

THE WHITE HOUSE

WASHINGTON

September 25, 1969

1241
BB ✓

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

SUBJECT: Implementation of the President's Comment on
Balance of Payments Effects of U. S. Government
Transactions

At Tab I is an information memo which you sent to the President on September 15. The President penned "no" in the margin next to the penultimate paragraph.

I interpreted that as meaning "no" to the suggestion by Arthur Burns which is the topic sentence of the paragraph, although it could also be "no" to the purely analytical point in the second sentence of the paragraph. I lean toward the former interpretation, since the President would be in error analytically under the latter interpretation.

I am sure that Burns did not feel very strongly about his suggestion, which was made on August 11, and I see no reason to pursue the matter any further, since no action is called for under either interpretation. Inaction is particularly appropriate because of the uncertainty over the "no" meaning and in view of Burns' sensitivity over his memos going to the President through you.

RECOMMENDATION:

That you take no action on the "no" written in the margin. (If you wish to convey the decision to Burns, there is at Tab A a memorandum that would do so.)

APPROVE

✓
9-29-69

DISAPPROVE

MEMO TO BURNS NOT SENT.

J

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

September 15, 1969

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *HK*

SUBJECT: Payments Effects of U. S. Government Transactions,
FY 1968-70.

Attached at Tab A is Bob Mayo's report on the balance-of-payments effects of recent and current U. S. Government international transactions. Comments by Arthur Burns and Paul McCracken are at Tabs B and C.

The key elements of the report are:

1. The payments effects of all government transactions leveled off during the past two years at about \$2 billion net deficit.
2. This figure, however, includes window-dressing receipts of about \$1.5 billion.
3. The deficit on regular transactions has thus been about \$3.5 billion, although it has shown steady improvement and is expected to diminish by 12% to about \$3 billion in FY 1970.
4. Because this Administration has decided to eschew window-dressing statistical gimmickery, however, the total net payments effect of government transactions will deteriorate this year.
5. The Defense Department accounts for over two-thirds of the gross payments -- almost \$5 billion annually -- and is responsible for the total net deficit on regular transactions plus offsetting the effect of the special transactions.
6. Non-defense agency transactions now produce a slight favorable balance on their regular transactions, which should grow somewhat in 1970. Much of the inflow is return on previous loans.
7. AID, which is often labeled as a major source of the U. S. payments deficit, has steadily reduced its foreign payments to the relatively small figure of \$145 million in 1970. This is a good bit less than half its receipts and less than the combined payments of Interior, NASA and the Panama Canal. The AID receipts are mainly repayments on past loans.

Analytically, this report is useful but cannot be simply compared with our overall payments position -- as many people do to conclude that "the deficit is caused by government spending." This is because there are large offsetting feedbacks to the government expenditures which show up in the private accounts.

For example, Korea and Thailand would not buy as many U. S. exports if they earned no dollars from DoD programs. Even Japan and major countries in Europe adopt easier economic policies because of our military expenditures there, of which some share comes back to us. This is not to say that government expenditures are not a major factor in our payments deficit -- but simply to flag the error in simplistic comparisons.

Paul McCracken comments that we should carefully consider the domestic economic effects of the policies, which we inherited from the previous Administration, to minimize foreign expenditures for government programs. He is referring to such practices as the 50 percent preference extended by DoD to domestic suppliers and AID's tying policies, which create some balance of payments savings but are quite costly in budgetary terms. (Reductions in the level of our overseas programs, as per your recent directive on personnel and the Vietnam troop withdrawals, of course help our balance of payments. McCracken is here referring to the foreign exchange costs of a fixed level of government programs.)

Arthur Burns, on the other hand, suggests that you ask the Treasury Department to make recommendations on steps to reduce further the balance of payments costs of overseas government expenditures. Any such steps would probably carry the increased budgetary costs mentioned by McCracken and have small payments effects, unless they represented major program changes.

An interagency committee, chaired by Treasury, is in fact already reviewing present policy and will be making recommendations soon on possible changes. I therefore think that you do not need to take any action now. One change -- the elimination of the "additionality" requirements under our AID programs -- has of course already been made.

SEP 12 1969

WHITE HOUSE OFFICE OF
RECEIVED

9-27-69

A

THE WHITE HOUSE
WASHINGTON

September 25, 1969

MEMORANDUM FOR ARTHUR BURNS

FROM: Henry A. Kissinger

The President has asked me to inform you that he would prefer not to pursue at this time your suggestion of August 11 that the Treasury Department be asked to provide recommendations on further steps to reduce the impact of U. S. government transactions on our balance of payments.

9-24

Secretariat Re 1241

I had to tube the original memo back to Mr. Bergsten urgently. This is a copy of the original memo with the President's "no" on page 2. - for your files.

nancy

A

THE WHITE HOUSE

1241

ACTION MEMORANDUM

WASHINGTON

LOG NO.: 997

A

Date: Saturday, August 9, 1969

Time: 10:30 A.M.

FOR ACTION: ✓ Dr. H. Kissinger
P. McCracken
Dr. A. Burns

cc (for information):
Dir. Mayo

FROM THE STAFF SECRETARY

DUE: Date: Tuesday, August 12, 1969

Time: 2:00 P.M.

SUBJECT:

Director Mayo memo to the President regarding transactions of the Federal Government, Fiscal Years 1968-1970.

ACTION REQUESTED:

- | | |
|---|--|
| <input type="checkbox"/> For Necessary Action | <input checked="" type="checkbox"/> For Your Recommendations |
| <input type="checkbox"/> Prepare Agenda and Brief | <input type="checkbox"/> Draft Reply |
| <input type="checkbox"/> For Your Comments | <input type="checkbox"/> Draft Remarks |

REMARKS:

Please review the attached and submit your comments by return memorandum.

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting...

JRW

W. B. COLE, JR.

For the President

1241
A

EXECUTIVE OFFICE OF THE PRESIDENT
BUREAU OF THE BUDGET
WASHINGTON, D.C. 20503

AUG 8 1969

MEMORANDUM FOR THE PRESIDENT

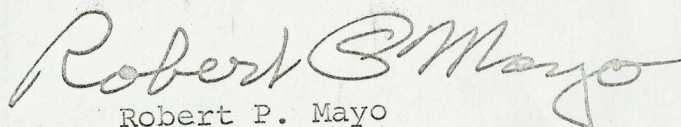
Subject: International transactions of the
Federal government, fiscal years 1968-1970

Highlights

The most recent agency reports on the balance of payments impact of their budgetary transactions (which do not reflect your directives for reductions in overseas personnel) indicate:

- The net dollar outflow abroad from the Federal Government's regular activities amounted to an estimated \$3,413 million in fiscal year 1969, or \$55 million less than in fiscal 1968.
- In fiscal 1970, the net outflow for regular activities is expected to fall by another \$377 million.
- In both 1969 and 1970, a small but increasing surplus for non-Defense agencies is indicated. This reverses the net outflow for these agencies in all other recent years.

Attached is a more detailed summary of the impact of the Federal Government's activities on the U.S. balance of payments during fiscal years 1968-1970. (This report has in past years been misleadingly nicknamed "The gold budget.")


Robert P. Mayo
Director

Attachment

SUMMARY OF RESULTS
(May-June 1969 Agency Submissions)

The excess of payments over regular receipt transactions, as now estimated, amounted to \$3,413 million in fiscal 1969, a decline of \$55 million from 1968. Net payments by Defense rose by \$86 million, but all other agencies had a net improvement of \$140 million. In 1970, net payments are expected to decline by \$377 million; both Defense and other agencies show improvement.

If special transactions are included, net payments are estimated to have declined by \$262 million in 1969.

Payments increased by an estimated \$258 million in 1969, almost entirely because of higher Defense outlays (\$245 million). For 1970, a further increase of \$161 million is expected in total payments, about half of which would come from Defense.

Regular receipts increased by an estimated \$312 million in 1969, and are forecast to rise even more (\$538 million) in 1970. Both Defense and other agencies contribute substantially to these increases.

Special transactions receipts were relatively higher in both 1968 and 1969 (\$1,321 million and \$1,528 million, respectively). These consist largely of sales of non-marketable Treasury securities and of Export-Import Bank loans. As in the past, special Treasury security sales for 1970 are not forecast in advance; hence, the net credits of \$183 million shown in the table provide no indication of the special transactions that will ultimately be made in 1970.

PAYMENTS

Both the current levels and the changes in overseas expenditures continue to be dominated by Defense outlays. The latter increased by \$245 million in 1969 and will rise by \$88 million more in 1970.

Non-Defense outlays account for about 30% of total payments. The revised 1969 total of \$1,841 million represents an increase of \$13 million over 1968. The only major increases in specific agency programs were a one-time reimbursement on completion of a Canadian reservoir paid for by the Corps of Engineers (\$40 million) and an increase in Treasury interest payments on the public debt held abroad (\$15 million). The further rise of \$73 million

in non-Defense outlays now forecast for 1970 predominantly reflects increased Treasury contributions to the capital of international financial agencies (\$61 million). AID payments are scheduled to decline in both years.

RECEIPTS

Total receipts overseas rose by an estimated \$521 million in 1969. Substantially larger principal and interest receipts by the Export-Import Bank, increased military sales by Defense, and higher loan collections by AID were offset in part by deferral of principal and interest payments on Treasury loans to the United Kingdom.

In 1970, total receipts are currently estimated to be \$1,175 million lower than in 1969, because of the absence of any estimate for foreign sales of special Treasury securities.

Table 1. SUMMARY OF INTERNATIONAL TRANSACTIONS
OF THE FEDERAL GOVERNMENT
(Fiscal years; in millions)

	<u>1968</u> actual	<u>1969</u> estimate	<u>1970</u> estimate
<u>Governmentwide</u>			
Payments-----	\$6,323	\$6,581	\$6,742
Regular receipts-----	<u>2,856</u>	<u>3,168</u>	<u>3,706</u>
Excess of payments over regular receipts-----	3,468	3,413	3,036
Less:			
Special transactions, net-----	<u>1,321</u>	<u>1,528</u>	<u>-183</u>
Excess of payments over total receipts-----	2,147	1,885	3,219
<u>Defense:</u>			
Payments-----	4,495	4,740	4,828
Regular receipts-----	<u>1,063</u>	<u>1,222</u>	<u>1,592</u>
Excess of payments over regular receipts-----	3,432	3,518	3,236
Less:			
Special transactions, net-----	<u>-13</u>	<u>27</u>	<u>-391</u>
Excess of payments over total receipts-----	3,445	3,491	3,627
<u>All agencies excluding Defense:</u>			
Payments-----	1,828	1,841	1,914
Regular receipts-----	<u>1,793</u>	<u>1,946</u>	<u>2,114</u>
Excess of payments, or regular receipts (-)-----	35	-105	-200
Less:			
Special transactions, net-----	<u>1,334</u>	<u>1,501</u>	<u>208</u>
Excess of payments, or total receipts (-)-----	-1,299	-1,606	-408

Notes: (1) In instances where Defense and a civilian agency both reported the receipts from certain transactions, half of the total receipts were credited to each agency.

(2) Details may not add to totals because of rounding.

Table 2. INTERNATIONAL PAYMENTS BY AGENCY
(Fiscal years; in millions)

	1968 actual	1969 estimate	1970 estimate
Defense-Military ^{1/} -----	\$4,425	\$4,705	\$4,791
AID-----	178	159	145
Subtotal-----	<u>4,603</u>	<u>4,864</u>	<u>4,936</u>
<u>Uncontrollable items:</u>			
Pensions and annuities-----	382	385	400
Treasury - Interest on public debt	620	635	635
Other financial transactions---	207	156	213
Subtotal-----	<u>1,208</u>	<u>1,176</u>	<u>1,249</u>
<u>Export promotion:</u>			
Agriculture-----	13	15	18
Commerce-----	4	6	8
Subtotal-----	<u>17</u>	<u>20</u>	<u>25</u>
<u>Other agencies:</u>			
State ^{1/} -----	155	154	146
USIA-----	56	56	58
Panama Canal ^{1/} -----	46	53	58
Interior-----	50	56	59
NASA-----	30	36	37
Agriculture ^{2/} -----	28	24	25
Peace Corps-----	22	23	23
Post Office-----	17	18	18
Transportation-----	14	18	18
TVA-----	14	15	23
Corps of Engineers-----	12	53	*
AEC-----	7	6	5
GSA-----	6	12	14
Commerce ^{2/} -----	6	7	7
HEW ^{1/} -----	3	2	2
Treasury ^{3/} -----	3	4	5
NSF-----	3	3	2
Justice ^{1/} -----	2	2	2
ABMC-----	2	2	2
VA ^{1/} -----	1	2	2
Subtotal-----	<u>478</u>	<u>546</u>	<u>504</u>
Total-----	6,307	6,606	6,715
Add: Net purchases of foreign currencies for "unfunded" reserved currency accounts----	16	-25	27
Total payments-----	<u>6,323</u>	<u>6,581</u>	<u>6,742</u>

1/ Excludes payments of pensions and annuities.

2/ Excludes payments for export promotion.

3/ Excludes uncontrollable transactions and \$16.5 million payments to Interhandel in 1968 and 1969.

* Less than \$500,000.

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

Table 3. INTERNATIONAL RECEIPTS, BY AGENCY.
(Fiscal years; in millions)

<u>Total receipts:</u>	1968 <u>actual</u>	1969 <u>estimate</u>	1970 <u>estimate</u>
Defense-----	\$1,249	\$1,439	\$1,397
Treasury-----	1,429	1,293	177
Export-Import Bank-----	952	1,314	1,325
Agriculture-----	473	404	425
AID-----	259	367	342
Panama Canal-----	90	91	95
AEC-----	44	77	76
State-----	26	24	23
Post Office-----	24	24	24
Transportation-----	14	10	10
Interior-----	4	13	6
NASA-----	2	11	7
All other-----	10	9	8
Less: Duplication in agency reporting-----	399	380	392
 Total receipts-----	 4,176	 4,697	 3,522
 <u>Special transactions, net:</u> (included in totals above)			
Defense, advance payments for military sales, drawdowns, and related adjustments, net----	-90	23	-398
Treasury, sales of medium term, non-marketable securities-----	1,185	1,154	-48
Special deposit item-----	--	52	--
Loan prepayments:			
Ex-Im Bank-----	7	--	--
DOD-----	38	4	--
AID-----	--	66	--
Export-Import Bank sales of loans and certificates-----	103	230	255
Other:			
Agriculture/DOD-----	78	--	--
 Total, special transactions-----	 1,321	 1,528	 -183
of which Defense is-----	-13	27	-391
 <u>Regular receipts:</u> ^{1/}			
Governmentwide-----	2,856	3,168	3,706
Defense-----	1,063	1,222	1,592
All agencies, excluding Defense--	1,793	1,946	2,114

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

1/ See note 1/ on Table 1.

B

THE WHITE HOUSE

WASHINGTON

August 11, 1969

MEMORANDUM FOR THE STAFF SECRETARY

FROM: Arthur F. Burns *AFB*

SUBJECT: Director Mayo's Memo to the President re:
Transactions of the Federal Government FY 1968-1970

Director Mayo's memorandum is informational in character. It presents no recommendations for Presidential action.

The report demonstrates that the contribution of Federal Government activities to the deficit in our balance of payments has lately diminished somewhat; but that neither the actual diminution, nor that in prospect, is at all substantial.

I suggest that the President seek the recommendations of the Treasury Department on what steps can be reasonably taken to reduce further the impact of governmental transactions on the balance of payments.

C

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

August 15, 1969

MEMORANDUM FOR KEN COLE

Subject: Memo of Director Mayo to the President regarding
International Transactions of the Federal Government,
Fiscal Years 1968-1970

The memo of Director Mayo to the President provides information on the balance of payments impact of the international transactions of the Federal Government -- i. e., on the balance of payments budget, which in preceding years had carried the misleading title of "The Gold Budget."

It would, however, be desirable to place discussion of these transactions within a broader context. Apart from the political question of reducing the obtrusiveness of the American presence abroad, which is associated primarily with the number of personnel abroad and is being dealt with by Secretary Richardson's Committee, the domestic economic effects of government international transactions should also be considered. For instance, increased preferential use of domestic suppliers to service installations abroad would reduce the balance of payments cost of such installations, but resources would be allocated less efficiently and the budgetary cost to the government would be increased. These are considerations which should be examined explicitly. Studies underway at the Defense Department, regarding the budgetary implications of the preference for U.S. suppliers, should throw light on these problems.


Paul W. McCracken

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

ACTION

August 26, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

SUBJECT: Payments Effects of U.S. Government
Transactions, FY 1968-70

Attached is a revised memorandum for the President on overseas expenditures under Government programs. It incorporates the changes which you directed and the comments made by Paul McCracken and Arthur Burns, which Ken Cole asked us to incorporate in our memo. Because of their comments, I have also added a note as to where the policy review of this issue stands.

RECOMMENDATION:

That you sign the attached memorandum to the President (Tab I).

Analytically, this report is useful but cannot be simply compared with our overall payments position -- as many people do to conclude that "the deficit is caused by Government spending." This is because there are large offsetting feedbacks to the Government expenditures which show up in the private accounts.

For example, Korea and Thailand would not buy as many U.S. exports if they earned no dollars from DOD programs. Even Japan and major countries in Europe adopt easier economic policies because of our military expenditures there, of which some share comes back to us. This is not to say that Government expenditures are not a major factor in our payments deficit -- but simply to flag the error in simplistic comparisons.

I

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

August 25, 1969

MEMORANDUM FOR FRED BERGSTEN

FROM: Jon Howe *JH*

Attached are memoranda from Paul McCracken and Arthur Burns commenting on Mayo's memorandum to the President concerning international transactions of the Federal Government fiscal years 1968 through 1970. Ken Cole's office has requested that we incorporate these memoranda into ours for the President so that he will have one concise package. They would like to have this in Tuesday's pouch. OK?

Attachments
a/s

*PNC Phys need to consider even effort of
By us -
under control - help what
AB - sub this with my for
phys to value 456
put - help*

MEMORANDUM

THE WHITE HOUSE
WASHINGTON

*Send to Pres.
after dating*

Sent to Pres 8-21-69

1241

AUGUST 13, 1969

W

MEMORANDUM FOR HENRY A. KISSINGER

FROM: Fred Bergsten
SUBJECT: Payments Effects of U.S. Government
Transactions FY 1968-70

The memorandum at Tab I summarizes and comments on a report from Bob Mayo on the balance-of-payments effects of U.S. Government transactions in the fiscal years 1968-70. This is the report which was formerly labeled the "gold budget." It is an effort to see how much defense, aid and other government activities contribute to the U.S. payments deficit.

Analytically, these reports are useful but cannot be simply compared with our overall payments position - as many people do to conclude that "the deficit is caused by Government spending." This is because there are large offsetting feedbacks to the Government expenditures which show up in the private accounts. For example, Korea and Thailand would not buy as many U.S. exports if they earned no dollars from DOD programs. Even Japan and major countries in Europe adopt easier economic policies because of our military expenditures there, of which some share comes back to us. This is not to say that Government expenditures are not a major factor in our payments deficit - but simply to flag the error in simplistic comparisons.

*Wrote
memo to Pres.*

THE WHITE HOUSE

WASHINGTON

August 12, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

SUBJECT: Payments Effects of U.S. Government Transactions
FY 1968-70

The memorandum at Tab I summarizes and comments on a report from Bob Mayo on the balance of payments effects of U.S. Government transactions in the fiscal years 1968-70. This is the report which was formerly labeled the "gold budget." It is an effort to get at just how much defense, aid and other government activities contribute to the U.S. deficit.

The recent wide discrepancy between the official settlements and liquidity payments accounts and their wide swings over the past year show that the rather steady, though considerable, government deficit is easily swamped by private capital movements, particularly from the Eurodollar market. Nevertheless, their report on the government sector, apart from the special or window dressing transactions and the repayment and extension of loans, does give a fairly good picture of the net foreign resources the U.S. Government is consuming. This particular summary, however, does not sufficiently separate the long-term or "capital" transactions from current expenses and receipts and will need to be reviewed by the group working to improve U.S. balance of payments definitions.

RECOMMENDATION:

That you sign the attached memorandum to the President. (Tab I)

Comes back to us. This is not to say that Government expenditures are not a major factor in our payments deficit - but simply to flag the error in simplistic comparisons.

Analytically, these reports are useful but cannot be simply compared with our overall payment position -- as many people do to conclude that "the deficit is caused by Government ~~transaction~~ spending." This is because there are large offsetting feedbacks to the Government expenditures which show up in the private accounts. For example, Korea and Thailand would not buy as many U.S. exports if they did not earned no dollars from ODD programs. Even ^(Japan and) ^(in Europe) ~~other~~ ^{many} countries accept easier economic policies because of our military expenditures, some of which some share

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger

SUBJECT: Payments Effects of U. S. Government Transactions, FY 1968-70

Attached at Tab A is Bob Mayo's report on the balance of payments effects of recent and current U. S. Government international transactions.

The key elements of the report are:

1. The payments effects of all government ~~official~~ transactions have been on a ~~slightly descending plateau~~ for the past two years at a ~~level of almost \$2 billion net deficit~~. *levelled off during*
- 2.3. The deficit on regular transactions ~~shows steady improvement~~ over the ~~three years~~, ~~diminishing by some 12%~~ to about \$3 billion in FY 1970. *has this been about \$3.5 billion, although it has shown*
3. Favorable special transactions (mainly Treasury sale of non-marketable securities) increased between 1968 and 1969 (though traditionally no estimate is given for the future year's estimate) reinforcing the improvement in the net for all transactions. Special transactions, however, are mainly window-dressing and do not really represent payments for consumption of resources. *and is expected to*
4. Non-defense agency transactions now produce a slight favorable balance on their regular transactions, which should grow somewhat in 1970. Much of the inflow, ~~however~~, is return on previous loans and is thus a draw down on our government "capital" abroad. *-- almost \$5 billion annually --*
- 5.5. The Defense Department accounts for over two-thirds of the gross payments, and is responsible for the total net deficit on regular transactions plus offsetting the effect of the special transactions.
- 6.7. AID, which is often labeled as a major source for the U. S. payments deficit, is steadily reducing its foreign payments to the relatively small figure of \$145 million in 1970, which is a good bit less than half its receipts and less than the combined payments of Interior, NASA and the Panama Canal. ~~However~~, the AID receipts are also mainly repayments on past loans. *has*

2. This figure, however, includes window-dressing receipts of about \$1.5 billion.

4. Because this Administration has decided to eschew window-dressing (statistical gimmickery), however, the total (net) effect of Government transactions will probably be...

*From Haig to
Bergsten*

SCB021
00 WTE
DE WTE15 B0021

1969 AUG 19 05 04

FROM: AL HAIG
TO : COMMANDER HOWE (WHSR) FOR FRED BERGSTEN
CITE: SCWH90021

BIR
AUG 19 1969

UNCLAS

AUGUST 18, 1969

REQUEST TRANSMITTAL MEMORANDUM TO THE PRESIDENT FOR HENRY'S SIGNATURE BY NOON SAN CLEMENTE TIME, AUGUST 19.

AUGUST 14, 1969

MEMORANDUM FOR THE PRESIDENT

SUBJECT: BALANCE OF PAYMENTS, SECOND QUARTER 1969

MORE DEFINITE FIGURES FOR THE MAIN COMPONENTS OF THE BALANCE OF PAYMENTS HAVE JUST BECOME AVAILABLE FOR THE SECOND QUARTER.

THE DIVERGENCE BETWEEN THE "OFFICIAL SETTLEMENTS" AND "LIQUIDITY" MEASURES CONTINUED AND WIDENED. THE LIQUIDITY DEFICIT, WHICH IS SUPPOSED TO MEASURE OUR POSITION WITH RESPECT TO ALL FOREIGNERS (OFFICIAL AND PRIVATE), SOARED TO \$15.2 BILLION (SEASONALLY ADJUSTED AT ANNUAL RATES). THIS IS A LITTLE MORE THAN DOUBLE THE FIRST QUARTER DEFICIT ITSELF A RECORD. HOWEVER, THE OFFICIAL SETTLEMENTS SURPLUS REFLECTING ONLY CHANGES IN OUR RESERVE AND IN THE CLAIMS OF FOREIGN CENTRAL BANKS ON US, INCREASED SOMEWHAT FROM THE FIRST QUARTER UP FROM AN ANNUAL RATE OF \$4.5 TO \$5.0 BILLION. THE DIFFERENCE BETWEEN THE TWO MEASURES WAS DUE TO CONTINUED HEAVY SHORT-TERM BORROWINGS ABROAD BY AMERICAN BANKS AND BUSINESSES, PARTICULARLY IN THE EURODOLLAR MARKET. A SUBSTANTIAL AMOUNT OF THE MONEY BORROWED FROM THE EURODOLLAR MARKET APPEARS TO HAVE COME FROM U.S. RESIDENTS, HOWEVER, AND SHOULD NOT THEREFORE BE COUNTED AS A REAL OUTFLOW FROM THE UNITED STATES. THE LIQUIDITY DEFICIT IS THEREFORE QUITE MISLEADING.

FOR THE FIRST TWO QUARTERS COMBINED THE OFFICIAL SETTLEMENTS AND LIQUIDITY FIGURES WERE AT ANNUAL RATES OF \$4.8 BILLION SURPLUS AND \$11.0 BILLION DEFICIT, RESPECTIVELY. THESE COMPARE WITH ANNUAL RATES OF \$2.3 BILLION SURPLUS AND \$1.2 BILLION DEFICIT FOR THE FIRST HALF OF LAST YEAR AND \$1.6 BILLION SURPLUS AND \$0.1 BILLION SURPLUS FOR THE WHOLE YEAR 1968.

NET FOREIGN PURCHASES OF OUR STOCKS AND BONDS FELL SUBSTANTIALLY IN THE SECOND QUARTER FROM THEIR PREVIOUS HIGH LEVELS. MERCHANDISE EXPORTS AND IMPORTS BOTH ROSE SHARPLY AFTER THE DOCK STRIKE WAS SETTLED, WITH THE MERCHANDISE BALANCE RETAINING A SMALL DEFICIT. U. S. OFFICIAL RESERVE ASSETS CONTINUED TO RISE (BY \$229 MILLION) AND THE GOLD STOCK INCREASED BY \$317 MILLION.

ALTHOUGH THE LIQUIDITY DEFICIT, AS REPORTED, IS HUGE, IT WILL NOT COME AS A SURPRISE TO THE MARKET AND THEREFORE SHOULD NOT WEAKEN THE DOLLAR. IN FACT IT IS THE LARGE OFFICIAL SETTLEMENTS SURPLUS THAT KEEPS THE DOLLAR TECHNICALLY STRONG. IT IS CLEAR, HOWEVER, THAT WE NEED BETTER CONCEPTS TO REPRESENT OUR TRUE BALANCE OF PAYMENTS POSITION.

/S/ PAUL W. MCCRACKEN

DTG: 190340Z AUG 69

GPS: 630

SECRET

June 6, 1969

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *HK*

SUBJECT: The International Monetary Situation

Memoranda from Paul McCracken

Attached at Tabs A and B are information memoranda from Paul McCracken on the international monetary situation. Their major points are:

1. The U.S. balance of payments was in deficit by the incredible amount of \$2.1 billion in the two weeks ending May 14. (The deficit has never been more than \$4 billion in any previous year.) The U.S. was thus the source of about one-half the money which flowed into Germany during that period. For the year to date, we are now in small surplus on one of our payments definitions and in deficit by about \$4 billion on the other.
2. Germany has lost about \$1.2 billion of the \$5 billion inflow of those two weeks. The market is not convinced that the DM will not be revalued and most of the speculative money is sitting tight to await further developments.
3. The UK has regained about \$400 million of its \$600 million loss. France has regained about \$100 million of its \$500 million loss.

Memorandum from Secretary Kennedy

Attached at Tab C is an earlier information memorandum from Secretary Kennedy which gives his views on the international monetary situation.

The Secretary concludes that our short-term interests lie in promoting capital reflows out of Germany and into the UK. He thus:

1. Sees no alternative to accepting the German decision against revaluation, privately as well as publicly.
2. Notes that the issue of additional credits to the UK is bound to arise; their "new" \$1 billion credit from the IMF contains at best \$300 million of really new money.

SECRET

3. Feels that the German decision will change only if an even more severe crisis develops or if other countries decide to change their exchange rates as well.

4. Suggests that an orderly exchange rate realignment may be possible this summer, implying (per 3) either that a severe crisis lies ahead or that countries other than Germany will decide to change their rates.

5. Judges that we will continue to face formidable uncertainties until the exchange rate situation is resolved.

Further developments

Developments since the German decision give little hope that the immediate problem of exchange rate disequilibrium has been solved.

First, the "recycling" of speculative funds agreed upon by the central bankers at Basel on May 11 is very meager. The Bundesbank has agreed only to recycle \$500 million to countries other than the UK and \$120 million to the UK. They will not agree to any recycling for the UK unless the German government guarantees the credit against UK default. Coming against the total inflow of \$5 billion since the French referendum, the amount is thus grossly inadequate and, unless Britain is better provided for, may not be adequately distributed.

Second, as noted by Dr. McCracken, the market is clearly skeptical that exchange rates changes will be avoided. Only about 25 percent of the inflows have moved back out through the market. Most of the speculative money, at least for the moment, is awaiting further developments.

Third, there are additional uncertainties:

- Dr. McCracken relayed the bad U. S. balance of payments figures.
- The British trade figures are bad for the third month in a row and will heighten doubts that Britain has solved its balance-of-payments problem.
- The French trade figures for April are also bad and have intensified the view that devaluation of the franc must occur fairly soon.
- The additional German economic measures, adopted "in lieu of revaluation", are aimed mainly at their domestic inflationary pressures and hence will further increase their external surplus; their measures to deal directly with the external position are puny.

Outlook

The one ray of hope is that Germany, despite its public avowals that its decision not to revalue is "eternal", has already indicated privately that it will still consider revaluation if it can get company from other countries. But no "company" seems interested and the Germans have also indicated that "eternal" means "until after its election in September." There is virtually unanimous agreement that a DM revaluation is inevitable; hence a new speculative crisis is certain to develop as the election approaches.

What France will do regarding devaluation, after the runoff election, is unclear. Some experts think that Pompidou would devalue quickly and pin the blame on de Gaulle. And Poher has begun to echo the Strauss call for a "multilateral realignment".

Any new French government, however, would probably wish to deal with the pending wage negotiations before devaluing and would also need time to prepare a plan for supplementary domestic measures to make any devaluation work. (Such a position is quite defensible.) By the time these two problems are met, the Bonn elections may be close at hand and Germany will probably not wish to move even in concert with others. In short, there is no certainty that France will provide Germany with its desired "company" very soon.

The UK will also remain on the margin, with liquid debts swamping its meager reserves, especially if the Wilson Government continues to face major political problems. There is little chance of a discreet UK devaluation, however, which would provide "company" for Germany. The British would be more likely to impose additional import controls or let the pound float freely. A French devaluation without a German revaluation could force such action on the UK.

General uneasiness about exchange rates, especially if coupled with large U. S. deficits, could also jeopardize European agreement to early and sufficient activation of Special Drawing Rights and thereby exacerbate the jitters surrounding the system.

The United States has two tactical options in the present situation:

(1) We can attempt to apply pressure soon, during a period of relative calm, to try to pre-empt future crises. The pressure would be mainly on the Germans to revalue or take decisive alternative steps to reduce their payments surplus, but might have to extend to other countries to provide "company" for them.

SECRET

(2) We can simply await the next crisis, which is virtually certain to occur by September and could come much earlier, and seek the desired changes then.

Experience shows that intervention in a period of relative calm -- unless handled extremely deftly and with extremely good luck -- can create the very crisis it seeks to pre-empt. Intervention during a crisis, however, could plunge us even more deeply into the midst of a major domestic political struggle in Germany.

Embassy Bonn has recommended against any U.S. intervention due to the possibility of fanning "nationalistic sentiments" in Germany and strengthening the right wing there. Our approach prior to the decision not to revalue was, of course, unsuccessful. We are thus threatened with policy paralysis in dealing with the immediate situation.

However, inaction carries serious risks. The certainty of renewed crises and the nearness of the UK to bankruptcy means that the system could suffer severe disruption. This could lead to renewed pressures on the U.S. gold stock, especially if our balance of payments were to deteriorate sharply, and force us to make some difficult decisions on our own international monetary policy.

And even if the system does not face fundamental disruption, there is likely to be a further escalation of restrictions on international trade and payments by other countries unless the necessary exchange rate realignment occurs and there is reform of the overall system.

Conclusion

The short-term threat of renewed crises highlights the more fundamental problems of the international monetary system. In fact, the short-term problem of exchange rate realignment probably must be solved before we can get the type of long-range reform favored by most of our officials -- greater flexibility of exchange rates -- or even before this kind of reform can be openly discussed internationally, because of the probability of kindling speculation if rates are out of line when such reform is discussed.

The time has thus come when the United States needs to define clearly its strategy on both the short-term and longer-term aspects of the monetary problem and pull the two together.


There are a number of important international monetary meetings in June. In addition, Secretary Kennedy's speech to the American Bankers Association on June 20 provides an excellent opportunity for a major statement of the Administration's international monetary policy. If we do not begin to move now, it will be difficult to do so before September. At a minimum, we should be ready to take major initiatives in the fall after the key European elections are over. We should thus try to make our decisions fairly quickly.

In early April, you asked the Secretary of Treasury to coordinate for you an interagency options paper on monetary reform. Two weeks ago you agreed to my recommendation to convene an early meeting to discuss overall international monetary policy, to be attended by the Secretaries of Treasury and State, Chairman Martin, Paul McCracken and myself.

RECOMMENDATION:

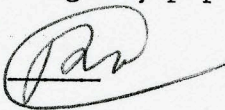
I now recommend that you authorize me to:

1. Set up a meeting in about ten days to consider U.S. international monetary policy, both short-term and toward longer run reform of the system. (If our meeting slides beyond that point, it will be difficult to take any initiatives you might decide before summer.)

Approve 

Disapprove _____

2. Ask Treasury to submit, as the basis of discussion for that meeting and sufficiently prior to it, the interagency paper you asked for earlier.

Approve 

Disapprove _____

See me _____

Historical File

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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

May 16, 1969

MEMORANDUM FOR THE PRESIDENT

Subject: International Financial Report for the Current Week

This was a relatively quiet week on the international financial markets, after the hectic rush of last week. The slower pace was, of course, encouraging, as was the direction of international reserve movements. The British, who had lost over \$600 million on the markets in the previous two weeks, regained \$310 million this week. The French were also gainers, although to a lesser degree (over \$100 million, although a complete figure for the week is not yet available). There was an outflow from Germany of about \$840 million -- less than a fifth of the \$4.6 billion inflow (gross of swaps) during the previous two weeks.

(Note: These data are confidential data involving the accounts of other countries, and cannot be used publicly.)

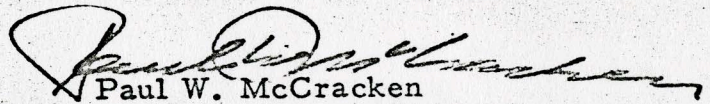
Grounds for concern, however, remain. The return flow was heavily concentrated at the beginning of the week, and dropped off sharply as the week wore on. This in itself was not surprising, as there was pressure at the beginning of the week on some of those, who "took positions" in the speculative rush, to reverse themselves. But the signs that the flow might be drying up suggested that the greater part of the money which moved into Germany is sitting tight to see what develops. Thus, while the market does not have the immediate expectations of a German revaluation which were evident last week, some skepticism remains over the continuing viability of the present exchange rate structure.

For the week ending Wednesday, May 14, (which includes the rush of Thursday and Friday a week ago), the U. S. had a deficit of \$1,340 million on the liquidity basis, and \$1,755 million on the official settlements basis. For the two week period ending May 14, the two deficits were almost identical, at \$2.1 billion. This suggests that about half of the inflow into Germany originated in the U. S.

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The cumulative 1969 liquidity deficit through May 14 has been just over \$4 billion, compared with just under \$1 billion in the corresponding periods of 1967 and 1968.

The cumulative 1969 official settlements deficit through May 14 was about the same as a year ago, though the pattern was sharply different.

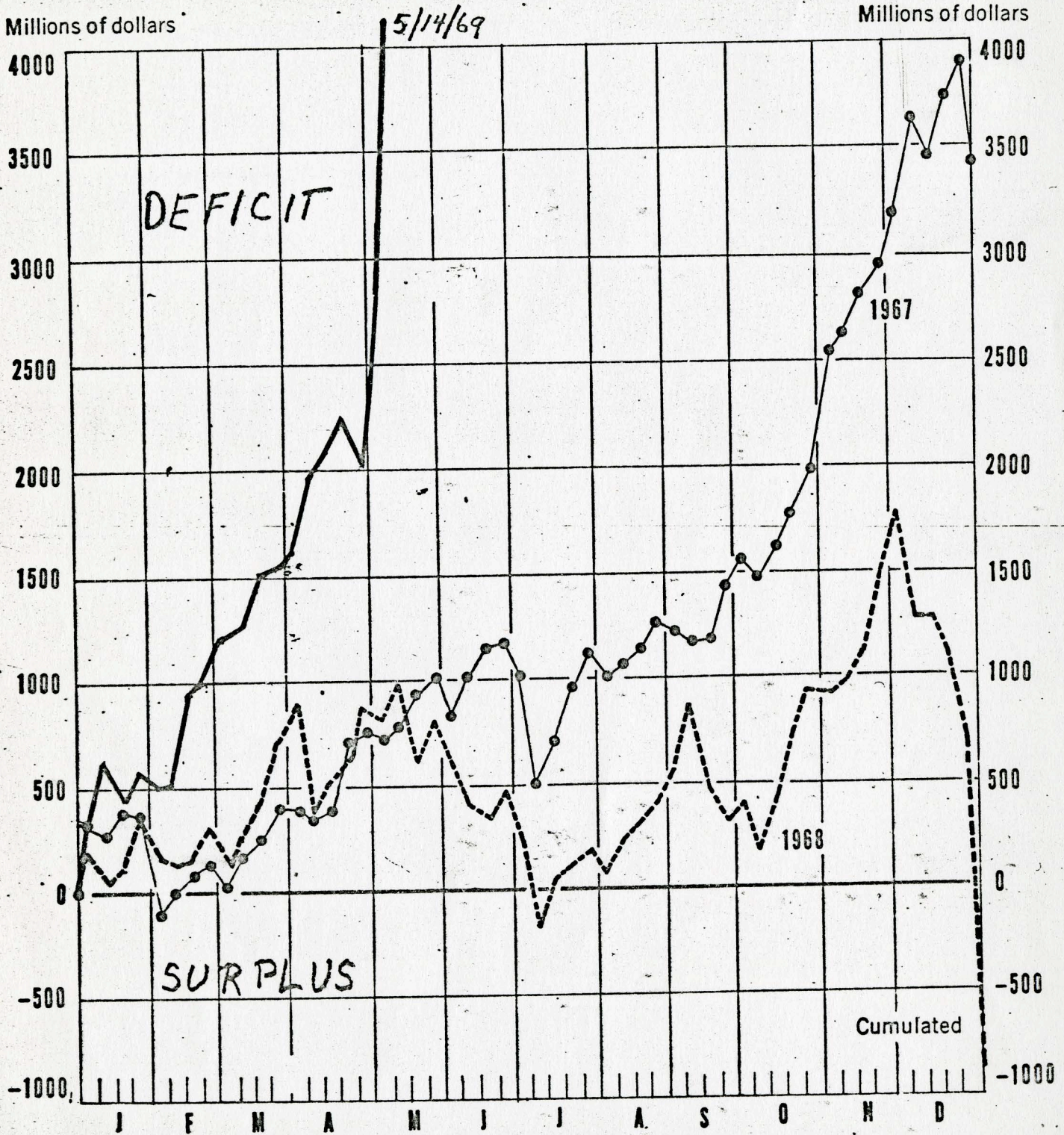


Paul W. McCracken

Chart I

U.S. BALANCE OF PAYMENTS BASED ON WEEKLY DATA
(LIQUIDITY BASIS)

Deficit (+), surplus (-)

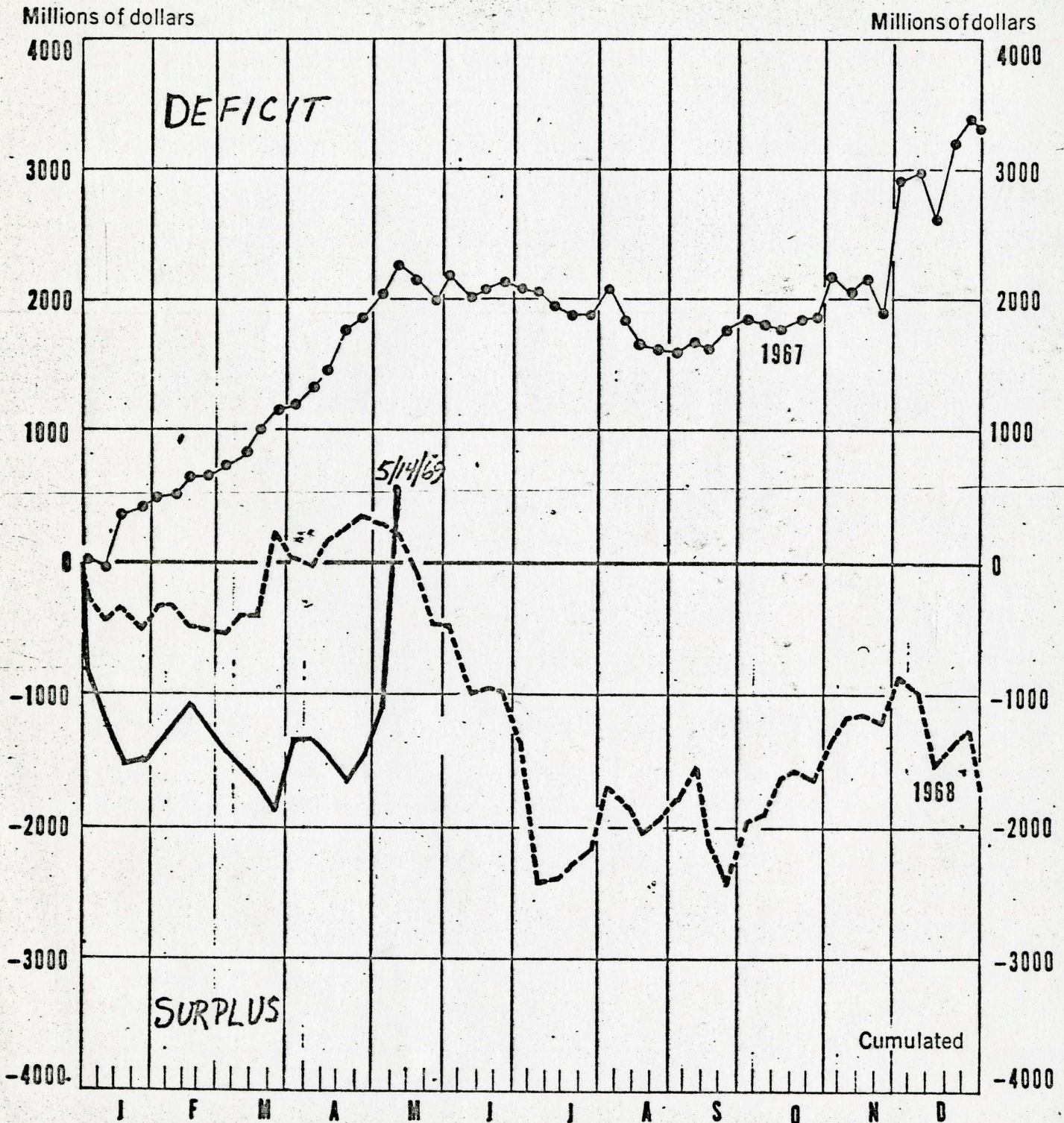


The \$823 million net surplus for the week ended January 4, 1967 is shown as a \$1,145 million surplus for December 28-30, 1966 and a \$322 million deficit for January 1-4, 1967. Likewise, the \$276 million net surplus for the week ended January 3, 1968 is shown as a \$458 million surplus for December 28-29, 1967 and a \$182 million deficit for January 1-3, 1968.

Chart II

U.S. BALANCE OF PAYMENTS BASED ON WEEKLY DATA (OFFICIAL RESERVE TRANSACTIONS BASIS)

Deficit (+), surplus (-)



The \$474 million net surplus for the week ended January 4, 1967 is shown as a \$499 million surplus for December 29-30, 1966 and a \$25 million deficit for January 1-4, 1967. Likewise, the \$341 million net surplus for the week ended January 3, 1968 is shown as a \$70 million surplus for December 28-29, 1967 and a \$271 million surplus for January 1-3, 1968.

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THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

B
May 24, 1969

MEMORANDUM FOR THE PRESIDENT

Subject: Weekly Report on International Finance

The Germans continued to work off some of the dollars that they had acquired during the recent speculative wave. During the current week, they sold \$405 million in U. S. dollars on the spot market.

On Wednesday, they began swapping out dollars again and worked off another \$262.5 million from their official holdings in this manner. (Swaps involve a sale of dollars by the German Central Bank to German Commercial Banks under a repurchase agreement. By this procedure, the Central Bank is able to reduce temporarily its holdings of unwanted dollars. The Commercial Banks find it advantageous to engage in the transaction because of the interest incentive, and because the repurchase agreement protects them from a capital loss on their acquired dollar assets in the event of a revaluation of the D.M.)

The swapping procedure had been suspended during the speculative wave because the dollars swapped out by the Bundesbank were finding their way into the hands of speculators, who sold them back to the Bundesbank for D.M. Thus, in effect, the Bundesbank found itself buying the same dollars more than once.

The Germans raised their required reserves on bank deposits, effective June 1. While this and other anti-inflationary steps will act as partial domestic substitutes for revaluation, in that they will reduce pressures on prices, they will tend to make the international imbalance worse. The reduction in the rate of increase of German prices will tend to make German goods even more competitive on world markets, and German demand for imports will also moderate.

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During the past week, the British took in \$95 million on the market, bringing their total recovery in the past two weeks to over \$400 million, or about two thirds of their losses during the preceding two weeks of speculative activity.

The net change in the franc position was small, with modest gains at the beginning of the week offset by a loss on Thursday.

The price of gold on the London market remained steady in the \$43.425 - \$43.50 range.

During the week ending May 21, the U.S. had surpluses of \$94 million on the liquidity basis, and of \$570 million on official settlements. This leaves the cumulated liquidity deficit for 1969 at around \$4 billion, but puts us back into a small official surplus.



Paul W. McCracken

SECRET

June 2, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

SUBJECT: International Monetary Situation

Attached per your instructions via Al Haig is a revision of the memorandum to the President on the international monetary situation, which recommends that we move quickly toward setting U. S. policy on both the short-run crisis possibilities and longer-run reform of the system.

I have two points on your comments as relayed by Al. You indicated a belief that it is the close balance between the CDU and SPD which makes likely a new DM crisis as the German election approaches. The fact is that such a crisis will result whatever the German political alignment, since almost everybody in the world is convinced that revaluation is inevitable and will be carried out by any new FRG government -- even one in which Kiesinger and/or Strauss remain dominant.

Second, you note that application of pressure during a period of relative calm can create the very crisis which the intervention seeks to pre-empt. I make the point in the memo to the President but have qualified it partially: if applied skillfully and with luck in avoiding publicity, such intervention could work without generating enough speculation to produce a crisis.

I have also sent to you a memorandum for the President reporting on the offset negotiations with Germany, which are not going too smoothly at the moment. If timing permits, you might wish to read them together yourself and send them together to the President.

RECOMMENDATION:

That you sign the attached memorandum to the President.

SECRET



THE SECRETARY OF THE TREASURY
WASHINGTON
CONFIDENTIAL

MAY 10 1969

MEMORANDUM FOR THE PRESIDENT

The decision of the German Cabinet not to revalue the mark will leave an air of uncertainty over international financial developments for some time. The immediate outlook for the exchange markets is highly uncertain, and turns on the credibility of the German position. This will depend, in large part, on what other tax and financial measures the Germans are prepared to take. The Germans have been extremely vague on this, and no decisions are expected until the middle of next week, at the earliest.

While the German position on the mark parity is unsatisfactory, I see no alternative but to accept it as an accomplished fact for the time being, and to work as best we can within that framework in the days ahead. Revaluation has become a straight party issue, with Strauss leading the CDU opposition. While some reports indicate the Chancellor himself has some sympathy for revaluation, in the last analysis there seems little chance that he would reverse the decision, unless or until external conditions and pressures change. In practice, this would require an even more severe crisis in the exchange markets or changes in parity by other countries so the Germans have "company."

Our interest for the short run lies in (1) promoting a reversal of the recent speculation into marks, and (2) building protection against the possibility that new speculative pressures will converge on sterling. To help achieve the former, in press statements and contacts we will cast no doubt on the ability of the Germans to sustain their position, accept it as a fact, and make plain the necessity for supporting measures to repel speculation.

The second objective is supported by the agreement now reached under pressure from events and the U. S., between the U. K. and the IMF in negotiations on a \$1 billion

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- 2 -

credit package. This will be leaked to the press in London in time for the Monday papers.

The question of additional credit facilities for the British, by the U. S. and other countries, will also arise, especially if speculative pressures on sterling are not reversed. The Federal Reserve, in contacts this weekend at the regular Basle meeting of central bankers, will test sentiment on this difficult issue. With respect to "recycling" recent German gains, the question of a German government guarantee may arise.

If a calmer market atmosphere prevails in the days and weeks ahead, some orderly realignment of exchange rate parities still may be possible this summer. This would be a prelude to our efforts to achieve more fundamental reforms. But it is clear we will continue to face formidable uncertainties until the politically-charged impasse on exchange rates is resolved.

David M. Kennedy

CONFIDENTIAL

BP

May 31, 1969

*HK has
seen ^{DONE}
if memo attached
Get 2nd page
which is
missing*

MEMORANDUM FOR THE PRESIDENT

FROM: Arthur F. Burns

The attached memorandum was written by Professor Aschheim at my request. It is a summary of a competent paper that he prepared for the Joint Economic Committee.

Professor Aschheim is critical of the way in which the Germans have been off-setting the drain on our balance of payments caused by our military expenditures in Germany. I have long felt as he does about this problem.

Attachment

cc: Honorable William P. Rogers
Honorable David M. Kennedy
✓ Honorable Henry A. Kissinger

Summary of the Dollar Deficit and German Offsetting
by Joseph Aschheim

In recognition of the impact upon the U.S. balance of payments of the U.S. Defense Establishment in the Federal Republic of Germany, a series of economic agreements was concluded between the U.S. and German Governments. The agreements have as their objective the offsetting by the German Government of this U.S. balance-of-payments impact.

For the years 1961-1966, the agreements called for the offsetting of U.S. military expenditures in Germany by German expenditures in the U.S. for military procurement by the German Bundeswehr. The average annual offset amounted to \$680 million.

A new type of offset agreement went into effect in mid-1967. This agreement committed Germany's Bundesbank to purchase \$500 million dollars of U.S. Treasury notes maturing in $4\frac{1}{2}$ years.

Quantitatively, the second type of offset agreement is a retreat from the first type. In the first type there was an attempt by the parties to approximate a full offset of the foreign-exchange cost to the U.S. of the American defense presence in Germany. By contrast, in the second type the U.S. Government openly conceded that the offset would only be partial.

Qualitatively, as well, the second type of agreement was a retrogression by the U.S. in several respects. Firstly, under the second type, the Germans receive interest income, not provided for in the first type. Secondly, instead of buying American merchandise outright, the Germans are merely extending a loan to the U.S. Government, and will accordingly expect re-payment of principal in the future. Thirdly, if prior to the expiration of the loan additional amounts were lent in subsequent years, there would cumulatively be generated German pressure against an indefinite pileup of such loans in the insistence that sooner or later they ought to be re-paid.

Accordingly, the second type of agreement is a substantial surrender of principle from the U.S. standpoint not only because \$500 million is less than \$680 million. The U.S. Government has acceded to the position of debtor to the German Bundesbank, thereby not solving, but only deferring the solution of, the problem posed

for the U.S. by its defense expenditures in Germany.

Conceptually, there are four kinds of foreign-exchange offsetting: (1) offsetting by buying; (2) offsetting by lending; (3) offsetting by remitting; and (4) offsetting by compensating. The first type of agreement was offsetting by buying; the second is offsetting by lending.

It turns out that there is inherent in both the first and second kinds of offsetting, a misallocation of resources. The U.S. would be both unwise and unfair to inflict economic waste upon its allies. Fortunately, such misallocation has not occurred thus far, because the offset agreements were essentially window-dressing by Germany. In other words, thanks to German shrewdness, the several offset agreements have been economically ineffective.

To avoid both the practice of window-dressing (which implies hoodwinking the American public) and the saddling of an ally with uneconomical purchases or loans, offsetting must be at the least by remitting. Offsetting by remitting would mean the rendering of annual (or other periodic) payments by the West German Government to the U.S. Government in the amount of the U.S. balance-of-payments drain due to the American defense presence in Germany, in excess of \$800 million annually.

Though vastly superior in both economic and ethical soundness to offsetting by buying as well as by lending, offsetting by remitting still falls short of constituting an entirely rational and fully equitable sharing of the economic burden of the U.S.-German defense alliance. For offsetting by remitting confines the offset to the foreign-exchange cost alone. The full cost borne by the American taxpayers, however, is the budgetary cost of the U.S. Defense Establishment in Germany. This cost is conservatively estimated by this writer at \$4 billion per annum. Its equitable sharing would, then, imply a \$2 billion annual payment by Germany to the U.S. as the offset by compensation.

The Germans have been calling on the U.S. for several years now both to restore equilibrium to the U.S. balance of payments and to put the U.S. fiscal house in order. It is indeed high time that the U.S. rose to the opportunity of taking up its German ally on this wise counsel.

TRANSLATION FROM DER VOLKSWIRT

("The Economist") of Germany, Nr. 41, October 11, 1968, p. 21, of item entitled in the German text, Window-Dressing.

Window-Dressing

The Americans have subjected the foreign-exchange offsetting arrangements thus far in effect, to a critical analysis. Joseph Aschheim, professor of economics in the George Washington University, contributed a 35-page memorandum commissioned by the U.S. Congress whose quintessence is:

- (a) Foreign-exchange offsetting by arms-buying leads to economic nonsense.
- (b) Offsetting by German lending is virtually window-dressing.

Therefore, while the German Central Bank has not contravened the letter, it has contravened the spirit of these agreements, in that it simply exchanged maturing U.S. Treasury bonds (Roosa bonds) for newly issued balance-of-payments-offsetting bonds. In his contribution, the American professor reduces the foreign-exchange-offsetting problem to the formula of "offsetting by remitting". According to Aschheim, there exists for the U.S. only one real solution, "namely, genuine transfer of German budgetary appropriations to the U.S. Government in the amount of the U.S. defense expenditures in Germany."

In the American Congress, as well, there is growing unrest about the annual haggling over German foreign-exchange credits. Thus Senator Mansfield has pointed out that for the stationing of American troops in Germany the U.S. is paying interest.

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MEMORANDUM

THE WHITE HOUSE

WASHINGTON

SECRET

May 10, 1969

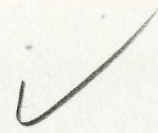
MEMORANDUM FOR DR. HENRY A. KISSINGER

FROM : C. Fred Bergsten

SUBJECT: The Monetary Crisis

Following is the memorandum which you requested, which Dick Cooper (who flew down for the day) and I wrote today. Volcker would not commit himself to prepare an Options paper so we proceeded fully on our own. The Volcker group will meet tomorrow night.

SECRET



SECRET

May 2, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: Richard N. Cooper

SUBJECT: Implications of Gold Suspension and a Floating Pound

At present, the United States is technically running a large balance-of-payments surplus, due largely to our extremely tight monetary conditions.

In the event of a real monetary crisis, however, funds might leave the United States in large amounts. Until the German mark is revalued, Germany would be the logical destination for such funds, and Switzerland to a lesser extent. Some Americans might attempt to purchase gold, although the major gold market has been quiet during the past week, perhaps reflecting some uncertainty about what the U. S. would do in the face of a crisis.

Under an existing agreement, Germany would not convert dollar inflows into gold. But Switzerland would. Furthermore, large outflows of funds to Germany and Switzerland might induce other Central Banks to convert their dollar holdings into gold. Thus, there is some risk of a large drain on the U. S. gold stock, but it is by no means a certain risk.

If such a drain showed signs of materializing, the U. S. should cease to pay out gold in exchange for dollars. (We should consider the possibility of taking such an occasion to launch discussions for basic reforms of the monetary system, but that topic is not dealt with here.) On its merits, this action has much to be said for it. It would go further toward eliminating an increasingly anachronistic feature of the international monetary system. But it would be a great psychological shock to many, and especially in Europe, where gold is still accorded an important place in monetary affairs. The United States would be charged with violating a commitment, and President Nixon would be accused of failing to live up to his promise to consult with his major allies on important decisions. Bitterness in certain financial circles would be great.

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Attitudes must be distinguished from behavior. While the United States would get a bad financial press, there is not much Europeans or others could do about it. Their broad options would be three. They could:

(1) Cease to peg their ^{perhaps} currencies to the dollar, as they do now, and allow their exchange rates to float -- upward in the case of the mark, the Swiss franc and the Italian lira, and downward in the case of the French franc and the pound;

(2) Impose controls on the inflows of dollars, especially on American investment in Europe;

(3) Maintain existing exchange rates as they do now, adding ^{any} surplus dollars to their international reserves.

The first outcome would not be undesirable under present circumstances, though it would, no doubt, be temporary because of European aversion to exchange flexibility. But a temporary period of floating rates would leave the world with a better structure of exchange rates than now exists.

The second option would be far worse. It would very likely lead to a revival of protectionism by immobilizing those domestic political forces within foreign countries who favor a liberal trading world, and it would certainly inject economic questions into foreign affairs in a major way.

The third option is the most likely, provided the outflow of dollars from the United States is not too great. Otherwise, the first or second option would eventuate.

To sum up, on substantive merits Secretary Kennedy's inclination is correct, but it would create a bad press and resentment within foreign governments, thus souring the general diplomatic atmosphere. There is little the Europeans could do about it, however, that would not also be of serious damage to themselves.

On the narrower question of the British pound: any major currency movements could force the British to act, because their financial margin is at present so narrow. They could devalue the pound by a fixed amount, as they did in November 1967; they could allow the pound to float freely; in which case it would certainly depreciate in the first instance; or they could impose restrictions on imports. Devaluation of the pound

SECRET

-3-

would not, in the short run, have very wide repercussions, although it might stimulate other countries to devalue their currencies too, either at once or in the near future. Devaluation is probably not necessary for Britain in the long run, but it could quell short-run speculation against the pound.

Allowing the pound to float freely would be far more unsettling. Countries with close trading or financial ties to Britain would either allow their currencies to float with the pound or impose countervailing import duties on British goods to limit the impact of a sharp depreciation of the pound on their own economies. The only merit of this course of action, in my view, is that it might provide a sufficiently great shock to stimulate European officials to a serious reconsideration and reform of the present payment system.

The third course of action, imposition of controls on imports, while offensive to liberal traders, might serve best the immediate requirement of halting speculation against the pound without representing major shocks and requiring major long-run adjustments, as the other two options would do. On these grounds -- its temporary and limited purposes -- I am less opposed to this third solution than is CEA.

SECRET

RCN:mst

THE WHITE HOUSE

WASHINGTON

ACTION

SECRET

May 6, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

SUBJECT: The Present International Monetary Situation

Attached at Tab I is a memorandum from you to the President on the present international monetary situation. It summarizes and analyzes a memorandum from Paul McCracken on the subject.

I know that you are reluctant to make judgments on the economics of this issue, but some of McCracken's analysis is inadequate and some of his recommendations are extremely dangerous politically.

McCracken's recommendations:

1. Call for us to intervene quite deeply in Britain's decision-making process, by indicating that we oppose additional import restrictions but would support them if they decided to float the pound.
2. Would commit us to underwrite future British policy to an almost unlimited extent with US money, because support for a floating pound means in practice that we might have to give Britain huge amounts even if their domestic economic policies were profligate.
3. By talking openly about US support for greater flexibility of exchange rates (the "crawling peg") and by trying to get Britain to float, could contribute to bringing on the very financial panic we seek to avoid and the politically disruptive action which the US might be forced to take under such circumstances.

RECOMMENDATION:

I therefore urge that you sign the attached memorandum to the President.

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May 7, 1969

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *HK*

SUBJECT: The Present International Monetary Situation

Issue

Attached at Tab A is a memorandum from Paul McCracken which reviews the present status of the international currency difficulties and makes three recommendations:

1. That we inform the United Kingdom, which is the main potential crisis point, that:

(a) We hope they will continue to defend their present exchange rate.

(b) We are opposed to their adopting any new import restrictions.

(c) We are willing to help them manage a floating exchange rate for the pound, if they are forced to abandon their present parity, presumably by making available to them enough money to moderate any decline in its value.

2. That we make no statements supporting the present structure of exchange rates (except for the gold-dollar price) or minimizing the seriousness of the situation.

3. That we come out more openly for the "crawling peg", a basic reform of the international monetary system which would permit gradual adjustment of exchange rates and hence help avoid future crises.

Present Situation and Analysis

Dr. McCracken's memorandum is contradictory on one of the crucial elements of the situation. It states at one point that "there are no indications" that Germany will revalue unilaterally, and at another that they "will probably change their view if more money flows in". I share the former judgment; the present monetary system puts very little real pressure on surplus countries to act short of intense political pressure

SECRET

from the rest of the world. In the case of Germany, this means in practice that the US would have to involve itself deeply -- probably including your personal intervention -- to change their minds.

Second, the memorandum indicates only by omission that the US is well shielded from any direct effects of the present European currency problems. Our exceedingly tight monetary policy is keeping the dollar extremely strong in the exchange markets. Thus our only purely national worry is the possibility that a real financial panic will ensue and lead foreign monetary authorities to lose their nerve and seek to convert their dollars into US gold. We might then be forced to suspend the convertibility of the dollar into gold, which would risk major foreign policy problems as outlined in my memo last Friday.

Third, I fully endorse Dr. McCracken's conclusion that the UK is the major potential crisis point in the system and therefore agree with his recommendation that we express our hope that the UK will hold its present exchange rate.

However, I do not agree with his recommendation that we tell the UK that we would prefer a floating exchange rate for the pound to new import restrictions, if they are forced to do something. Even on purely economic grounds, it is not clear that our balance of payments would be hurt more by restrictions than by a change in the exchange rate of sterling. More important, however, a UK decision to float would represent a major break with the present monetary system and is much more likely than new restrictions to induce other countries to follow. Thus, a decision to float is much more likely to touch off a panic. It is true that import restrictions would only buy time for the UK, but there is good economic reason to believe that they are finally on the right track and that a bit more time will permit them to hold their present exchange rate.

Finally, I agree that we need to move specifically toward reforming the monetary system so that such crises will not recur continuously and that the "crawling peg" is a desirable element in such reform. There are two problems with his recommendation that we come out more openly for such an approach, however.

One problem is that we should be very cautious about openly advocating the "crawling peg" at the present time. Any US statement on exchange rates would increase market nervousness and run counter to Dr. McCracken's other recommendation that we avoid making any statements on the present situation. (We should, however, be alert to opportunities afforded by the present situation to increase support for our reform ideas.)

The other problem is that you have not yet received the options paper on monetary issues which you asked the Treasury to provide a month ago. As a result, you have not had an opportunity to consider the subject systematically and we have no agreed policy. We need to move on this quickly before a real crisis overtakes us.

RECOMMENDATIONS:

- 1. That we inform the UK, in low key, of our hope that they can maintain their present exchange rate.

Approve _____
 Disapprove _____

- 2. That we go no further in our policy recommendations to the UK.

Approve _____
 Disapprove _____

- 3. That we make no statements at all concerning the present European currency situation, or, for the moment, our specific proposals for international monetary reform.

Approve _____
 Disapprove _____

- 4. That you convene an early meeting to consider overall US international monetary policy. I recommend that such a meeting include the Secretary of Treasury, the Secretary of State, the Chairman of the Federal Reserve Board, the Chairman of the Council of Economic Advisers, and myself.

Approve _____
 Disapprove _____

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

May 5, 1969

MEMORANDUM FOR THE PRESIDENT

Subject: The International Monetary Situation

Friday's meeting at Treasury brought out the political difficulties in getting France to devalue, a solution about which we had economic doubts in any case. The action proposed in Secretary Kennedy's memo of May 1 is therefore ruled out for the time being. But the monetary situation continues to give concern.

After a week in which close to \$1 billion (net) flowed into Germany, and in which the British lost some \$200 million, today (Monday) was fairly quiet. Some speculators, who had counted on weekend devaluations or revaluations, revised their positions, but it is expected that pressure will pick up again during the week. Confidence in the dollar has so far held fairly firm, and the London gold price remains slightly below its 1969 peak reached several weeks ago. However, the interest rate on Eurodollars has risen significantly in the last few days.

It would be nice if the Germans, without waiting for "company," revalued the mark unilaterally, but there are no indications they will do so. Strauss made another statement on Sunday which gave additional encouragement to speculators. Further complicating factors are a central bankers' meeting in Basle, scheduled for next weekend (traditionally an object of speculative interest) and the publication of our first-quarter balance of payments figures by the middle of May. So far the press has generally put our liquidity deficit at around \$1 billion for the first quarter, while it was actually nearer \$2 billion, an unusually large amount.

Evidently we are faced with a very hazardous situation. If the British lose too many reserves they are likely to do one of three things: (a) introduce tight import restrictions; (b) devalue to a new fixed rate; or (c) let the pound float. The first course would be directly contrary to our interests, not only because the U. K. is still one of our best customers, but also because our policy is to eliminate barriers to trade. In any case import quotas are not likely to give any durable relief.


The second course seems less probable. Their 1967 experience was not encouraging, and it would be difficult to pick a new fixed rate.

A decision to float also has its dangers since the pound may drop sharply and drag several other currencies (such as the Scandinavian and the Australian currencies) with it. But it would be quite possible to prevent extreme movements by suitable management and international cooperation. Basically the pound is not really over-valued at the present parity, but confidence in the British government is low. Therefore our efforts should be directed at keeping any downward movement in sterling within bounds. We suggest that the British government be informed of our opposition to import restrictions and our readiness, if necessary, to help in managing a floating rate. For the time being, however, we would prefer that the British continue to defend the existing exchange rate.

Apart from this there appears to be little we can do at the moment. A French devaluation would weaken both sterling and the dollar and is therefore undesirable, quite apart from political feasibility. The Germans are still insistent that they will not revalue alone, but they will probably change their view if more money flows in. In the meantime it would be good to avoid any statements minimizing the seriousness of the situation or implying support for existing parities (other than the dollar price of gold).

For the somewhat longer run it is clear that we have to take the leadership in improving the international monetary system. In particular we should come out more openly for the "crawling peg," a device that permits gradual adaptation of parities to changing economic conditions and thus forestalls crises. We have now had technical discussions with several countries on the crawling peg. Although

these have not uncovered much enthusiasm abroad they have not uncovered any insuperable technical difficulties either, and there is considerable interest in Germany. Unless we act to improve the present System we will be forced to defend it by allowing controls to proliferate, which is essentially what the previous Administration did (with indifferent success). The crisis now in progress should lead to a realignment of par values and thereby provide the foundation for a more satisfactory framework.



Paul W. McCracken

THE WHITE HOUSE

WASHINGTON

SECRET

May 2, 1969

~~HAK~~

MEMORANDUM FOR DR. KISSINGER

FROM: Richard N. Cooper *per CM*

SUBJECT: Implications of Gold Suspension and a Floating Pound

At present, the United States is technically running a large balance-of-payments surplus, due largely to our extremely tight monetary conditions.

In the event of a real monetary crisis, however, funds might leave the United States in large amounts. Until the German mark is revalued, Germany would be the logical destination for such funds, and Switzerland to a lesser extent. Some Americans might attempt to purchase gold, although the major gold market has been quiet during the past week, perhaps reflecting some uncertainty about what the U.S. would do in the face of a crisis.

Under an existing agreement, Germany would not convert dollar inflows into gold. But Switzerland would. Furthermore, large outflows of funds to Germany and Switzerland might induce other Central Banks to convert their dollar holdings into gold. Thus, there is some risk of a large drain on the U.S. gold stock, but it is by no means a certain risk.

If such a drain showed signs of materializing, the U.S. should cease to pay out gold in exchange for dollars. (We should consider the possibility of taking such an occasion to launch discussions for basic reforms of the monetary system, but that topic is not dealt with here.) On its merits, this action has much to be said for it. It would go further toward eliminating an increasingly anachronistic feature of the international monetary system. But it would be a great psychological shock to many, and especially in Europe, where gold is still accorded an important place in monetary affairs. The United States would be charged with violating a commitment, and President Nixon would be accused of failing to live up to his promise to consult with his major allies on important decisions. Bitterness in certain financial circles would be great.

SECRET*Cy sent Cooper 5/7/69*

Attitudes must be distinguished from behavior. While the United States would get a bad financial press, there is not much Europeans or others could do about it. Their broad options would be three. They could:

(1) Cease to peg their currencies to the dollar, as they do now, and allow their exchange rates to float -- upward in the case of the mark, the Swiss franc and the Italian lira, and downward in the case of the French franc and the pound;

(2) Impose controls on the inflows of dollars, especially on American investment in Europe;

(3) Maintain existing exchange rates as they do now, adding ^{any} surplus dollars to their international reserves.

The first outcome would not be undesirable under present circumstances, though it would, no doubt, be temporary because of European aversion to exchange flexibility. But a temporary period of floating rates would leave the world with a better structure of exchange rates than now exists.

The second option would be far worse. It would very likely lead to a revival of protectionism by immobilizing those domestic political forces within foreign countries who favor a liberal trading world, and it would certainly inject economic questions into foreign affairs in a major way.

The third option is the most likely, provided the outflow of dollars from the United States is not too great. Otherwise, the first or second option would eventuate.

To sum up, on substantive merits Secretary Kennedy's inclination is correct, but it would create a bad press and resentment within foreign governments, thus souring the general diplomatic atmosphere. There is little the Europeans could do about it, however, that would not also be of serious damage to themselves.

On the narrower question of the British pound: any major currency movements could force the British to act, because their financial margin is at present so narrow. They could devalue the pound by a fixed amount, as they did in November 1967; they could allow the pound to float freely; in which case it would certainly depreciate in the first instance; or they could impose restrictions on imports. Devaluation of the pound

would not, in the short run, have very wide repercussions, although it might stimulate other countries to devalue their currencies too, either at once or in the near future. Devaluation is probably not necessary for Britain in the long run, but it could quell short-run speculation against the pound.

Allowing the pound to float freely would be far more unsettling. Countries with close trading or financial ties to Britain would either allow their currencies to float with the pound or impose countervailing import duties on British goods to limit the impact of a sharp depreciation of the pound on their own economies. The only merit of this course of action, in my view, is that it might provide a sufficiently great shock to stimulate European officials to a serious reconsideration and reform of the present payment system.

The third course of action, imposition of controls on imports, while offensive to liberal traders, might serve best the immediate requirement of halting speculation against the pound without representing major shocks and requiring major long-run adjustments, as the other two options would do. On these grounds -- its temporary and limited purposes -- I am less opposed to this third solution than is CEA.

THE WHITE HOUSE

WASHINGTON

CONFIDENTIAL

April 11, 1969

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *K*

SUBJECT: Relaxation of Balance of Payments Controls

The relaxation of our controls on capital outflow which you announced on April 4 carries certain foreign policy risks but, as you know, I consider them acceptable in the context of this limited action. I recommend that you proceed. However, due to Secretary Kennedy's reluctance to have this matter referred to the National Security Council, you were in effect asked to make a statement of your overall balance of payments strategy without an opportunity to address the subject systematically and in context.

I therefore recommend that you ask Secretary Kennedy to prepare, for your early consideration, a memorandum outlining your options in the balance of payments and international financial area. A memorandum for your signature instructing Secretary Kennedy to do so is attached.

RECOMMENDATION:

That you sign the memorandum at Tab A.

Attachment

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APR 14 1969

RECEIVED
OFFICE OF THE
SECRETARY OF THE
WHITE HOUSE

File

April 15, 1969

MEMORANDUM FOR

THE SECRETARY OF THE TREASURY

On April 3, I approved the action proposed in your memorandum concerning relaxation of balance of payments controls, and authorized the release of the draft statement prepared for this purpose.

While I thought it desirable to approve your recommendations now, I would like to know what my choices are with respect to our international monetary policy. Please prepare, in coordination with interested agencies, a paper which will permit me systematically to look at the available options, including full consideration of the implications of each.

(initialed "RN")

(rewritten)
RN:HAK:CFB:mz

THE WHITE HOUSE
WASHINGTON

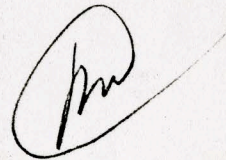
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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

CONFIDENTIAL

April 1, 1969

ACTION

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

SUBJECT: Relaxation of Balance of Payments Controls

The attached memorandum from Secretary Kennedy recommends that the President announce shortly the modest relaxation of all three aspects of our controls over private capital outflows already decided. The recommendation is agreed to by Secretaries Rogers and Stans, Chairman Martin, Paul McCracken, and Bob Mayo.

I recommend that you support the recommendation, although it carries significant foreign policy (and domestic economic) risks as outlined in the memo itself and conveyed to you in my earlier memos. There are, however, two specific problems of concern to us, one relating specifically to our new emphasis on consultations and one relating to the decision-making process.

This recommendation was delayed for two weeks to permit Treasury Under Secretary Volcker to consult with the Europeans on it. None of the Europeans oppose the move outright, but virtually all of them were highly cautionary. They indicated that any resultant increase in the U.S. payments deficit would weaken our over-all bargaining position, particularly with regard to early and sizeable activation of Special Drawing Rights. The major implication of this conclusion is that our preferred multilateral approach to monetary reform is now less likely to succeed, and we may be forced to take unilateral steps which could be seriously disruptive to the entire Atlantic Alliance.

Since we do not plan to reduce the pressure on the Europeans to move ahead on SDRs -- and on much more "radical" reforms -- the question of our sincerity in undertaking consultations will arise at some point in the near future. We gave them a chance to record their views and they did so. Our future action may well imply that we have ignored those views. I flag this as an early case of the obvious problem that the new emphasis on consultation will create.

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On decision making, this is a prototype case of unsatisfactory ad hocery. The President is being asked to enunciate his over-all international monetary policy without ever considering that policy. He has been given no choices, nor even a paper on the over-all subject. In retrospect, the decision to lift the subject from the NSC agenda was a mistake -- since the Secretary of Treasury has not exercised the responsibility which he sought and received.

This factor does not lead me to recommend your opposing the proposed action, since the President has made known his strong desire to begin relaxing the controls as soon as possible. But I suggest that you remind the President that he is being asked to do something without consideration of its context and without systematic exploration of its full implications, and recommend that he instruct the Secretary of Treasury to present an options paper for his consideration in the near future.

RECOMMENDATION:

That you sign the attached memorandum to the President, recommending that he:

- (1) Approve the proposed relaxation of controls.
- (2) Do so between 2 P.M. Thursday and 11 A.M. Saturday for market reasons.
- (3) Instruct Secretary Kennedy to prepare an options paper on our international monetary policy with a meeting to take place on it at an early date.

Col Haig:

I don't think you want this to go to the President now -- it was being provided for his meeting with the Quadriad on 3/18. If the information is still valid for the President, perhaps the reference to the Quadriad meeting should be deleted.

Lora

BP
[Handwritten signature]
[Handwritten signature]

THE WHITE HOUSE

WASHINGTON

CONFIDENTIAL

March 17, 1969

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *HK*SUBJECT: Reductions of Controls on U. S. Capital Outflows:
Foreign Implications and a Note of CautionIssue

I understand that you will discuss the reductions of our present capital controls with your economic Quadriad tomorrow afternoon. There are major foreign policy implications of our moving in this direction. As a result of the considerations outlined below I recommend that you not commit the Administration irrevocably to the abolition or large scale reduction of the controls until an alternative solution to our international monetary problems is in sight. I have no objection to the limited reduction which is proposed for the near future although I agree fully with Secretary Rogers that it should not be undertaken until after full consultation with our European allies.

Foreign Policy Aspects

Eliminating restraints on private investment abroad has three foreign policy aspects. The first is that the initial effect of easier monetary conditions in the U. S. in the absence of controls would be an enlarged payments deficit, to which most of the countries of continental Europe would object strongly. Foreign disapproval would be expressed relatively quickly, even before the emergence of a large deficit, since foreign officials can look ahead. The move would be interpreted as a disavowal of our earnest intentions to maintain a strong payments position.

Such officials, incidentally, do not share U. S. antipathy to controls over capital movements. Nor does the foreign business community. Except for Germany, all the European countries maintain some form of restraints on international capital movements. Even Switzerland, the citadel of free enterprise, controls the access of foreigners to the Swiss capital market.

The main effect of this reaction would be a setback to our efforts to improve the monetary system through cooperative steps with the Europeans.

CONFIDENTIAL

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-2-

Thinking that the U. S. no longer cares about its payments position, their propensity to cooperate even in the activation of Special Drawing Rights, let alone more far-reaching reforms such as adoption (or even serious study) of greater exchange rate flexibility, will be sharply reduced. In short, we may be circumscribing our option of a cooperative solution -- forcing us inevitably toward the kind of unilateral action described below. (The counter-argument is that a cooperative approach will not work anyway and that unilateral U. S. moves are inevitable. I do not share this pessimism.)

Second, many -- probably most -- Europeans welcome U. S. controls on direct investment (i. e., investment involving U. S. management control) as providing some slowdown to the takeover of European industry by American firms. This potentially explosive anxiety is by no means confined to government officials. To be sure, Europeans are ambivalent about American investment. Except for those firms feeling the direct competition, they generally welcome the infusion of technology and even new management techniques. But, because of the central position of the U. S. dollar in the international monetary system, we are open to charges of dollar imperialism if American capital is permitted to move to Europe without restraint -- at least as long as our balance of payments is in sizable deficit. Some kind of restraint on direct investment -- even the pre-1968 voluntary restraints were helpful in this regard -- provides the necessary ambiguity on our side, combined with their own ambivalence, to diffuse the issue.

Finally, and most important, the alternative policies which we might be forced to adopt in lieu of capital controls could be much more damaging to U. S. foreign policy. Troop withdrawals, additional pressure on Germany and others for "better" offset arrangements, and further restrictions on the aid program are only the most obvious possibilities -- and ones which we should reject for obvious foreign policy reasons. Unilateral U. S. suspension of gold convertibility -- essentially adoption of a floating exchange rate of the dollar -- would represent a massive display of U. S. power and rupture all our efforts to forge a new partnership with Europe on the basis of greater equality. An increase in the official price of gold -- which would represent only a temporary solution anyway -- would also be a unilateral act rejected by most official Europeans and would betray \$15 billion worth of dollar holders from Germany to Thailand. Adoption of trade controls, such as export subsidies and import surcharges, would be no economic improvement over capital controls and would be much more damaging to our foreign policy, because of the network of international rules which govern trade and which would be broken in the process.

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- 3 -

As I understand it, the present proposal of the Secretary of Treasury is for some relaxation in all three of the present control programs but mainly affecting direct investment. The estimated gross cost to the balance of payments is about \$400 million. The relaxation would come against an agreed projection of significant deterioration -- at least \$1 billion and possibly more -- in our payments position in 1969. This first step will raise the problems outlined above to only a minor extent, but I recommend that you not commit yourself irrevocably to the abolition of investment restraints until a clear alternative is in sight.

CONFIDENTIAL

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ACTION

March 17, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

The issue of relaxing the capital controls is on the agenda of tomorrow's meeting of the President with his "Quadriad" of domestic economic advisers -- Secretary Kennedy, Chairman Martin, Budget Director Mayo, and Paul McCracken. Pursuant to your instruction, attached is a memo to the President informing him of the major foreign policy implications of the proposed line of action and advising him to adopt a "go slow approach" in implementing it.

CFB:mst

CONFIDENTIAL

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March 17, 1969

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger

SUBJECT: Reductions of Controls on U. S. Capital Outflows:
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CONFIDENTIAL

-3-

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HAK:CFB:mst

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THE WHITE HOUSE

WASHINGTON

LIMITED OFFICIAL USE

INFORMATION

March 12, 1969

MEMORANDUM FOR DR. KISSINGER

FROM: C. Fred Bergsten

SUBJECT: Relaxation of U.S. Controls on Capital Outflows

Any decision to relax the present controls has been postponed. At a Cabinet-level meeting yesterday, Secretary Rogers insisted that we were obligated by the President's trip to consult with the Europeans before taking a step with such far-reaching implications. (See my memo of March 4 on this subject.) Arthur Burns and Secretary Stans, to a lesser extent, resisted this decision but their views were finally rejected by Secretary Kennedy.

Treasury Under Secretary Volcker will thus raise the issue on his upcoming European trip. He will inform them that we plan to reduce our reliance on controls but will seek their views on timing and complementary steps. This approach will stand in marked contrast to that of the previous Administration, which enacted the entire control program -- a much more drastic step than the marginal relaxation now envisaged -- and then sent teams to Europe and the Far East to inform them of the action. In fact, it could be argued that it is stretching the President's commitment quite far to consult on an issue of this magnitude. However, I supported Secretary Rogers on the grounds that any unilateral action should be avoided so shortly after the trip.

LIMITED OFFICIAL USE

THE WHITE HOUSE

WASHINGTON

CONFIDENTIAL

January 28, 1969

ACTION MEMORANDUM FOR DR. KISSINGER - URGENTFROM: Richard Cooper
C. Fred BergstenSUBJECT: Proposed Precipitate Action on the Balance of Payments

not done | The President met last Friday with his new Cabinet Committee on Economic Policy. It comprises his domestic economic advisers: Secretary Kennedy, Secretary Stans, Budget Director Mayo, CEA Chairman McCracken, etc. They discussed the removal of present controls over the export of funds by American banks and businesses. The sentiment was very strong for immediate removal of these controls, with little consideration of the consequences of so doing or of the actions to be taken in response to those consequences. It now appears possible that Secretary Stans will announce a change in his part of the program as early as tomorrow (Wednesday).

This question has a high foreign policy content. No action should be taken before a thorough review of both the effects on the balance of payments and foreign, especially European, reaction to removal of the controls. Removal of the controls might well result in a substantial increase in the payments deficit, or at least widespread expectations thereof, confronting the Administration with an international monetary crisis. It would evoke a strong negative reaction from high officials in Germany, France, the Netherlands, Switzerland, and possibly other countries -- a reaction that would, among many other things, undercut our efforts to work out more satisfactory arrangements for sharing the financial burden of NATO.

The NSC is the natural place to consider the foreign policy implications of our balance of payments program and a meeting is scheduled for February 26 on international monetary arrangements. You should urge the President to avoid making any decision or public commitments on this question until after the NSC review and to instruct his Cabinet Members (especially Secretary Stans) not to do so either. Attached is a draft memorandum to him on the subject.

CONFIDENTIAL

File H

THE WHITE HOUSE

WASHINGTON

CONFIDENTIAL

January 28, 1969

copy given
to Bengsten
2/4/69

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger *H*

SUBJECT: Foreign Policy and U.S. Controls
on Foreign Investment

I understand that you have discussed with your domestic economic advisers the removal of our present controls on American investment abroad. I heartily agree with the desirability of removing the controls. However, such a move has vitally important foreign policy implications, especially with respect to our relations with Europe.

Removal of the controls must be planned carefully and, to avoid risking an international monetary crisis, probably must be coupled with new and positive U.S. policy initiatives. I ^① therefore urge you to defer any final decision on this matter until you can review the foreign policy aspects with the NSC, and to instruct your Cabinet officers likewise to defer any decision. An NSC meeting on international financial matters is now scheduled for late February. ^②

① I agree

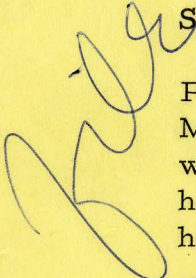
② I believe Kennedy et al
think we should act sooner -
check with *Mr. [unclear] & [unclear]* -
(who is the U.H. man in charge of this area)

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+ set an earlier date for
N.S.C. meeting if his check with
the principals involved believe
it is ~~immediately~~ advisable

PRESERVATION COPY

6307 1/19

 Secretariat

Please send this covering memo back to Mr. Bergsten for further action. Memo was signed and sent to the Pres. I will hold the file - filed with the Pres. Please have Mr. Bergsten's answered kept under this number - 6307.


nancy

THE WHITE HOUSE
WASHINGTON

6307

ACTION 1970
January 13, ~~1969~~

MEMORANDUM FOR DR. KISSINGER

FROM: Fred Bergsten 

Attached for your signature is a memorandum to the President covering Paul McCracken's Weekly Report during the first week of January.

*Fred - what is significance
of lower gold prices
Also please explain
different forms of
accounting of
foreign transactions*

JAN 19 1970

File Copy

MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger

SUBJECT: International Monetary Situation

Paul McCracken's weekly report (Tab A) indicates that the U. S. balance of payments moved back into sizeable deficit during the first week of January. You will recall that it showed a huge surplus in late December as U. S. firms repatriated capital to meet the requirements of our control program. A large portion of these funds was apparently re-exported immediately, so we showed a liquidity deficit of about \$1 billion and an official settlements deficit of over \$400 million last week.

On January 1, however, we received our 1970 allocation of Special Drawing Rights which amounted to \$867 million. This windfall receipt thus reduced our liquidity deficit to about \$100 million and moved our official settlements position into a surplus of over \$400 million.

Foreign exchange markets were quiet with the Germans continuing to lose reserves and the French continuing to gain. The price of gold has now stayed below the official \$35 price for several days, and the South Africans may take advantage of our new agreement with them to sell some gold to the International Monetary Fund.

CFBergsten:lw

1/13/70

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

January 10, 1970


MEMORANDUM FOR THE PRESIDENT

Subject: Weekly Report on International Finance

During the first week in January, there was a sizable reversal of the late December inflow of funds into the United States, and the U. S. balance of payments swung back to the negative side. On a basis comparable to earlier figures the liquidity balance was in deficit by about \$1,000 million during the first week of January, but the \$867 million allocation of SDR's to the U. S. at the beginning of January, which is counted as an inflow, reduced the liquidity deficit to \$131 million. The SDR allocation, which comes only once a year, resulted in an official settlements surplus of \$428 million instead of the \$439 million deficit which would otherwise have been recorded.

The foreign exchange markets were quiet during the past week. The British did not intervene in the market, and the pound stayed around par for most of the week. The Germans engaged in no intervention until Friday, when they lost \$127 million. The French gained \$70 million during the first three days.

On Wednesday, the price of gold in London fell to \$35.00, and on Thursday and Friday it was quoted slightly below \$35.00. Thus, for three days this week, the conditions were fulfilled for a South African gold sale to the IMF. South African sources suggested that a gold sale would indeed be made to the Fund, although South Africa would probably hold off for a week or so in order to allow the volume of salable gold to accumulate, and thus avoid transactions of trivial size.


Paul W. McCracken

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Chart I
 U. S. BALANCE OF PAYMENTS BASED ON WEEKLY DATA
 (LIQUIDITY BASIS)

Deficit (+), surplus (-)

Millions of dollars

Millions of dollars

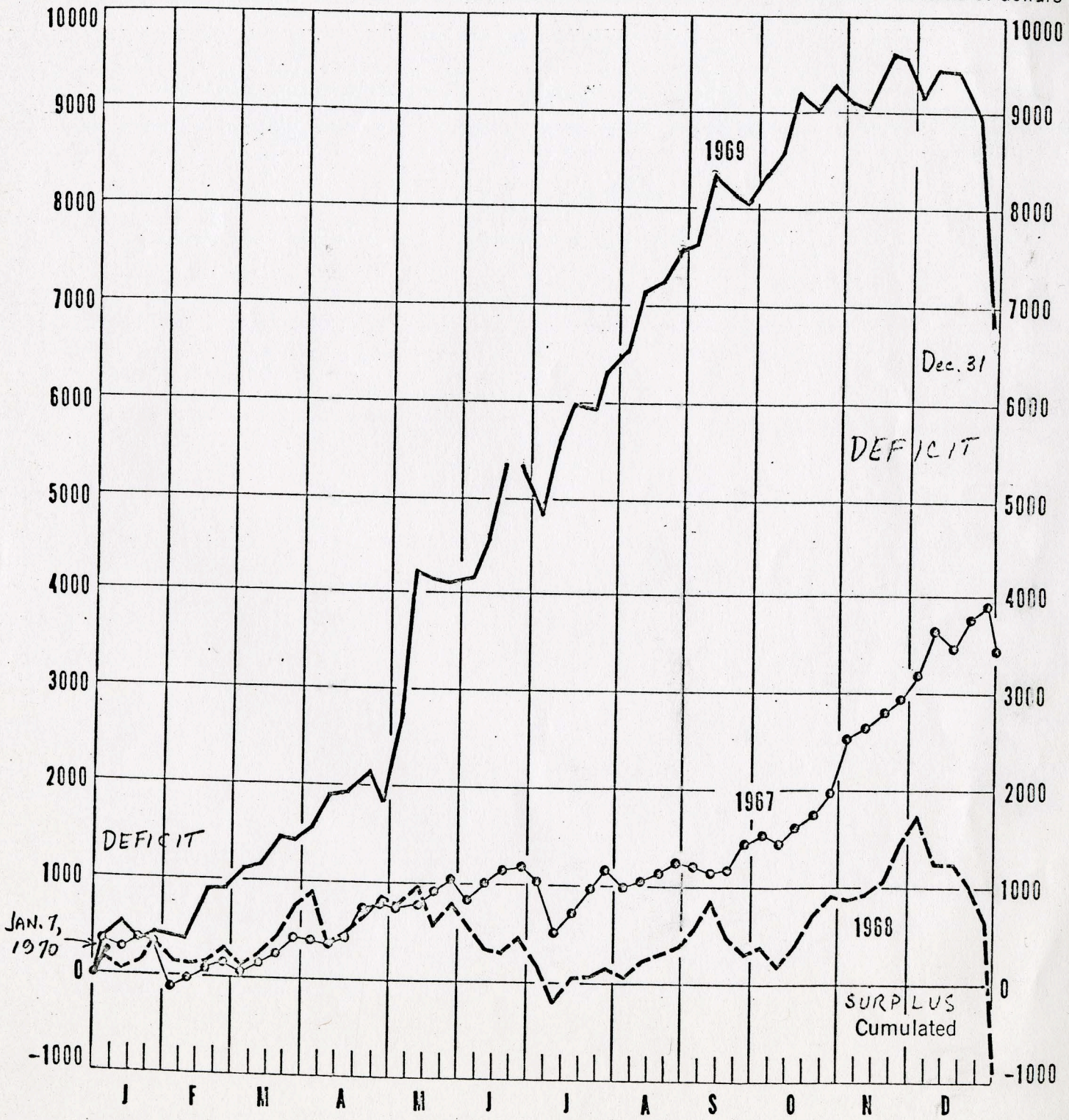
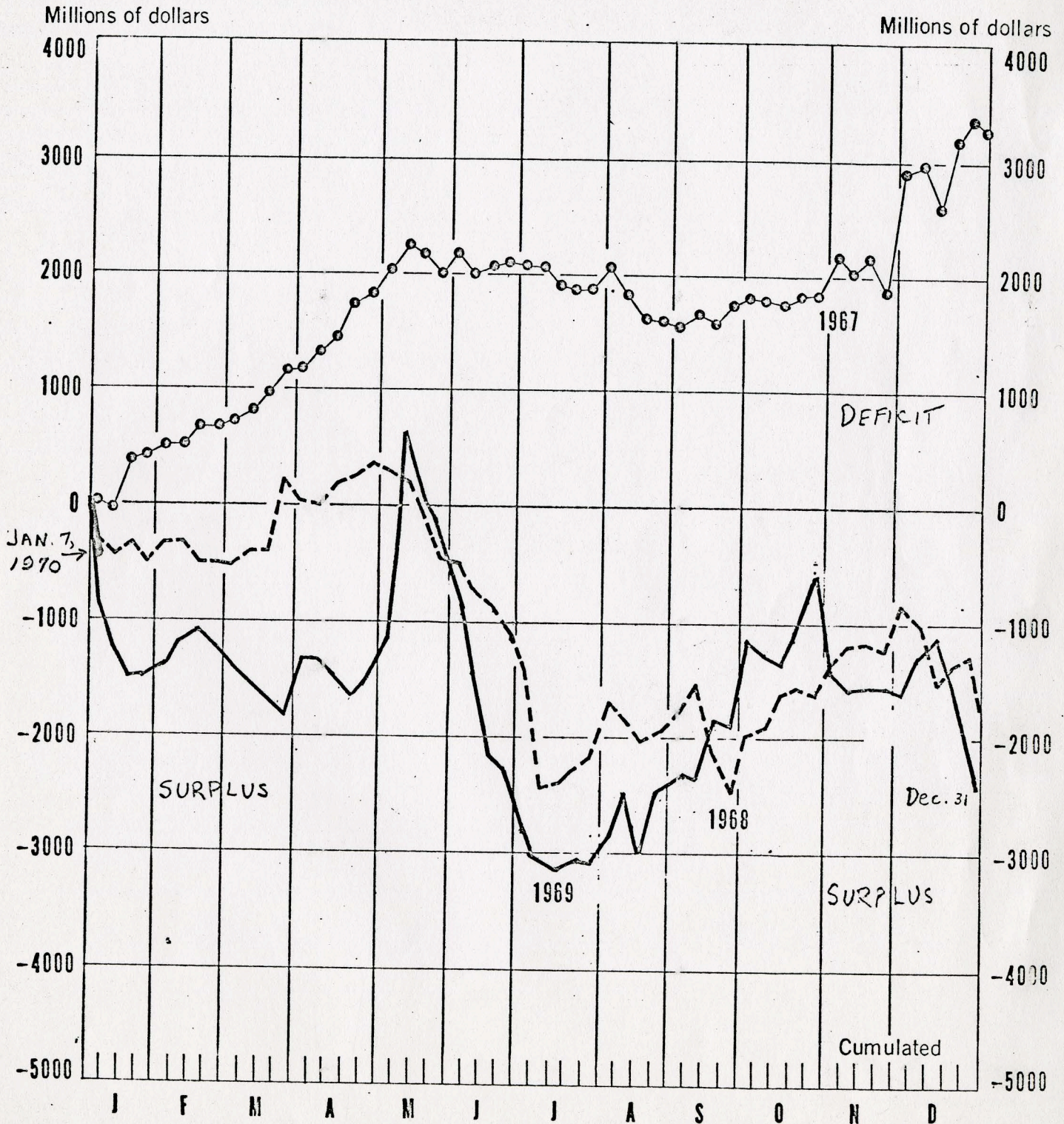


Chart II
U. S. BALANCE OF PAYMENTS BASED ON WEEKLY DATA
(OFFICIAL RESERVE TRANSACTIONS BASIS)
 Deficit (+), surplus (-)



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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

International Finance Series No. 11

Gold and Monetary Reform: A Brief Interim Report

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February 1969

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E.O. 12958, as amended, Sect 3.5

NLN 04-06/2 per sec. 3.3(b)(1) ltr.

By  NARA, Date 16 Oct 07

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1969

INTELLIGENCE MEMORANDUM

International Finance Series No. 11

Gold and Monetary Reform: A Brief Interim Report

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1. Press [redacted] suggests that the French may be mounting an elaborate effort to set the Parisian monetary stage for the forthcoming Presidential visit -- the objective being to create conditions favorable for discussion of international monetary questions within terms of reference satisfactory to General de Gaulle. There has developed in Paris a school of thought -- encouraged if not inspired by French officials -- that the new US administration is basically in sympathy with de Gaulle's international monetary views. This school has few adherents in other major Western money centers. In Paris it is led by a phalanx of financial writers, the most influential of whom has allied himself closely with French official views in the past.

2. Adherents to the school claim to see US officials progressively excluding from consideration all monetary reform proposals except for the well-known French ones -- an increase in the official price of gold and a movement toward an international monetary system based on a pure gold standard. This school of thought is becoming a "line" with the corollary that the United States and France share the same leaky boat, the repair of which involves joint devaluation through an increase in the price of gold.

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[NLN 04-06/2:3]

3. Adherents to this school claim that the objective circumstances, that is, developments on the foreign exchanges and in world gold markets, point to the increasing relevance of reforms of the Gaullist type. Although the principal gold and foreign exchange markets continue to behave erratically and to reflect the persistent instability of the international monetary system,* recent developments do not support the view that increased gold prices can furnish the only acceptable solution. These developments are reviewed below.

Performance of the Two-Tier Gold Market System

The Official Sector

4. Since the establishment of present gold trading arrangements in March 1968, nearly all nations of the West have adhered to the principle laid down in the Washington Agreement that governments not engage in gold trading with any element of the private sector. The minor exceptions -- indeed the only violations of the principle -- have been purchases of gold by Portugal and the Congo (Kinshasa) directly from the South African Reserve Bank, which markets South Africa's production.

The Private Sector

5. Gold trading in London and Zurich furnishes the bellwether for performance of the unofficial segment of the world gold market. Since March 1968, free gold market trading volumes have generally been low, and prices have shown considerable variation with no clear trend, although current prices are at a near all-time high. In April-May 1968, weekly average prices climbed to a peak of about \$42.00 per ounce, then fell to a low of about \$38.50 in July. Subsequently, they fluctuated between a low of \$38.70 and a high of about \$40.40 until the end of November, with no

**This Memorandum is concerned only with very recent market developments. An extensive analysis of the fundamental problems of the international monetary system will be published at a later date.*

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trends in evidence. In December 1968 and January 1969, prices rose steadily until they reached the \$42.50 - \$42.70 range, within which they have remained during the last three to four weeks.

6. The December-January price rise reflects speculation that the new US administration would opt for an increase in the official price of gold and abandonment of the two-tier arrangement. This speculative movement lost momentum except in Paris following the Inauguration. Recent London market performance indicates that the modestly higher price of roughly \$42.50 is the limit to which speculators are willing to gamble.

7. Compared with London and Zurich, the Paris gold market is unimportant and influenced primarily by domestic factors. Prices have fluctuated more widely while generally following the lead of London and Zurich. During the summer of 1969 and since November 1968 -- the periods in which French exchange controls have been in force -- Paris gold prices have, as expected, risen to substantial premiums above those prevailing in other gold markets. The present premium is between \$2.00 and \$3.00 per ounce.

8. On 17 February, the Paris price of the French hoarder's favorite bar -- the one-kilo ingot -- rose to a historic high, equivalent to \$46.32 per ounce, after a weekend in which Parisian financial writers had filled the press with conclusions that the United States was clearly comprehending the correctness of the French official position on the role and price of gold. However, the high Paris gold price -- which has fallen slightly from the \$46.32 level -- also reflects the continuing weakness of the franc on the foreign exchanges and the persistent problems of the French economy. French nationals continue to move out of francs and into real estate, securities, objets d'art, and gold as a hedge against possible franc devaluation.

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The Foreign Exchanges

9. In marked contrast to the crisis period which led to the establishment of the two-tier gold price system, market response to the instability of the international monetary system has resulted in exchange rate fluctuations rather than speculative gold buying. Moreover, pressure against the US dollar has eased. At the moment, the dollar is strong, Eurodollar rates are firm or rising, and there is every indication of a strong demand for dollars in the world's principal money and capital markets. If it were the collective judgment of the international financial community that the dollar is -- or ought to be -- headed for devaluation in the short term, this judgment would be reflected in a combination of dollar weakness on the foreign exchanges, liquidation of dollar debt in favor of debts denominated in other currencies, and rising prices and trading volumes in the principal world gold markets. None of these factors is in evidence.

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