help meet the investment requirements of developing nations in Latin America and elsewhere."

Secretary Kennedy's proposal would redeem that pledge by the increase in the overall restraint level and the preferential "minimum allowable" for investment in LDCs. Arthur Burns' proposal would do so to an even greater extent, by providing a greater degree of LDC preference and less cumbersome rules to implement it.

CONFIDENTIAL

CONFIDENTIAL

- 3 -

Tightening of the controls or the "no change" option would clearly not redeem your pledge. Neither would Commerce's proposal, which would eliminate the favored treatment for LDCs under the present program.

RECOMMENDATION:

That you approve the proposal of Secretary Kennedy, agreed or acquiesced in by Arthur Burns, Secretary Stans, and all other relevant parties, for modest liberalization in 1970 of our controls on capital outflows by U. S. corporations and banks.

Approve _____

Prefer liberalization for investment in LDCs only, as preferred by Arthur Burns. (I would find this fully acceptable.) _____

Prefer no liberalization, as initially proposed by the Federal Reserve and the Budget Bureau. _____

Prefer slightly greater liberalization as initially proposed by Commerce. _____

DEC 9 1969

CONFIDENTIAL

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

December 3, 1969

CONFIDENTIAL

TO: THE STAFF SECRETARY

FROM: PETER FLAHERTY

RE: Log 2310

Our balance of payments has been in deficit for a decade. During the recent election campaign the President strongly criticized the Democratic administrations for not having taken steps to cure this serious problem. Since we have been in office we have already had a modest relaxation of foreign investment control. In the first year of this Administration the balance of payments deficit has risen dramatically to a \$10 billion deficit on a liquidity basis, two and one-half times the previous peak figure. The outlook for 1970 is not encouraging.

Our apparent unwillingness to take strong action in this area as opposed to the strong action taken in other areas, such as monetary and fiscal policy, raises questions in the US and abroad as to the seriousness with which we regard this problem.

Based on the above, I strongly recommend liberalization for investment in LDC only (set forth as No. 3 on page 2 of Dr. Kissinger's memo).

Attachment

B

THE WHITE HOUSE
WASHINGTON

Bergsten
5320

B

December 4, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: PETER FLANIGAN 

RE: Proposal for Relaxation of Foreign Investment
Controls

The President approved both the Kennedy proposal and the Burns proposal regarding relaxation. Based on a memorandum submitted to the President with a copy to you, I strongly urge ^{that} when you ask the President for clarification you guide him towards the Burns proposal.

Bergsten - please refer
my recollection in
bill memo - due
morning Dec 9

THE WHITE HOUSE
WASHINGTON

TO: AL Haig
FROM: JOHN BROWN

FILES
J. Brown
called

FYI _____

COMMENT The Flanigan memo

Came in after the TT had taken
action on HAK's recommendations.

However since the TT approved
two different courses of action
this issue may still be alive.

Flanigan wants you to know
that he feels strongly on his
recommendation.

DEC 12 1969

NATIONAL SECURITY COUNCIL

December 12, 1969

MR. BERGSTEN:



This folder is being returned to you for you to note Brown's note to HAIG, and Flanigan memo to Staff Secretary.

Thank you,

NSC SECRETARIAT

*Folder care of
C. M.*

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

December 3, 1969

CONFIDENTIAL

TO: THE STAFF SECRETARY
FROM: PETER FLANIGAN *PMO*
RE: Log 2310

Our balance of payments has been in deficit for a decade. During the recent election campaign the President strongly criticized the Democratic administrations for not having taken steps to cure this serious problem. Since we have been in office we have already had a modest relaxation of foreign investment control. In the first year of this Administration the balance of payments deficit has risen dramatically to a \$10 billion deficit on a liquidity basis, two and one-half times the previous peak figure. The outlook for 1970 is not encouraging.

Our apparent unwillingness to take strong action in this area as opposed to the strong action taken in other areas, such as monetary and fiscal policy, raises questions in the US and abroad as to the seriousness with which we regard this problem.

Based on the above, I strongly recommend liberalization for investment in LDC only (set forth as No. 3 on page 2 of Dr. Kissinger's memo).

Attachment

MEMORANDUM

THE WHITE HOUSE
WASHINGTON

4027
K
12-9-69

ACTION
November 28, 1969

CONFIDENTIAL

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *K*

SUBJECT: Balance of Payments Program for 1970

At Tab A are recommendations from Secretary Kennedy for next year's balance of payments control programs on foreign investment by U. S. companies and banks. An early announcement is needed to permit the companies and banks to develop their own plans in light of the new program. I have checked this memorandum with Arthur Burns.

Level of Restraint

Secretary Kennedy, with the concurrence or acquiescence of all relevant parties, recommends a modest liberalization of the present controls on foreign investment by U. S. firms:

1. An increase in the level of foreign investment for each firm exempted from the controls, from \$1 million to \$3 million.
2. Exemption from control of an additional \$2 million per firm for investment in LDCs.

These steps represent a compromise between the preferences of some for more liberalization and the preferences of others for less. They would:

- Be a next move toward implementing your April 4 call for "ultimate dismantling of the network of direct controls."
- Eliminate about 350 companies from coverage by the Commerce program, which would be popular politically.
- Risk an increase in capital outflows of up to \$600 million. (The net effect on our balance of payments would be decidedly smaller because any additional capital outflows would generate additional U. S. exports.)
- Risk foreign policy problems, if our balance of payments turns sour enough next year to require us to take tough unilateral actions -- such

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Historical File

as suspension of the gold convertibility of the dollar -- since we might be blamed for creating the problem ourselves by relaxing our defensive measures.

Five other options were considered:

1. Tightening of the controls (This would signal a new policy direction for the Administration, contrary to our basic philosophy of freer trade and payments.)
2. No change from 1969. [This would disappoint some businessmen but would reduce the risks cited above. It was initially preferred by the Budget Bureau and the Federal Reserve. It is strongly opposed by CEA (Tab B).]
3. Liberalization on investment in LDCs only. (This is strongly supported by Arthur Burns, who would increase the level of investment exempt from control to \$5 million for LDCs only.)
4. Slightly greater liberalization than finally proposed by Secretary Kennedy, by eliminating the present program's preferential treatment from LDCs in addition to the two steps proposed by Secretary Kennedy. (Its gross payments effect of up to \$900 million would run greater real and psychological risks but would be better received by some businessmen. It is preferred by Secretary Stans.)
5. A large reduction or complete elimination of the controls. (This was deemed by all as too risky in view of next year's unfavorable balance of payments outlook.)

Treatment of LDCs, including Latin America

In your speech on Latin America, you said that, "We are examining ways to modify our direct investment controls in order to help meet the investment requirements of developing nations in Latin America and elsewhere."

Secretary Kennedy's proposal would redeem that pledge by the increase in the overall restraint level and the preferential "minimum allowable" for investment in LDCs. Arthur Burns' proposal would do so to an even greater extent, by providing a greater degree of LDC preference and less cumbersome rules to implement it.

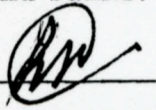
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Historical File

Tightening of the controls or the "no change" option would clearly not redeem your pledge. Neither would Commerce's proposal, which would eliminate the favored treatment for LDCs under the present program.

RECOMMENDATION:

That you approve the proposal of Secretary Kennedy, agreed or acquiesced in by Arthur Burns, Secretary Stans, and all other relevant parties, for modest liberalization in 1970 of our controls on capital outflows by U. S. corporations and banks.

Approve 

Prefer liberalization for investment in LDCs only, as preferred by Arthur Burns. (I would find this fully acceptable.) 

Prefer no liberalization, as initially proposed by the Federal Reserve and the Budget Bureau. _____

Prefer slightly greater liberalization as initially proposed by Commerce. _____

*See action
5320*

Historical File

NATIONAL SECURITY COUNCIL

November 26, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

At Tab I per your instruction is a revised memorandum for the President on the control programs which incorporates your earlier instructions to simplify it and to include the specific steps proposed by Secretary Kennedy.

*Return to Bergsten:
Fred: that would
like the memo to the Pres
simplified. He finds it
confusing.
R*

Tab
A

4524

CONFIDENTIAL

November 24, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

SUBJECT: Balance of Payments
Program for 1970

At Tab I, per your instruction, is a revised memorandum for the President on the control programs.

RECOMMENDATION:

That you sign the memorandum for the President.

CFB:mmm

CONFIDENTIAL

THE WHITE HOUSE
WASHINGTON

This should go
to Beyot
for prompt
action.

DP

4524

CONFIDENTIAL

THE SECRETARY OF THE TREASURY
WASHINGTON



NOV 19 1969

MEMORANDUM FOR THE PRESIDENT

Subject: Recommendations Concerning 1970 Balance of
Payments Programs -- Controls on Capital Outflows

To permit time for orderly business planning for next year, our intentions with respect to the restraints on foreign direct investment and bank loans, administered by the Department of Commerce and the Federal Reserve, respectively, should be announced shortly. Following your approval, a coordinated Treasury-Commerce-Federal Reserve announcement will be prepared. An attachment to this memorandum outlines the details of the proposed moves.

The proposed changes in the Federal Reserve program have the concurrence of all interested agencies. However, some differences in approach toward the controls on direct investment, administered by the Commerce Department, have not been fully reconciled. The main alternatives are set forth in this memorandum, with a proposed compromise that seems to me to best reconcile the conflicting considerations. This would be supported as "second best" by other agencies.

Essentially, the proposed moves represent limited steps toward simplification of the existing programs and some very modest liberalization to achieve specific purposes. There is broad agreement that our balance of payments situation rules out more dramatic action at this time. Indeed, except for the desirability of announcing now our intentions for next year, the question of liberalization would not arise at this time.

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- 2 -

We hope to follow this announcement with some early indication of our longer-term programs for improving our trade performance, emphasizing improved export credit facilities and some possible changes in tax arrangements. These are under intensive study now, and we will be reporting to you shortly on these programs in the light of the entire balance of payments outlook.

Balance of Payments Background

Decisions on the direct investment and bank loan restraint programs must be made against the background of a seriously unfavorable balance of payment performance and outlook. Third quarter figures, just published, show a deficit on the conventional "liquidity balance" of \$2.5 billion. This brings the cumulative deficit for the first nine months to \$8.1 billion. Despite some anticipated improvement in the fourth quarter, our "liquidity" deficit for the year as a whole could total as much as \$10 billion, two and one-half times the previous peak in 1959 and 1960.

For technical reasons, these figures somewhat overstate -- by perhaps \$2 - \$3 billion -- the magnitude of the underlying deficit. More importantly, the extreme tightness of money in the U. S., by inducing unprecedented amounts of bank borrowing abroad, has tended to keep the dollar relatively scarce in foreign markets despite the underlying deficit. This short-term borrowing does not enter into the calculation of the commonly-used liquidity deficit, but it is reflected in the alternate "official settlements" balance. This latter balance shows a cumulative surplus of \$1.4 billion over the first nine months. In effect, tight money has protected our payments position and the international strength of the dollar through this period.

CONFIDENTIAL

CONFIDENTIAL

- 3 -

This situation may now be changing. In fact, we are currently showing some deficit on the official settlements basis as well as a continuing large deficit on the liquidity basis. Our staff projections suggest that, despite limited improvements on the trade account, the liquidity deficit may total \$4 - \$5 billion in 1970. There is a substantial danger that repayment of some of our bank borrowings from abroad may produce a considerably larger official settlements deficit. Such repayments will depend to a considerable extent on whether credit eases in the U. S. relative to abroad.

At present, international financial markets are exceptionally calm, reflecting the successful resolution of the mark crisis, the indications of renewed strength in sterling, and the glow of the SDR agreement. But, in the light of our balance of payments outlook, we must anticipate that the dollar -- in contrast to the past two years -- will be under strong pressure in the exchange markets. Already, our major financial partners in Europe are aware of this prospect and have begun to raise questions about our ability and willingness to finance our prospective deficit.

Role of Capital Restraint Programs

The liberalization of the Commerce and Federal Reserve restraint programs you approved last Spring has not been an important factor in our poor balance of payments performance. As expected, with money tight, many banks and corporations are not utilizing their full "allowables." As money eases, this situation will change, and we must anticipate that companies will operate closer to their ceilings in 1970. Thus, even with no further liberalization, additional direct investment and bank loan outflows can be anticipated in 1970 in a general magnitude of, perhaps, \$3/4 billion, with somewhat more than half accounted for by direct investment. Further liberalization will tend to raise the projected deficit above the range cited above.

CONFIDENTIAL

CONFIDENTIAL

- 4 -

The psychological and foreign policy aspects of liberalization must also be considered. Financial officials of European creditor countries, some of which resent heavy U. S. investment in their economies in any event, will tend to consider liberalization unwarranted in the light of our balance of payments outlook. Carried far enough, they might read it as an aggressive act -- a precursor of a de jure suspension of gold payments or even devaluation. Monetary and balance of payments cooperation on other fronts would thus be made much more difficult. On the other hand, some capital-short countries (particularly some LDC's) would welcome liberalization, at least to the extent it is directed toward their countries.

Of course, both banks and corporations would also welcome some liberalization and simplification. However, radical liberalization or abandonment of the existing programs has not been pressed in recognition of the serious balance of payments situation.

Major Options

1. Tightening Controls by Reducing Ceilings

As a practical matter, only limited tightening would be possible without jeopardizing our ability to maintain the minimum of business cooperation needed to administer the programs effectively. Thus, sizable reduction of the projected deficit (say, more than about \$500 million) through this means is not practicable. Within that limitation, tightening could be a gesture toward indicating our concern over the balance of payments. On the other hand, this would be a backward step in terms of our basic objective of maximizing freedom of trade and payments and would signal a new policy direction for the Administration. Given this disadvantage and the limited substantive benefits, this course has no support among interested agencies.

CONFIDENTIAL

CONFIDENTIAL

- 5 -

2. "Hold the Line" -- No Important Changes

This course would not raise the serious administrative and political problems inherent in tightening. It would be readily defensible in terms of the balance of payments outlook and facilitate our financial relationship with other leading countries. The disadvantages are that it might raise some questions as to the degree of your commitment to liberalization, would forego any significant simplification, and would be inconsistent with the objectives of providing some help for export credits or LDC's.

This is a practicable course of action, initially preferred by the Federal Reserve and the Bureau of the Budget, and strongly supported by Arthur Burns.

3. Moderate Liberalization

Within the basic framework of the present program, further liberalization could be undertaken to achieve substantial simplification, some benefits for less developed countries, and fresh incentives to export credits. The estimated balance of payments cost would be roughly \$700 - \$900 million (on top of the added outflows anticipated without any program liberalization), assuming only moderate easing of domestic credit conditions next year. This cost would be about evenly divided between additional bank loans and direct investment.

This course would underscore your commitment to liberalization. There will be clear gains in administrative simplicity; e.g., the number of companies involved in detailed reporting could be reduced by 40 percent to less than 350. To some extent, the added capital outflows will be employed to assist our export effort, tending to offset a portion of the cost.

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The major disadvantage is that it will aggravate our already serious balance of payments problem. The psychological repercussions in Europe will be adverse. (More critical factors affecting the balance of payments situation and confidence in the dollar will be the extent to which the domestic credit situation eases and our progress against inflation.)

The attached memorandum by Secretary Stans suggests this course, which would also be supported by the CEA.

4. Large Relaxation or Elimination

This option would move directly toward the objective of freedom from controls, but there is substantial danger that it would be counter-productive. It would release so large a volume of funds abroad as to significantly jeopardize efforts to maintain international financial stability. Foreign reaction would be adverse, substantially limiting our influence and ability to exert leadership in the direction of needed reforms. This course has no substantial support within the Administration.

A Desirable Compromise Proposal

In my opinion, the conflicting considerations surrounding this matter can best be resolved by limited steps to combine some simplification with two specific purposes: (1) greater freedom for investment in LDC's and (2) greater priority for export credits. This could be achieved by accepting certain Federal Reserve proposals concerning export credits for banks (described in detail in the attachment) and increasing from the present \$1 million to \$3 million the minimum amounts a nonfinancial corporation may invest abroad, with a special \$2 million bonus when funds are directed to LDC's.

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This falls short of Secretary Stans' desire to eliminate the three schedules now controlling investment by area. Elimination of these schedules would cost as much as \$300 million and appear to work at cross-purposes with the desire to provide special priorities for investment in LDC's.

The compromise proposal might entail a gross balance of payments cost of \$500 - \$600 million. About \$300 million of this estimated cost would be incurred to facilitate export credits and thus should help our export effort. Some \$250 million of the cost would be in the direct investment program and would tend to be directed to the LDC's. I believe the compromise fairly balances the competing considerations, foreign and domestic. While it is not the preferred course of action of other agencies, it is a practical course that can be supported by all.

RECOMMENDATION: That you approve the "compromise proposal," for prompt release at or before the session with businessmen this Friday.

Approve: _____

Disapprove: _____

David M. Kennedy

Attachments

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ATTACHMENT

THE DIRECT INVESTMENT PROGRAM FOR 1970

Secretary Stans' proposal raises the ceiling for 1970 by \$550 million to \$3.90 billion and involves the following changes:

- (A) Raise the minimum investment allowable for each company from \$1 million to \$3 million.
- reduces the number of companies involved in quarterly reporting by almost 40 percent to less than 350;
 - assists small to medium companies or those without historical experience.
- (B) Eliminate the arbitrary division of the world into three schedules by going to a worldwide program for companies using historical and earnings allowables. These historical and earnings allowables would be calculated as done at present but would be applied on a worldwide basis. Carry-forwards of unused schedular allowables into 1970 could also be applied on a worldwide basis.
- represents a major simplification of the complex program;
 - appropriate step for the ultimate elimination of the program.
- (C) Offer up to \$2.0 million additional allowables on a matching basis to companies using the minimum allowable and investing in the LDC's (Schedule A).
- gives real benefit to LDC's who may feel elimination of the schedules was a removal of preferential treatment;
 - to be administered through the specific authorization process to avoid complication of the Regulations and to maintain control of the amount of the relief.

The alternative proposal simply foregoes step (B), thus saving more than \$200 million, leaving the new target at \$3.7 billion.

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ATTACHMENT

THE FEDERAL RESERVE PROGRAM FOR 1970

The Board of Governors proposes that the 1970 Federal Reserve guidelines for restraints on credits by U. S. financial institutions to foreigners be revised principally to insure that more emphasis is given to credits for financing U. S. exports than to credits for other purposes.

As compared with the present ceiling of \$10.1 billion for commercial banks, of which \$9.1 billion is currently utilized, there would be two ceilings for each bank. A new Export Term Loan Ceiling will be applicable to all export term loans financing goods exported from the U. S. after October 31, 1969. The amount of this ceiling for participating banks, as a group, will be \$1.3 billion. A General Ceiling, unchanged from the present ceiling of \$10.1 billion, will be applicable to all other bank loans to foreigners. However, as outstanding export term loans under the General Ceiling are repaid, the level of this ceiling will be reduced accordingly but the Export Term Loan Ceiling will be increased by the same amount.

Export credits guaranteed or participated in by the Export-Import Bank, guaranteed by the Department of Defense or insured by the Foreign Credit Insurance Corporation will continue to be exempt from the ceiling.

Minor changes will be made in the guidelines applying to nonbank financial institutions, such as insurance companies and pension funds. These changes will also provide some new leeway for export term loans.

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MEMORANDUM FOR THE PRESIDENT

Subject: Proposed 1970 Program on Foreign Direct Investments

I propose that we adopt the moderate liberalization and substantial simplification of the Foreign Direct Investment Program as described in Secretary Kennedy's memorandum. This proposal raises the target ceiling by \$550 million from \$3.35 billion to \$3.90 billion, and involves the following changes:

- A. Raise the minimum investment allowable for each company from \$1 million to \$3 million. This will reduce from 650 to 350 the number of companies required to report quarterly.
- B. Eliminate the arbitrary division of the world into three schedules by going to a worldwide program. The historical and earnings allowables would be calculated as done at present to continue to reward companies that have historically invested in the LDCs, but would be applied on a worldwide basis. Carryforwards of unused schedular allowables into 1970 could also be applied on a worldwide basis.
- C. Offer up to \$2.0 million additional allowables on a matching basis to companies using the minimum allowable and investing in the LDCs (Schedule A).

The major reasons for this modest liberalization and simplification of the program are as follows:

1. There is general agreement that restrictions on capital are counter-productive in the long-run. If the FDIP is not to become a permanent program, there must be steady progress toward the goal of ultimate elimination.
2. You have announced that some liberalization will be forthcoming with regard to investment in the LDCs.
3. In Commerce we have continued to say that we are opposed to controls of this nature and, in reliance upon the prevailing attitude in the Administration, have given the impression that the program

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would be relaxed for 1970. As a result, business and financial circles are expecting some liberalization of the program to be announced shortly.

4. In view of the growth of foreign earnings, making no change for 1970 is effectively a tightening of the program for those companies electing the historical allowable.

5. The relatively small dollar differential between the proposed program and the present program will not have any significant impact on the balance of payments next year.

6. To announce no change when some liberalization was expected here and overseas could telegraph uncertainty as to the strength of the dollar on the part of the Administration itself.

7. A modest change in this program should help reduce some of the unhappiness among our business friends which results from the tax bill, antitrust actions, etc.

8. There is no real evidence that foreign bankers would look with disfavor on a liberalization as mild as that proposed. Foreign governments and foreign businessmen have expressed to us greater interest in more investments by U.S. companies.

9. The changes proposed are mostly for simplification. The requirement for repatriation of foreign earnings is unchanged.

To help insure that companies react as desired in the fourth quarter and do not make needless outflows due to the uncertainty of the 1970 program, a timely decision is important. Announcement of the program prior to our meeting with business leaders on November 21 would be highly desirable.

Maurice H. Stans

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THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.: 2066

4524

Date: Tues. November 11, 1969

Time: 4:30 p.m.

FOR ACTION: Dr. Kissinger

cc (for information):

FROM THE STAFF SECRETARY

DUE: Date: Fri. November 14, 1969

Time: 2:00 P.M.

SUBJECT:

Dr. McCracken's memorandum recommending a further liberalization of exchange controls over foreign investment.

ACTION REQUESTED:

___ For Necessary Action

X For Your Recommendations

___ Prepare Agenda and Brief

___ Draft Reply

___ For Your Comments

___ Draft Remarks

REMARKS:

Please review the attached memorandum and submit your recommendations in coordination with the appropriate involved agencies.

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

BOG
K. R. COLE, JR.
For the President

Tab
B

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

November 11, 1969

MEMORANDUM FOR THE PRESIDENT

Subject: Further Liberalization of Exchange Controls over
Foreign Investment

Within the next few days the shape of our two principal exchange control programs for 1970 has to be determined. These are the Foreign Direct Investment Program, operated by Commerce, and the Voluntary Credit Restraint Program (for banks) operated by the Federal Reserve System. A small relaxation of the Direct Investment Program in April was among the first actions of this Administration in the international monetary field.

Maintaining the momentum towards our goal of a more free and open economy, both domestically and internationally, should itself be a primary objective of economic policy for us. While we must be cognizant of the effects of these actions on our external payments, and must not take disruptive actions, we must also keep making some progress toward a more liberal international economy. The outlook for our balance of payments is not rosy enough to permit complete abandonment of these programs, but neither is it so bad that we cannot do anything at all. We want to keep the dollar strong, but our objectives are more fundamental than to preserve the appearance of strength through direct controls. Our leadership in international financial matters requires us to set an example of the liberal policies which we are urging upon other countries (in our interest as well as theirs).

The Direct Investment Program has also been unpopular with our own business community, whose increasingly international orientation has become a powerful factor in preventing

a new isolationism from emerging. In my opinion further progress toward liberalization is desirable in itself, and worth the risk of a small loss on the balance of payments.

I urge, therefore, that a further modest step be taken soon. This could be either the elimination of the present differentiation according to which schedule the foreign nation is in, or it could take the form of raising the minimum not subject to control. Since the Secretary of Commerce must administer these, I would be strongly influenced by his preference here.



Paul W. McCracken

NOV 11 5 00

RECEIVED
OFFICE OF
THE SECRETARY OF
COMMERCE

Revised copy submitted to Kissinger
on November 26 (last revision) under
Log No. 4524. Also attached is
Treasury's revised memo dated 11/19/69

Ruth:

Think this should go
to files with notation.



THE SECRETARY OF THE TREASURY

WASHINGTON

NOV 5 1969

CONFIDENTIAL

MEMORANDUM FOR THE PRESIDENT

Subject: Recommendations Concerning 1970 Balance-of-Payments Programs--Controls on Capital Outflows

To permit time for orderly business planning for next year, our intentions with respect to the restraints on foreign direct investment and bank loans, administered by the Department of Commerce and the Federal Reserve, respectively, should be announced shortly. With your approval, a coordinated Treasury-Commerce-Federal Reserve announcement is planned for Monday, November 10. An attachment to this memorandum outlines the substance of the recommended further liberalization and simplification. These recommendations have been shaped in detail by Secretary Stans and the Federal Reserve Board, and have been discussed and concurred in by other interested agencies including State, the Council of Economic Advisers, Budget, and the Export-Import Bank.

Essentially, the proposed moves represent a limited but useful step toward the dismantling of these controls. Our balance-of-payments situation appears to rule out more dramatic action at this time. Indeed, except for the desirability of announcing now our intentions for next year, the question of liberalization would not arise at this time.

We hope to follow this announcement with some early indication of our longer-term programs for improving our trade performance, emphasizing improved export credit facilities and some possible changes in tax arrangements. These are under intensive study now.

Balance-of-Payments Background

Decisions on the direct investment and bank loan restraint programs must be made against the background

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of a seriously unfavorable balance-of-payments performance and outlook. Third quarter figures, to be published in the middle of this month, show a deficit on the conventional "liquidity balance" of \$2.5 billion. This brings the cumulative deficit for the first nine months to \$8.1 billion. Despite some anticipated improvement in the fourth quarter, our "liquidity" deficit for the year as a whole could well total \$10 billion, two and one-half times the previous peak in 1959 and 1960.

For technical reasons, these figures somewhat overstate--by perhaps \$2-\$3 billion--the magnitude of the underlying deficit. More importantly, the extreme tightness of money in the U. S., by inducing unprecedented amounts of bank borrowing abroad, has tended to keep the dollar relatively scarce in foreign markets despite the underlying deficit. This short-term borrowing does not enter into the calculation of the commonly-used liquidity deficit, but it is reflected in the alternate "official settlements" balance. This latter balance shows a cumulative surplus of \$1.4 billion over the first nine months. In effect, tight money has protected our payments position and the international strength of the dollar through this period.

This situation may now be changing. In fact, we are currently showing some deficit on the official settlements basis as well as a continuing large deficit on the liquidity basis. Our staff projections suggest that, despite limited improvements on the trade account, the liquidity deficit may total \$4-\$5 billion in 1970. There is a substantial danger that repayment of some of our bank borrowings from abroad may produce an even larger official settlements deficit. Such repayments will depend to a considerable extent on whether credit eases in the U. S. relative to abroad.

In the light of this outlook, we must anticipate that the dollar--in contrast to the past two years--will be under strong pressure in the exchange markets. Already, our major financial partners in Europe are aware of this prospect, and have begun to raise questions about our ability and willingness to finance our prospective deficit.

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Role of Capital Restraint Programs

The liberalization of the Commerce and Federal Reserve restraint programs you approved last spring has not been an important factor in our poor balance-of-payments performance. As expected, with money tight, many banks and corporations are not utilizing their full "allowables." As money eases, this situation will change, and we must anticipate that companies will operate closer to their ceilings in 1970. Thus, even with no further liberalization, additional direct investment and bank loan outflows can be anticipated in 1970 in a general magnitude of, perhaps, \$3/4 billion. Further liberalization will tend to raise the projected deficit above the range cited above.

The psychological and foreign policy aspects of liberalization must also be considered. European creditor countries, some of which resent heavy U.S. investment in their economies in any event, will tend to consider liberalization unwarranted in the light of our balance-of-payments outlook. Carried far enough, they might read it as an aggressive act--a precursor of a de jure suspension of gold payments or even devaluation. Monetary and balance-of-payments cooperation on other fronts would thus be made much more difficult. On the other hand, some capital-short countries might welcome liberalization, particularly if it is directed toward their countries.

Of course, both banks and corporations would welcome some liberalization and simplification. However, radical liberalization or abandonment of the existing programs has not been pressed in recognition of the serious balance-of-payments situation.

Major Options

1. Tightening Controls by Reducing Ceilings

As a practical matter, only limited tightening would be possible without jeopardizing our ability to maintain the minimum of business cooperation needed to administer the programs effectively. Thus, substantial reduction of the projected deficit (more than about \$500 million) through this means is not practicable. Within that limitation, tightening could be a gesture toward indicating our concern

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over the balance of payments. On the other hand, this would be a backward step in terms of our basic objective of maximizing freedom of trade and payments, and would signal a new policy direction for the Administration. Given this disadvantage and the limited substantive benefits, this course has no support among interested agencies.

2. "Hold the Line"

Limited changes to simplify the administration or to facilitate export credits could be undertaken within the framework of essentially unchanged ceilings.

This course would not raise the serious administrative and political problems inherent in tightening. It would be readily defensible in terms of the balance-of-payments outlook, and facilitate our financial relationships with other leading countries. The disadvantages are that it would raise some questions as to the degree of your commitment to liberalization, and prevent any meaningful gesture towards the desires of less developed countries for liberalization.

This is a practicable course of action, preferred by the Federal Reserve and the Bureau of the Budget.

3. Moderate Liberalization

Within the basic framework of the present program, further liberalization could be undertaken to achieve substantial simplification, some benefits for less developed countries, and fresh incentives to export credits. The estimated balance-of-payments cost would be roughly \$700-\$900 million (on top of the added outflows anticipated without any program liberalization), assuming only moderate easing of domestic credit conditions next year. This is the preferred course of Commerce. The Federal Reserve and the Bureau of the Budget would acquiesce. Treasury and other interested agencies would support this approach. (An outline of the specific proposals is attached.)

This course has the advantage of reiterating your commitment to liberalization. There will be clear gains in administrative simplicity; e.g., the number of companies involved in detailed reporting would be

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reduced by 40% to less than 350. To some extent, the added capital outflows will be employed to assist our export effort, tending to offset a portion of the cost.

The major disadvantage is that any liberalization will aggravate our already serious balance-of-payments problem. The psychological repercussions in Europe will be adverse. However, liberalization of the proposed magnitude will not, in itself, be the controlling factor bearing on our over-all balance-of-payments performance. More critical factors affecting the balance-of-payments situation and confidence in the dollar will be the extent to which the domestic credit situation eases and our progress against inflation.

One issue of substance arises in shaping a moderate liberalization of the Commerce program. Less developed countries are given preference at the present time through inclusion in a separate area schedule with a relatively generous allowable. With the proposed elimination of area schedules in the 1970 program, there might be some concern on the part of less developed countries. The Commerce proposal deals with this problem by establishing a preferential minimum allowable for direct investment in the less developed countries.

4. Large Relaxation or Elimination

This option would move directly toward our basic objective, but there is substantial danger that it would be counter-productive. It would release so large a volume of funds abroad as to significantly jeopardize efforts to maintain international financial stability. Foreign reaction would be adverse, substantially limiting our influence and ability to exert leadership in the direction of needed reforms. This course has no substantial support within the Administration.

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RECOMMENDATIONS: That you approve announcement of a liberalization of the 1970 programs in the magnitude suggested in option 3.

Approve: _____

Disapprove: _____

That, within the liberalization amount recommended above, you approve simplifying the Commerce program by eliminating the area schedules and extending special less developed countries' allowances to companies seeking them.

Approve: _____

Disapprove: _____

(Summaries of the substance of the proposed programs are attached.)

David M. Kennedy

Attachments

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The Direct Investment Program for 1970

Secretary Stans' proposal raises the ceiling for 1970 by \$550 million to \$3.90 billion and involves the following changes:

- A) Raise the minimum investment allowable for each company from \$1 million to \$3 million.
 - reduces the number of companies involved in quarterly reporting by almost 40 percent to less than 350;
 - assists small to medium companies or those without historical experience.

- B) Eliminate the arbitrary division of the world into three schedules by going to a worldwide program for companies using historical and earnings allowables. These historical and earnings allowables would be calculated as done at present, but would be applied on a worldwide basis. Carry-forwards of unused schedular allowables into 1970 could also be applied on a worldwide basis.
 - represents a major simplification of the complex program;
 - appropriate step for the ultimate elimination of the program.

- C) Offer up to \$2.0 million additional allowables on a matching basis to companies using the minimum allowable and investing in the LDC's (Schedule A).
 - gives real benefit to LDC's who may feel elimination of the schedules was a removal of preferential treatment;
 - to be administered through the specific authorization process to avoid complication of the Regulations and to maintain control of the amount of the relief.

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The estimated balance-of-payments burden of the liberalized program rests heavily on two conditions: that U.S. direct investors will continue to rely heavily-- although not as heavily as this year--on the use of foreign funds to finance their direct investment; and that they will use in 1970 a relatively small portion of unused 1969 allowables carried forward into 1970. These conditions seem likely to be met on the basis of an analysis of currently available company reports and plans.

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Attachment

The Federal Reserve Program for 1970

The Board of Governors proposes that the 1970 Federal Reserve guidelines for restraints on credits by U.S. financial institutions to foreigners be revised principally to insure that more emphasis is given to credits for financing U.S. exports than to credits for other purposes.

As compared with the present ceiling of \$10.1 billion for commercial banks, of which \$9.1 billion is currently utilized, there would be two ceilings for each bank. A new Export Term Loan Ceiling will be applicable to all export term loans financing goods exported from the U.S. after October 31, 1969. The amount of this ceiling for participating banks, as a group, will be \$1.3 billion. A General Ceiling, unchanged from the present ceiling of \$10.1 billion, will be applicable to all other bank loans to foreigners. However, as outstanding export term loans under the General Ceiling are repaid, the level of this ceiling will be reduced accordingly but the Export Term Loan Ceiling will be increased by the same amount.

Export credits guaranteed or participated in by the Export-Import Bank, guaranteed by the Department of Defense or insured by the Foreign Credit Insurance Corporation will continue to be exempt from the ceiling.

Minor changes will be made in the guidelines applying to non-bank financial institutions, such as insurance companies and pension funds. These changes will also provide some new leeway for export term loans.

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MEMORANDUM

THE WHITE HOUSE
WASHINGTON

ACTION

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November 20, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten *CFB*

SUBJECT: Balance of Payments Program for 1970

*I eat all the steps
Please just write
without delay
Nov 24*

At Tab I is a memorandum for the President on the 1970 balance of payments program, triggered by a memorandum from Secretary Kennedy. I have discussed the issue at length with Arthur Burns and have cleared your memorandum with him.

Early decisions are needed so that U. S. companies and banks can take the new rules into account in developing their 1970 investment plans. In fact, the agencies are anxious to announce the decisions before the big meeting of businessmen here on Friday, in which the President will participate, but this is not necessary.

Secretary Kennedy's recommendation is the result of a compromise which he worked out between Secretary Stans, who wants more liberalization of the controls on corporations, and Arthur Burns and the present Federal Reserve, who want little or no liberalization in view of the dismal outlook for our balance of payments.

Any liberalization runs some foreign policy risk vis-a-vis the Europeans because of our dismal payments outlook, and it is conceivable -- though highly doubtful in my judgment -- that we could be forced sometime next year to take drastic unilateral action such as suspending gold convertibility of the dollar. The foreign policy problem would arise because we might then be blamed for precipitating the crisis by relaxing our own defensive measures. The answer is that our liberalization is quite moderate and any crisis of the magnitude described would result overwhelmingly from other factors.

In any event, some liberalization -- at least toward the LDCs -- is virtually dictated by the President's commitment, in the Latin America speech, to seek ways to modify the controls to promote U. S. investment in Latin America and other LDCs. Commerce originally proposed a course of action which moved in the opposite direction: elimination of the present distinctions made among three groups of countries, under which allowable investment in the LDCs is much higher than elsewhere.

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Commerce proposed a substitute preference for investment in the LDCs, but it is highly technical and would only be applied on a case-by-case basis in any event. It would be lost in the shuffle of the overall changes in the program, and we would appear to have tightened our treatment of investment in Latin America as a result.

The Kennedy compromise would adopt the Commerce proposal in addition to the present preference for investment in LDCs and would therefore fully meet the President's commitment. I therefore recommend that you support it.

Arthur Burns has proposed a different compromise, however, which would amount to less overall liberalization but a greater degree of preference for the LDCs. It would amount to a liberalized version of the Commerce preference scheme, maintenance of the present preference for investment in LDCs, and no change at all in the controls over investment in industrialized countries. I am therefore tempted to support it and refrain from doing so only because of Secretary Kennedy's tortuous bureaucratic effort to achieve his compromise. I would find it fully acceptable and recommend that you so state in your memorandum for the President.

RECOMMENDATION:

That you sign the memorandum for the President at Tab I.

Concurrence: ANachmanoff 

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