

C. Douglas Dillon Oral History Interview – JFK#8, 08/18/1964
Administrative Information

Creator: C. Douglas Dillon
Interviewer: Professor Seymour Harris
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Biographical Note

Dillon, Secretary of the Treasury (1961-1965) discusses the balance of payments crisis and President Kennedy's concern over the balance of payments, among other issues.

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BY DOUGLAS DILLON

TO THE

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- b) Ten (10) tapes, containing the interviews, from which the transcripts were prepared;
- c) An unclassified subject index to the transcripts (attached herewith and labeled "Index I"); and
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Feb. 26, 1965

January 5, 2004

Allan B. Goodrich
Chief Archivist
John F. Kennedy Library
Columbia Point
Boston, MA 02125

Dear Mr. Goodrich:

This is in reply to your recent letter regarding the interviews my husband, Douglas Dillon, did for the John F. Kennedy Library Oral History Project in 1965.

I have looked over the documents you enclosed with your letter, and I agree that there are no longer any reasons to restrict access to the transcripts. As authorized by his deed, I hereby annul the clause that closes Mr. Dillon's interviews for a period of five years following his death that was originally stipulated in the deed.

This letter authorizes the Kennedy Library to open his Oral History interview tapes and transcripts for general research use without restriction.

Sincerely,

A handwritten signature in cursive script, appearing to read "Susan S. Dillon". The signature is written in dark ink and is positioned to the right of the word "Sincerely,".

Susan S. Dillon

C. Douglas Dillon – JFK #8

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Eighth Oral History Interview

with

C. DOUGLAS DILLON

August 18, 1964
Washington, D.C.

By Professor Seymour Harris

For the John F. Kennedy Library

HARRIS: Mr. Secretary, would you agree that the dollar problem with the balance of payments is perhaps our most difficult problem of the last few years?

DILLON: Certainly the balance of payments problem was the most difficult financial problem we faced when this administration came into office early in 1961. It was the result of a crisis that had begun to get acute during 1958.

HARRIS: Perhaps I should have said at the outset that Seymour Harris is the interviewer and Secretary Dillon is the interviewee. Would you also agree that perhaps one of the great advances made since 1960 has been in the area of cooperation with other countries in dealing with monetary and financial problems? I think you have had a lead in that particular program.

DILLON: I think this was most important. It was a sharp break from what we had traditionally done, as the United States had traditionally felt that monetary and financial matters were so secret and privileged that they could not be discussed frankly on a current basis with other countries. This had been a rather traditional attitude among the central bankers and Finance Ministries of all the industrialized countries. However, we were even more close-mouthed than other countries. The countries

of Europe, through their central banks, had been meeting regularly for some time, for some years, once a month at Basle, Switzerland in the offices of BIS, the Bank for International Settlements. The United States had a right to join in these meetings but we had not exercised this right simply because we did not feel that we should be in a position to give any information ourselves. Now, this is one of the very first things that I felt should be substantially changed and one of the first recommendations I made to the President [John F. Kennedy]. This is mentioned in a memorandum I wrote to Mr. Sorensen [Theodore C. Sorensen] at his request on the 4th of January in 1961 where I mentioned that one of our objectives should be the inauguration of a new policy of continuing consultation and cooperation with key foreign countries on matters affecting the international payments situation.

HARRIS: Didn't you have a good deal to do with the setting up of the OECD [Organisation for Economic Co-operation and Development] which is the vehicle for achieving this cooperation?

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DILLON: Yes, I had a great deal to do with it. In fact, when I was in the State Department I was the chief negotiator for the United States in setting up the Charter of the OECD. I was the senior negotiator who signed the original Charter for the OECD for the United States in Paris in the fall of 1960. When that was ratified we felt that it would be a useful organization for this purpose. So we suggested and, at our initiative, a special group of high level governmental monetary experts was set up which was called Working Party III. It was not foreseen in the actual charter of the organization but it was set up as a subcommittee of the Economic Policy Committee. In effect, it has acted as an independent organization. It was restricted in size with only about nine or ten members, about half the members of the OECD. The membership was limited to the larger countries who were more involved in the functioning of the international payments system.

We also, as I mentioned earlier, talked with the Federal Reserve and got them to agree, which they were very willing to do, to change our policy and their policy and to take an active part in the Basle meetings of the central bankers. So that began early in the spring of 1961 and since then a representative of the Federal Reserve Bank of New York has gone to each one of these monthly meetings and sat down there for two days to discuss current developments with the heads of all the European central banks—the important central banks of Europe. I think this has been most important. Through this consultation, both among the central banks and in the OECD, we have worked out a number of concrete methods of cooperation. We have developed a whole new feeling and philosophy of cooperation among the monetary authorities of industrialized countries, something which hadn't existed before in the world's history.

HARRIS: Would you say that one of the results of this has been, for example, the agreement to swap currency, the Paris agreement for increasing the amount of funds available for national reserves and that sort of thing?

DILLON: I think all of these things flowed from this new cooperation. Certainly this regular meeting at Basle was one of the forums in which we had a chance to meet with people of responsible authority and work out these problems of currency

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swaps, of forward operations in other currencies and things of that nature. It was also in this forum that we worked out something that was very important to bring order out of chaos. That was the agreement setting up what is now known as the London Gold Pool, which, through the cooperation of its members, some six or seven of the leading countries, has assured an orderly operation of the London gold markets. So there is very little profit in it for speculators any more. Nothing like what had happened in earlier years, particularly in the fall of 1960 when the price of gold got totally out of hand and resulted in very heavy outflows from the United States at the rate of \$100 million a week or so.

HARRIS: And this was largely through the initiative of the United States Treasury, wasn't it?

DILLON: It was entirely through the initiative of the United States Treasury that this got started. In this question of cooperation we received an unexpected assist from some happenings later in the spring of 1961, in March, when the Germans and later the Dutch revalued their currencies upward by about five percent. They were in surplus at that time. They thought this would help, and it did help over the longer run but it created big consternation in Europe because everyone wondered who was going to be next and there was speculation that there would be upward revaluations in Italy, in France, and in Switzerland. Currency ran from one place to another putting great pressure particularly on the pound sterling. This became an object lesson to the monetary authorities of Europe. They saw that it was absolutely essential to have the closest cooperation and to work very closely together. In fact, on an ad hoc basis, at that time they did come to the rescue of the pound sterling in what were known as the Basle agreements which were the first loans similar to the swap arrangements which we later worked out with the United States. These swaps or loans provided help for the pound sterling until such time as the British were able to arrange later that summer a substantial drawing from the International Monetary Fund.

HARRIS: I wonder if we mightn't check back a little just to make sure. Don't you think that would be a good idea? Now, Mr. Secretary, this remarkable memo of January, 1961, seems to me to raise so many of the important issues at the very beginning that it might be worthwhile for you to go over some of these from that memo.

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DILLON: Yes, I'd like to. The actual date of the memorandum, at least in draft form, was January 4th. In this we pointed out what a program for achieving international balance would require. And it is interesting looking back to see how much of what we had to do since was foreseen in that early memorandum. For instance, we listed the encouragement of foreign governments to prepay debts owed to the United States. We have had great success in that. It helped us very much in financing our balance of payments deficits in 1961 and 1962 and to a somewhat lesser extent in 1963. We had realized that we could not cure the balance of payments deficits overnight, that it would take quite a while. So, therefore, we had to adopt a series of methods which would help to finance the deficit during this period. This was one of them which was mentioned at that time. Another item was the intensification of pressure on foreign governments to remove trade restrictions and discriminations. We have been trying to do that right along, and I'm not sure that we have had any outstanding success, but that is a basic policy of the United States. Next, there was an item called intensification of efforts to maximize the contributions by other countries to the common military effort and to the programs for assisting the developing countries. This grew into the offset arrangements which were negotiated later that summer and fall with Germany, by which Germany undertook to buy, for cash from the United States, military equipment in an amount that would offset our entire balance of payments cost of maintaining troops in Germany.

HARRIS: Didn't the Italians come in on this to some extent?

DILLON: The Italians followed along and have been doing the same thing, and we also increased our military sales elsewhere. But we have these types of agreements only with Germany and Italy. Another item was cooperation in monetary policy which I have already discussed. Then came an item called inauguration of a policy of utilizing the United States drawing rights in the International Monetary Fund whenever desirable. Well, this didn't become desirable for some time but finally it did, and we inaugurated a standby with the Monetary Fund in the summer of 1963. We made our first drawings of \$125 million each, a total of \$250 million in the spring and early summer of this year, 1964.

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HARRIS: Can I interrupt you there for just a minute? Isn't it true that there were some doubts in the Treasury about the wisdom of using the IMF [International Monetary Fund] drawing because it might inspire some lack of confidence in the dollar?

DILLON: I think this had been Treasury feeling prior to the time I became Secretary of the Treasury, but when we looked at the crisis that we were facing at that time, we thought it was foolish to be afraid of an act which would stave off the evil day and give more time to get our payments in order. This is the purpose of the IMF; making use of it by the United States should not scare people. We thought it was just a question of explaining it properly. We turned out to be right, and it

hasn't had any frightening effects and has worked very well.

Another item was called reinvigorating the activities and operations of the Export-Import Bank, so that American exporters would be assured of export credit facilities equal to those enjoyed by their competitors in other countries. This was a new policy which took about a year to put into effect. It took another year to work the bugs out of it, but it is now working very well. We now have in the United States as a joint effort of the Export-Import Bank and our private insurance industry, with some seventy-five insurance companies cooperating, a system of export insurance that is just as good as any other in the world. Of course, that is of considerable help to our exports and so to our balance of payments.

Another item was promotion of foreign travel to the United States. We have set up a foreign travel promotion agency in the Department of Commerce which has had considerable success and is continuing to work in this field. Then there was the continuation of the policy of tying aid for American goods as long as it was necessary. Well, of course, we have done that very successfully and reduced the balance of payments drain of our foreign aid programs to about twenty percent of the total. This is the only reason we have been able to continue foreign aid at the necessary level without having such serious balance of payments problems that we couldn't have continued.

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HARRIS: Could I ask you a question there, Mr. Secretary. You may recall at the early period, there was a certain amount of impatience in the Treasury that this program wasn't moving ahead fast enough. I think particularly with the Defense Department which ultimately did, I think, achieve the largest economies here.

DILLON: Well, I think that was so, and I think it probably was correct. It needed impatience to get a large organization moving. The Defense organization was operating on the theory started in the early fifties that it should provide a maximum of free dollars to European countries, in particular, and generally around the world so as to close the dollar gap.

HARRIS: Do you think you might be interested in the letters here from the Secretary of the Treasury to the Secretary of State on February 20, 1962, in which you pass along to Mr. Rusk [Dean Rusk] the general idea that we have to save money on our foreign aid operations and the President was very much interested in this. You say, "I also told the President my view which I mentioned in our meeting last week that the overall balance of payments impact of foreign aid operations including our contribution to the Inter-American Bank, the International Development Association, as well as AID [Agency for International Development] and military assistance expenditures should not exceed a billion dollars annually as compared to last year's level of about a billion and two hundred million. The President expressed his concern that the figure was running this high and asked that I inform you of his concern and that we jointly furnish high with a progress report by the end of next week which would indicate what could be done to meet the one billion dollar goal." This suggests that the President was very much

worried about this.

DILLON: Oh, yes, he was worried all the time about the balance of payments problem. Of course, that's why we sent this memorandum we are discussing to Mr. Sorensen, which was dated early in January 1961. The purpose of the memorandum was to provide the background, which it did, for the Presidents Balance of Payments message on February 6th, which was the very first special message that President Kennedy sent to Congress. I think that's a way you can measure the importance with which he treated this particular problem.

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HARRIS: That particular memo must have had an awful lot to do with that particular message because an awful lot of what was in there went into that message.

DILLON: Certainly, there are only two other things I'd like to mention that were in that early memo which later got into the message. One was the need for an examination of our tax laws as they affected American investment abroad, so as to eliminate any special incentives for money to leave the United States. This resulted in the tax haven legislation of 1962, closing tax haven loopholes in our laws. And finally there was a suggestion that there should be a major strengthening of the international financial institutional arrangements so as to be sure that there would be adequate reserves available for the growth of world trade and investment.

This led that summer to the agreement called the General Arrangements for Borrowing from the International Monetary Fund, in which six billion additional dollars were put up, four billion by countries other than the United States, and nearly three of that four by the countries of continental Europe which were in a very strong position at that time.

It is certainly clear that right from the beginning President Kennedy was deeply interested in the balance of payments, which certainly was one of the major problems faced by the Treasury. In fact, it is no secret that probably the primary reason that President Kennedy turned to me and asked me to be Secretary of the Treasury was because of his concern regarding the balance of payments. It was his feeling, because of my experience both in banking and in foreign policy, particularly in the foreign economic end during my last four years in the State Department, that I would be able, probably quicker than anyone else, to gain the confidence of monetary and financial people abroad and here at home that was needed to bring this matter under control. So he asked me to be Secretary of the Treasury because of the crisis. This was also one of the main things that motivated me to accept this rather unusual assignment. And ever since then, right up to the President's death, this question of the balance of payments and, in particular, the question of the outflow of gold from this country, remained on his mind and was one of the key things that he was interested in. He knew that if this was not properly handled, everything else

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he wanted to do, both abroad to make peace and to protect the peace and promote development, and at home in the way of reducing unemployment and helping us to grow faster, could be brought to naught by a failure in this one area. So he was vitally interested in this all the time.

HARRIS: Mr. Secretary, do you have a feeling he understood these problems pretty well?

DILLON: He understood the problem of the balance of payments extremely well in the broad. He didn't make any attempt to understand the details of currency swaps or arrangements, things of that nature. He relied on the Treasury, quite properly because he had other things to do. But he was well aware of the overall, I might say the overriding importance of reaching a solution here, because if he didn't reach a solution here, as I said earlier, it would make impossible the achievement of other goals. He was quite ready to postpone his achievement of certain other goals to achieve success here so that he could continue to work toward those goals instead of risking total failure.

HARRIS: Mr. Secretary, you may be interested in regard to what you said a minute ago. Here is a letter that you wrote to Mr. Daniels, who was the export expeditor in the Department of Commerce. You wrote, and I quote: This is October 3, 1962. "The most important Treasury contribution to increase the U.S. exports lies in the field of tax policy. If our products are to be competitive there must be an incentive for investment in machinery and equipment that will make the United States produce more and better products at lower costs." This is a line that the Treasury took right along.

DILLON: That's right. Very much so. Of course, this was one of the major arguments for the investment credit which was part of our tax program which was sent to the Congress in early 1961. It was a double-barreled objective. The investment credit was designed to speed investment in new and modern equipment, which we felt was necessary for our growth rate here at home. We were investing less proportionately than any major country in the world and our tools were growing older while the average age of the tools and equipment of other countries was growing shorter. And secondly, the obvious fact that if we allowed this to continue we would lose our competitive position in the world which would be a very serious matter as far as our balance of

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payments was concerned. So we pushed the investment credit for balance of payments reasons as much as for domestic growth.

HARRIS: Well, now, I think perhaps the next issue—of course, the President was very much worried about the situation in 1962 and he suggested at one point that if any action were taken, such as in foreign aid, or anything of that sort, he wanted to be warned beforehand about what the effects would be on the balance of payments. In a number of memos which the President wrote on this particular issue—on June 20, 1962, a memorandum for the Secretary of the Treasury and the Administrator of AID from the President: “I would like in the future for all actions which affect our dollar drain or balance of payments to be brought to my attention before final decision is made. Before any loan stabilization or AID agreement is made I would like to have an indication of what effect it would have on our dollar position.”

DILLON: Yes, this is just another indication of the President’s continuing interest in this area. Very early in 1961, I think it was, he asked me to head a Cabinet Committee on the Balance of Payments and that continued in one form or another throughout his administration. He looked to me, as Secretary of the Treasury, as being primarily responsible for overall balance of payments results, although, naturally, our policies had to be carried out through other departments and agencies. Whenever necessary, I would bring matters to his attention, and he would talk directly to those concerned.

HARRIS: Of course, the balance of payments improved some in the early part of the administration. I think on the whole it was rather disappointing in 1962, wouldn’t you say?

DILLON: Well, yes. It seemed disappointing in 1962. It wasn’t unexpected to us. What happened in 1962 is that our overall payments deteriorated somewhat, not much. But the reason for this was that in 1961 we had benefited from the fact that we were in recession. We were right at the bottom of the recession in the beginning of 1961. So our imports were naturally depressed, and at the same time business was moving reasonably well in Europe and in the rest of the world, so our exports held up pretty well. We had a very substantial, unusually large, export surplus. We knew that our imports wouldn’t stay at this low level when we got our economy moving again. This happened by

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the beginning of 1962. Imports in the first six months of 1962 were up about a billion dollars over what they had been in the same period in 1961. So as a result, we had to make up that amount in other areas of our balance of payments. Well, we did make some of it up but we didn’t make it all up and so the overall balance deteriorated. It was somewhat disappointing because we had hoped that we could move more rapidly in reducing military expenditures and more rapidly in coming to overall balance than we found was the case.

HARRIS: In the first half of ’63?

DILLON: In late '62 and early '63 a new factor entered the scene which we had not foreseen. This was a tremendous outflow of portfolio capital, capital that flowed out of the United States as the result of the purchase of foreign corporate bond issues and foreign corporate stock by United States residents. Over the years this outflow had averaged maybe 600 million dollars a year. In 1962 as a result of the sudden increase in the last half of the year, the total rose to about a billion one hundred million dollars. And then in the first six months of 1963 it amounted to something just over a billion dollars, or an annual rate of about 2 billion dollars a year. So this outflow had more than tripled in a period of less than two years.

Obviously, we had no way of standing that sort of a drain after the number of years that we had been in heavy deficit, so direct action had to be taken in this field. We could have tightened credit very considerably and tried to drive up interest rates here at home but that would have brought our recovery to a halt. It might not even have been possible. So a new approach was evolved. It occurred to me—I have been an investment banker so I knew this type of business—that if we could think up some method of increasing the cost of these borrowings to foreigners, while not increasing them to our own domestic clients, this might do the trick. And I thought of the possibility of a tax on foreign securities.

I remember very distinctly when this came up, speaking to President Kennedy, late in June of 1963, when these figures had become very apparent, and saying that I thought something needed to be done, and that I was inclined to recommend a tax on new

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issues of foreign securities. He said right away, "That's fine, that makes good sense to me." I pointed out to him that this was a highly sensitive area and if it were mentioned at all before we were ready to announce it officially, it could have a very bad impact. I also pointed out that it should be announced only in the context of an overall plan of other things that we might do. The President wholeheartedly agreed and told me to keep this entirely to myself and limit it to the Treasury as much as possible. So we went back and worked for two or three weeks and worked out the details of this Interest Equalization Tax which was then joined in with the other elements of what became the President's Balance of Payments Message of July 18, 1963. This was one case where we were able to keep a new idea very close until the time when it actually was announced. In fact, I don't think there were any press leaks at all largely because we didn't even inform other people in the government until less than a week before the message on this particular item, which was, of course, one of the key elements of the message.

HARRIS: Did the State Department object?

DILLON: No, they didn't object at all on this because they didn't feel that this was one that they were particularly concerned with. They were very afraid that they would be pressured to withdraw troops or pressured to cut AID programs, and although there was a tightening up in both those fields, when they found that it was in an amount that they could stand they were very happy to accept action in this other area.

HARRIS: It may be of interest, Mr. Secretary—here's a memo from Bob Roosa [Robert V. Roosa] to the Legal Department of February 22, 1963, and it says, "In the confusion of getting away I unfortunately did not get an opportunity to talk personally with you about a matter that the Secretary wants for the present confined to you and me. Although the subject has come up in various ways and even been mentioned in congressional testimony by others, it is important to avoid all risks of any kind of leakage from the Treasury that we are thinking about this matter. Moreover, our thinking is, in any event, only on the precautionary side, etc. In essence, the Secretary wants us to think through the possibilities for legislation that would authorize the Treasury to impose a special tax on borrowing by foreigners in this market, or, put the other way around, lending by Americans to foreigners." Then it goes on to discuss the exemptions for Canada and Japan and so forth. It really raises a most vital issue. This was in February 1963.

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Then there is another memo in April of 1963. I wonder whether you remember that, in which you say to the President, "I feel it is incumbent on me in my capacity as chief financial officer of the government and Chairman of your Cabinet Committee on Balance of Payments to give you a full and frank exposition of my personal views of the balance of payments situation." And here you raise primarily the whole issue of confidence and the fear that certain things may be done that might impair the confidence in the dollar. You say, "In the past two years we have developed new and stronger defenses against international speculative raids, but nothing that could withstand a major loss of confidence in the dollar by our own citizens." One other short passage here which you might be interested in. "Specifically, there is a great danger in any attempt to limit capital flows," ... I think what you mean there is not so much a tax as a capital issues program... "to have resort to the IMF, except on an emergency basis, or to ask for governmental assistance from other countries. These are all actions which habitually are only taken at a time of severe balance of payments crisis." You didn't raise the issue again of the tax until just before....

DILLON: No, it was in June. As I said, we had thought about it briefly before and we had some very preliminary studies made in our tax section. They had raised a lot of problems as preliminary legal studies always do. And we set the matter aside to wait further developments. We were looking toward this July date because we had had an annual roundup in the spring of 1963 and we'd seen the situation was not developing as well as we would have liked. One of the major things that came out of the spring review was a definite instruction to the Departments of State and Defense to study ways and means of reducing gross dollar defense expenditure abroad. That involved reducing the number of troops and installations abroad. This was the first time this had been carefully studied in this way. There was a good deal of skittishness about this in the State Department, but anyway, this was decided and approved by the President, and a study was undertaken. The study was meant to come to an end and to have definite recommendations by about the first of July.

At that time we intended also to look again at the overall payments situation. So we were awaiting a time, as I said before, when we could do everything all at once. And at that time we did make an announcement of the proposed Interest Equalization Tax.

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The President did announce the reduction in defense expenditures of \$300 million and of a billion dollars total in overall defense and foreign aid dollar costs over an eighteen month period—\$200 million of that total being in the purchase of nuclear materials from abroad. Also, as I was going to say, he announced at that time that we had established a standby with the IMF.

This message followed in a cooperative pattern with action by the Federal Reserve, which had taken place a few days before, to raise the rediscount rate from 3 to 3-1/2 percent, which was something we approved of. It was the first time in our history that we had taken such action for balance of payments reasons, rather than for domestic economic reasons. So it was quite a watershed for U.S. policy, although this was commonplace in Europe. We felt this could be done without any major effect on long-term interest rates.

A year later, looking back, we are glad to see that we were proved right in this expectation. Our short-term rate was raised by about half to one percent, with increases in other longer term rates of less than one eighth of one percent—in some cases, no increases at all. It has been a success in that way. But what I want to emphasize is what I said in that earlier memorandum to the President. None of these things were done piecemeal. They were all done together with an objective of greatly improving our balance of payments position by the calendar year 1965. These measures have been successful and certainly now we are seeing the proofs of them. Our balance of payments is, for the first time, substantially better than it has been at any time in the last six years.

HARRIS: Mr. Secretary, I remember the President in that message—I think the general inference was that there would be improvement of about 2 billion dollars per year. Is this roughly what you say would have happened?

DILLON: Well, I say it's more at the moment because the deficit during the first half of the year was running at about a five billion dollar annual rate and in the first half of this year it ran just under a two billion dollar annual rate.

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So the improvement was about three billion dollars. Actually, that was a little better than we had thought because I think our trade balance had improved more than we had expected that it would. But, our objective was to get down by 1965 to between one and two billion dollars and I think we seem to be on target with that. That was the objective and that was what was foreseen at the time of that message.

HARRIS: Mr. Secretary, I just read your paper to the Democratic Party platform committee today, the 18th of August, and I thought we might put in the record the paragraph which I think summarizes very well the gains which have been made.

“While we have been strengthening our economy at home—and putting the nation’s financial affairs on a sound and viable basis—we have also made real and lasting progress in bringing our international accounts into balance. During the three years 1961-63—compared with the preceding three years—we have cut the balance of payments deficit by 33 percent, the gold outflow by 59 percent, net military expenditures abroad by 17 percent, and we have increased exports by 20 percent and our favorable trade balance by 62 percent. Thus we have substantially strengthened our national security. For a sound and strong dollar is as essential to the defense of freedom throughout the world as it is to our prosperity here at home.”

This is one of the best summaries I’ve seen of actually what has happened.

DILLON: That’s a good summary of what has happened. Those figures are averages of the three years 1961-63 compared with preceding years. Of course, we are a little better now than even those say. You might be interested in an ad lib I made, pointing out that perhaps the most graphic sign of improvement is the fact that in the past twelve months in our transactions with all foreign countries in gold the United States has actually been a gainer for the first time since the Suez crisis.

HARRIS: For what period was that?

DILLON: For the past twelve months. This means that the gold outflow to foreigners since the President’s message of last July, from July 31st on, that there has been an actual gain in gold from foreigners as compared to the year 1960 when we lost a billion and three quarters dollars in gold.

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HARRIS: In other words, when we do have a deficit the smaller rate of the loss of gold in relation to the amount of deficit, the greater the confidence in the dollar?

DILLON: I think that’s correct when you get the deficit down so it’s small enough. If the deficit is small, if we were running a small deficit, there is a demand for dollars on the part of private business to do business around the world. They take these dollars and they don’t go into the coffers of central banks. Therefore, they are not convertible into gold and they are not converted into gold. If we have a large deficit there are excess dollars, and they spill over and that leads the central banks to convert them into gold. We lost gold and that scares some of the private holders of dollars so they are apt to start a chain reaction, handing their dollars over to their central banks which then convert into gold and so forth. We are now on the right side of that cycle where the gold outflow seems to be very well in hand.

HARRIS: Mr. Secretary, while we are on that issue, since you just mentioned the gold problem, perhaps I can just say a word as to why we haven't been relieved of the 25 percent reserve requirement in the Federal Reserve System.

DILLON: Well, the President said in his message of February 1961 that all our gold stood behind the dollar. This was very important because it gave confidence throughout the world. And it was possible because the Federal Reserve has the right to waive this 25 percent requirement in an emergency and the Chairman of the Federal Reserve has said publicly that he would do so. Certainly, we are one of the few nations in the world, very few, that has a domestic requirement for the specific gold reserve. Gold is used now only to settle international accounts. Theoretically, we ought to be in a position where our gold was all available for that purpose and did not have this 25 percent requirement. Nevertheless, if we attempted to remove that requirement and suggested legislation to do so, which we never have, it would undoubtedly stir up a very violent and emotional debate in Congress. There are many who are emotionally attached to this 25 percent requirement, who feel that it somehow controls expenditures at home, which, of course, it doesn't.

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Nevertheless, there is that feeling and because of this we felt that it would be inadvisable to have this sort of a debate which would weaken confidence in the dollar around the world. So we have done nothing about this. If we should ever get to a point where we were approaching or at that 25 percent level then the Federal Reserve would act, gold would still be available, and presumably at that time Congress would also act because the 25 percent requirement would have become anachronistic.

HARRIS: The time that Congressman Multer [Abraham Jacob Multer] introduced the elimination of this 25 percent reserve, this was not a Treasury operation?

DILLON: No, not at all. He did this on his own because there had been a lot of talk about this. A number of the leading New York bankers, Henry Alexander of Morgan Guaranty was one, had made speeches saying that this requirement should be removed. I think all the New York bankers as a matter of good banking felt that way. Mr. Multer is a student of banking, comes from New York, and was probably influenced by their views and therefore introduced this bill on his own.

HARRIS: I think Mr. Anderson wasn't happy about it, as I recall.

DILLON: I don't know whether he was or not. He probably was disturbed for the same reason that we were—that it would upset confidence because he could foresee from his experience down here what would happen in

the Congress.

HARRIS: There is one important issue we haven't discussed at all and that's the issue of liquidity, whether there are enough international reserves. I recall there was some difference of opinion between the Council and the Treasury on this score. Perhaps you might say a word about this.

DILLON: Yes, I think there was a sort of running argument that culminated in a rather formal discussion in which the President took part in the summer of 1962. The State Department, with the support of the Council, made a suggestion that we didn't need to have any problem in our balance of payments if we could only increase international liquidity or could get foreign countries to make us more or less unlimited long-term loans. This was all

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very fine, and it was something that if it was possible, of course, would have done away with the balance of payments problem as far as we were concerned. But it did not really take account of the facts of the world today, where we are dealing with other nations who have another way of looking at the matter, and who feel that a deficit, a substantial deficit in the United States balance of payments, contributes to inflationary pressures in their own countries. Therefore, they wish to see action taken by the United States to bring this deficit to a halt and to reduce it. These countries simply would not make long-term loans to the United States for the purpose of funding our payments deficits. We had talked with them and gotten them to agree to make eighteen-month and two-year loans which were much more than they had ever done before, to help finance the deficit as it appeared necessary. We had their cooperation in the gold pool. We had their cooperation in making advance repayment of debts, but we simply could not give them the entire job of financing our balance of payments deficit, more or less ad infinitum. We had to show that we were going to work hard and really find a way to bring our payments into balance. That didn't mean that we couldn't ask them to help, which we certainly did, and we got very effective help in the German offset agreement, which I've mentioned where we get some \$650 million dollars a year. From Italy a much smaller amount but still a full offset—something like a hundred million dollars a year.

This argument was carried on at some length but the President was a very practical person. In the final analysis he fully recognized that you couldn't just tell the European countries to do something that they wouldn't do, and he realized that, irrespective of some of the theoretical attractions of these ideas, they were not practical as policies on which the government of the United States could rest the defense of the dollar. It requires two sides to make such a policy work, and the other countries simply wouldn't play on this basis. The President realized that, if he put his trust in that and it didn't work, we could have a catastrophe resulting in a dollar devaluation and the loss of everything he had wanted. So he decided that we should continue on the course we had been on and which we are still on today.

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HARRIS: In a general way, then it was your position, I think, and also Bob Roosa's, that there is no substitute for structural readjustments that may be required by changing market conditions or excessive costs. And that means you have to have an adequate amount of liquidity, but if you have too much liquidity you may not do the other things that are necessary in order to correct the balance of payments.

DILLON: That's right. It is a question of how much is enough. In general, those who think that the present situation calls for more international liquidity, which we don't feel is the case, feel that we ought to have enough so that we won't have to take any actions toward putting our payments in order at this time. They object to the tying of aid, to attempts to reduce defense expenditures and things of that nature. On the other hand, it must be realized, when you look at it from the point of view of other countries, that the United States has been running a deficit of over three billion dollars a year for six solid years. We have run a deficit of something of the nature of twenty-one billion dollars in those six years. Well, other countries are beginning to feel enough is pretty near there, and they don't quite see how you could go on more or less unlimitedly. That's a pretty big deficit, and we can't help but recognize that they can well hold such views and, therefore, we have to take action to substantially reduce the size of our payments deficit.

HARRIS: Wouldn't you also agree, Mr. Secretary, that all the problems are involved in trying to get somebody to hold on to more dollars and this, therefore, also involves the whole guarantee issue. Would you like to say a word about the guarantee issue?

DILLON: Yes, that involves the question of confidence. There was a lot of question of gold guarantees, whether that would help. We didn't think it would because we couldn't find anything that would increase our present agreement to pay gold for dollars. If you had a more specific guarantee for certain special deposits it would only call in question your willingness to pay gold for other dollars and promote a run by the holders of those dollars. We have been able, to some extent, to meet this issue by the sale of bonds denominated in foreign currencies, which do provide a guarantee against devaluation of the dollar versus the other currency, but not versus gold. It's just a currency clause. And this has been useful. We now have something like nine hundred million dollars of these securities outstanding.

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HARRIS: Would Congress be very friendly toward a guarantee which protects the foreigner and doesn't protect the American?

DILLON: No. That, of course, was another reason why this idea was totally impractical. It would have required a vote by the Congress, and it was perfectly clear that that never would have been obtainable.

HARRIS: There's one other issue that we perhaps might say a word about and that is—you have been very much interested in the whole problem of how you measure the balance of payments and the deficits in the balance of payments. I think that you also had a strong feeling that our method of measurement in 1960 and preceding years was not satisfactory and sometimes seemed to indicate a larger deficit than really prevailed.

DILLON: I think that is true. We have made some attempts to improve our figures and had some modest success. But I don't think half enough. We need to do a great deal more. We present our balance of payments in a way that is different from any other country—in a way that was developed at the end of World War II when the United States had the only convertible currency in the world. And, therefore, we were at that time in a very special and different position. We count in our deficit everything that we owe in any way to foreigners. And we do not count as an asset the parallel that foreigners owe to us. For instance, any American bank account abroad is counted as a liability, but a foreign bank account in the United States is not counted as an asset. This doesn't make much sense. It can be seen in a sort of reduction ad absurdum where an American company can now take a deposit out of the Chase Bank in New York, for instance, and take it across the street to the agency of the Bank of Montreal which will deposit it for the American company in the head office of the Bank of Montreal in Canada. The bank will then immediately return it to its agency bank in New York so that the dollars actually never leave New York. They will then be loaned out by that agency bank in New York. That is counted as an outflow of funds from the United States, although the dollars never left Wall Street.

As a result of this we made some attempts to see within the government if we could arrive at agreement on a better presentation. We were not successful, so we then suggested, and this was agreed to by the President who was also interested in this, and by the

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Director of the Budget, that the Bureau of the Budget would set up a special outside committee to study this problem and to make a recommendation for an improved presentation of our balance of payments statistics. This study has been underway for almost a year and a half now. The committee came into organization and started to act in the spring of 1963 under the chairmanship of Edward Bernstein [Edward M. Bernstein], who had formerly been with the IMF, and who is probably one of the leading monetary experts in the world. It is still studying this matter. It has only outside representatives on it, outside of the government, that is, private people from banks, from companies, from universities, from the Federal Reserve, and from the IMF itself. I would hope that we would get an interesting report which should come sometime this fall, and which would let us present our statistics in a fairer manner, a more understandable manner, and a more comparable manner with other

countries. This is, of course, something that is very much desired by the International Monetary Fund because it would make our statistics comparable with those of the rest of the world.

HARRIS: Is it true that if private bankers, or private individuals, accumulate short-term assets in the New York market it counts against our payment deficit but it doesn't in Europe?

DILLON: That's correct. What I said was that if an American company deposits funds in London, that is called a loss of reserves, short-term funds, but it is not called that by any other country because they know that deposit is good and can be called back at any time.

HARRIS: One other issue which isn't so terribly important but which you might have a few ideas on is you have had a gold committee. The Budget Bureau more or less watches what effect particular governmental expenditures have on the balance of payments or contribute to the loss of gold. Would you say this has been a great success?

DILLON: It wasn't meant to be a big thing because the big area here was the Defense Department and we have been handling that as an individual item. The second biggest area was the area of the aid program. That has also been handled on an individual basis. But we thought we should also do this as a government-wide policy. So the Bureau of the Budget has instituted this procedure.

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For budgetary purposes they require the balance of payments impact of all expenditures, and they hope to save maybe fifty million or a hundred million dollars a year in all the other agencies of the government combined in this process. I think they have made some progress, but it is on that order of magnitude. Nothing comparable to the billions of dollars involved in defense and aid.

HARRIS: One of the other interesting things you have done, Mr. Secretary, is trying to find out if foreign capital markets could not work somewhat better so they wouldn't be a drain on our capital market. Do you want to say a word about that?

DILLON: That was very important because that is part of what happened in 1963. I foresaw that a year earlier before this drain started. At a speech in Rome in the spring of 1962 I suggested that it was very important for Europe to rapidly increase the ability of their capital markets to provide the capital they would need if their industrial expansion was going to continue.

Nothing much happened. They continued to come in increasing volume to the New York market. I pointed out then that our market was not a bottomless pit and that there would

be an end to that if the recourse was too great. The well ran dry the following year, and we had to propose the Interest Equalization Tax. It is remarkable that under the spur of this there has been a great increase in the flotation of foreign loans in Europe which amounted in the first six months of 1964 to almost twice what had been done in any whole year before that.

HARRIS: That's interesting. Now one other issue which was discussed and nothing ever came of was the general idea of export subsidies.

DILLON: This was very difficult because there is the question of the GATT [General Agreement on Tariffs and Trade]. What we have been trying to do is study what these export tax rebates of excise taxes do in other countries. That study under way in the OECD should be completed this fall. We don't have that sort of tax system so we can't put in something similar. We would have to try to work it on income taxes with rebates which is not in accordance with our obligations under the GATT.

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HARRIS: Well, I don't have any other leads, Mr. Secretary. I would merely say that it looks as though we had made some considerable progress and it has been a very tough problem and is there anything else that you would like to add?

DILLON: No, I think we just have to continue this. I think this is very important in the history of the Kennedy Administration because we did meet this crisis. The dollar was in crisis when President Kennedy came into office. Many of the people best informed in New York felt that the dollar would have to be devalued that spring. It was not. They then felt it might have to be devalued the following spring. It was not. And the dollar is stronger than it has been in years today. This is because of the policies that were followed by President Kennedy, his keen interest in this matter, the support which he gave to me and to the Treasury Department throughout the government, in our discussions with the Defense Department, the State Department; his willingness to propose legislation that was new and difficult, such as the Interest Equalization Tax, and the general feeling of urgency which he imparted to the solution of this problem. Because of this we were able, I think to do reasonably well, to save the dollar, to put it into a much stronger position and to avoid the catastrophe that many saw ahead.

HARRIS: And you also are aware of the fact this was a period of exceptionally high unemployment and therefore you weren't free to do some of the things that could have helped the balance of payments much more.

DILLON: That's absolutely correct. Of course, this balance of payments is going to stay with us. I don't mean to say it is cured at all. It is going to be with us for a long time to come and it is going to require continued attention as long as currencies are convertible, which I hope will be forever. So it's going to

be a problem that all future Treasury Secretaries and Presidents will have to keep high on their list to watch.

HARRIS: In other words, we have now become like all other nations—a nation that has to watch its balance of payments. We were free of that particular responsibility for a long time.

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DILLON: That's absolutely correct. We were free of it in general for some thirty years, from the late 20's right through until currencies became convertible again early in 1959.

HARRIS: I think that sort of ends it up pretty well, don't you think?

DILLON: Yes, I think that's been a pretty complete discussion. Thank you.

[END OF INTERVIEW]

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