

637
INTERNATIONAL MONETARY REFORM

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE

OF THE

COMMITTEE ON BANKING AND CURRENCY

HOUSE OF REPRESENTATIVES

AND THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE

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INTERNATIONAL MONETARY REFORM

TUESDAY, NOVEMBER 13, 1973

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
COMMITTEE ON BANKING AND CURRENCY,
AND CONGRESS OF THE UNITED STATES,
AND SUBCOMMITTEE ON INTERNATIONAL ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittees met, pursuant to notice, at 10:10 a.m., in room 2359, Rayburn House Office Building, Hon. Henry B. Gonzalez [chairman of the subcommittee] presiding.

Present: Representatives Gonzalez, Reuss, Rees, Hanna, Stark, Johnson, Stanton, Frenzel, Burgener, and Senator Javits.

Also present: Representative Widnall.

Mr. GONZALES. The joint subcommittees will come to order, and let me say at the outset that for the sake of economy energy on the part of our administrators, who oftentimes find them having to come to about a half a dozen different legislative panels, we thought at this time on the eve of the House subcommittee going into the question of the International Development Association that it would be well to come back to our pre-August situation on international monetary problems, and since the Joint Economic Subcommittee was interested in the same thing, happily Chairman Reuss broached the idea of a joint meeting and we all agreed with it to be a very good one. The Joint Economic Committee and the House Subcommittee on International Finance have a joint interest, and I think properly so, on the stability of the world monetary system.

We are therefore particularly pleased that we are able to conduct this hearing as a joint effort. This is the first time, as far as I know that this is done.

I want to welcome this morning all of our distinguished friends, welcome the witnesses, and particularly Under Secretary Paul A. Volcker and Freeman H. Huntington.

I would like to offer a few comments. As I see it, the problem of monetary reform has two facets. The problem of so-called dollar stability, and the problem which everybody tells us is interrelated, general stability. The dollar seems to be stronger this week than it has been in months. I for one do not know what to attribute this to, improved U.S. trade figures; the acute threat of an energy shortage in Europe that could weaken the economy of that part of the world;

the prospect of an oil shortage, that could choke off Japanese prosperity, or a combination of these, but whatever the reason for the current strength of the dollar, I do not think that we can afford to indulge in any self-congratulations or relax our efforts to strengthen our basic position.

We still need to rehabilitate the dollar. Staff studies of my subcommittee indicate that several things can and ought to be done as part of that effort. One, we could welcome continued direct foreign investment in this country. Presently there is a substantial return flow of dollars in the direct form of investment, and this should be encouraged. I do not think that such investment is going to result in any foreign takeover of our economy. After all, our total corporate assets in this country today are valued at \$2.4 trillion, with a net worth of U.S. corporations of \$728 billion. Moreover, our investment abroad is now \$90 billion, against foreign investment here of \$15 billion, and the rate of domestic investment here is \$178 billion annually against foreign investment of \$1 billion. So I do not think there is any danger that our economy is going to be foreign dominated. There is every reason to believe that foreign investments here would be healthy, at least in the short to medium run, because it will help reduce the so-called dollar overhang.

Second, I think that we could do a little more to reduce our tourism deficit which now runs at about \$3 billion a year. Devaluation may result in improvements, but maybe we should say a little more about it and pay more attention to the activities of the travel service and encourage their efforts.

Third, staff studies indicate that foreign investment in U.S. securities could be encouraged by removal of the present 30 percent tax on gross dividends and interest. Our studies indicate that this tax produces little return, and that its elimination could stimulate a much greater rate of foreign investment in U.S. stocks and bonds.

Finally, of course, there is the oil problem. Staff studies show that this is our biggest and the least manageable problem of all. It is a problem that affects all other currencies of any stature. The pound, the franc, the mark, and the yen are all affected by this tremendous outflow to the petroleum exporting countries.

This remains the greatest single threat to the stability of the dollar and all currencies, and I think that the test of any reform monetary system will be how well it can deal with the oil dollar overhang. I was disappointed to see that this problem received little attention, at least publicly, in Nairobi.

The second problem we are dealing with in general is the general monetary reform situation. The present floating system has survived war in the Middle East, the political turmoil in the United States, and inflation in Europe, but the question is whether the system can survive indefinitely. I have my doubts.

Secretary Voleker has been heading our efforts to negotiate a reform system, but progress has been slow. I hope that he will bring in some good news today, some news that the Committee of Twenty has been able to reach agreement in principle on the fundamental issues.

Mr. Reuss?

Mr. REUSS. I would simply like to join with you, Mr. Chairman, in this excellent effort to conserve energy. I am most happy to see our friend Undersecretary Volcker. I have had a chance to look at his statement which is, as usual, well addressed to the problems before us, and I think we should get started.

Thank you.

Mr. GONZALEZ. Thank you.

Mr. JOHNSON?

Mr. JOHNSON. I want to join with Congressman Reuss and yourself in welcoming Paul Volcker here today, and it is going to be very interesting and refreshing to hear from Mr. Huntington, senior vice president of the First National City Bank, which is one of the great banks of the Nation, and with worldwide connections, and I think you are to be commended for holding this hearing this morning which will be a good background for us as we proceed on the very vital questions which face our subcommittee.

Mr. GONZALEZ. Mr. Rees, do you care to make any statement?

Mr. REES. No; I think Mr. Volcker and Mr. Huntington might have better statements.

Mr. GONZALEZ. How about you, Mr. Stanton.

Mr. STANTON. No; thank you.

Mr. GONZALEZ. Mr. Volcker, thank you for being with us. You have the forum.

STATEMENT OF HON. PAUL A. VOLCKER, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

Mr. VOLCKER. Thank you, Mr. Chairman.

I must say I do appreciate these opportunities to come up occasionally and keep in touch with the subcommittee on the subject of international monetary reform, and I think I doubly appreciate it when you combine committees this way.

I was also interested in your opening statement, Mr. Chairman. I would like to associate myself with the points that you made about welcoming foreign investment and tourism and I think, the withholding tax as well.

I will proceed by reading the statement, if that seems the most expeditious way to proceed, Mr. Chairman.

Mr. GONZALEZ. Fine.

Mr. VOLCKER. The recent annual meeting of the International Monetary Fund in Nairobi marked the completion of a year of negotiations in the Committee of Twenty to reform the international monetary system. Alongside these formal negotiations, the past year has also been marked by important changes in the actual functioning of the system. I am glad to report on these matters to your two subcommittees, and I particularly appreciate your willingness to meet jointly on this occasion.

The status of monetary reform was marked by three essentially procedural steps taken at Nairobi:

First, Ministers set a deadline for the completion of a basic agreement on reform by the Committee of Twenty by July 31, 1974.

Second, they agreed to procedures for facilitating the committee's negotiations, and for enabling as much work as possible to be completed well before the agreed deadline.

Third, they published a first outline of reform, summarizing the chairman's assessment of the status of the negotiations thus far.

The deadline for reaching agreement reflects, I believe, the collective political determination to move ahead in the reform work with a clear sense of urgency and dedication. In a sense, it is a prod or a goad to the technicians and negotiators. But it is also a realistic assessment both of what is attainable and what is required. There is no doubt in my mind that, in setting such a deadline, the ministers mean to meet it.

More generally, the tenor of the discussions at Nairobi ran counter to some doubts and false impressions which had grown in some minds about the negotiations. Certainly, tough issues central to the negotiations remain unresolved. But the Nairobi meeting did not support an impression that the negotiations are stalemated, with no solution possible or likely within a reasonable time. Nor did I detect any feeling among the politically responsible ministers that the arrangements that have grown up over the last 2 years, culminating in the decisions last March of a number of nations to permit their currencies to float, were in themselves a satisfactory substitute for organized reform. To the contrary, I believe virtually all countries went to, and came away from, Nairobi attaching high priority to the reform effort, and with a sense that the remaining issues could be resolved.

To assist in this resolution, a schedule of ministerial meetings of the committee was tentatively set for January and March 1974. Meanwhile, four technical groups have been established to explore more thoroughly certain aspects of the reform proposals. These groups are designed to provide smaller, more informal forums for detailed study of individual elements that might be included in a reformed system, including adjustment rules, convertibility arrangements, the supply and composition of liquidity, and the flow of resources to poorer countries. As these groups complete their work, together with related efforts by the IMF executive board, the Committee of Twenty will be in a much better position to finally decide upon the components that will go into a comprehensive reform package.

The so-called first outline of reform released at Nairobi notes areas of agreement and issues yet to be resolved. The assessment is the chairman's: Governments are not committed to specific language, and the report explicitly and correctly recognizes that agreement on any particular issue is subject to final agreement on the reform package as a whole. The report does, however, provide a useful benchmark of the progress that has been made in some areas, and helps as well to highlight certain points at issue. I will comment on several of these in turn.

First, adjustment. The problem of balance of payments adjustment is a central issue to be resolved in the reform negotiations. At the highest level of generality, there is agreement on the need to establish clear adjustment rules and disciplines falling symmetrically on surplus and deficit countries, with adequate incentives and pressures for enforcement. However, the area of agreement has tended to breakdown as these generalities are placed in a more operational context.

As you know, the United States has attached considerable weight to the use of movements of reserves as a so-called objective indicator of adjustment needs. We believe this is particularly important in the context of a system of general convertibility, where losses of reserves in any event bring strong, and eventually irresistible, pressures for adjustment on deficit countries.

In general terms, as the draft outline suggests, the idea of using a reserve indicator has attained support. But agreement has not been reached on the weight to be placed on that or other indicators in helping to guide the adjustment process. In the jargon that has grown up, the question revolves around the degree of presumption toward adjustment action, or in pressures or sanctions to be applied, to be associated with an objective indicator.

In contrast to the United States view, there are some governments that would prefer to rely much more fully on assessment, meaning a more subjective evaluation emerging out of a consultative process. Certainly, an active consultative process is an essential ingredient of an effective monetary system. But, taken alone, experience shows it lacks the essential discipline and certainly that will be necessary. Consequently, present efforts are concentrated on finding an appropriate synthesis combining consultation, assessment and reserve indicators in a coherent and workable whole.

Now, the means of adjustment. Questions of adjustment encompass not only which nation will initiate adjustment action and when, but which instruments of adjustment will be used, for instance, whether domestic monetary or fiscal policies, exchange rate changes, or controls. Again, as a broad generality, there is substantial agreement with the concept that a reformed system should afford national governments that freedom of choice and action which is consistent with the needs of the system as a whole. Moreover, within this framework, there is almost universal recognition of the need to make the exchange rate mechanism more flexible and accessible as an instrument of adjustment than it was in practice in the Bretton Woods system. Thus, changes in par values would not be considered so exceptional an adjustment measure, there would be some provision for floating, and wider margins for exchange rate fluctuation above and below established par values—on the order of the margins agreed to provisionally at the Smithsonian Institution for nondollar currencies—are accepted in principle as a desirable permanent feature of the system.

This degree of consensus on the nature of the exchange rate regime is summed up in the ambiguous phrase "stable but adjustable par values, with provision for floating in particular situations." That phrase is obviously too vague, and too subject to different interpretations, to represent the last word in this sensitive area. For instance, some countries wish to circumscribe the floating option narrowly, by stating it must be transitional or temporary, by closely restricting the definition of particular circumstances, and by directing the IMF to limit its use in other respects. In the view of the United States and a number of other countries, however, practical experience strongly suggests that the so-called floating option must not be so narrowly conceived; that particular situations, impossible to define adequately

in advance, may well arise in which floating would constitute both the most effective and least disturbing course of action open to a country wishing to act in an internationally responsible manner.

Our own reform proposals, and those of others, contemplate that most countries, including the largest nations, will want to maintain established exchange rates; in other words, that par values will remain the center of gravity of the system. We do not see that as inconsistent with a workable floating option. What we do feel is that the essential disciplines and rules of the system should be applicable both to the management of par values and to the management of floating exchange rates so that we have a consistent whole. Indeed, viewed in that light, many of the same issues arise whatever the formalities of the exchange rate regime. A floating exchange rate, in my judgment, cannot provide a country with a means for escaping the disciplines and constraints inherent in being a part of an international economy.

CONVERTIBILITY AND SETTLEMENT

Closely related to provisions for adjustment are the rules to govern the convertibility and settlement mechanism. Again, there is broad agreement that countries maintaining par values will be responsible for converting into agreed reserve assets those official balances of their currencies which are presented to them for conversion. Beyond that general statement, however, some countries, preoccupied with placing strict controls on use of national currencies in a new system, would prohibit new currency holdings, would make it mandatory that all imbalances from whatever source be settled by the transfer of reserves unless credits are internationally negotiated, and would centralize virtually all official settlements in the International Monetary Fund.

We have felt that such a system would be overly rigid, as well as overly complicated, and probably break down in the face of sudden strains, for example, from large movements of volatile capital. On the other hand, we share the concern that, in the context of a new system, we do not again permit the growth of excessive and ultimately destabilizing balances of official currency holdings over longer periods of time.

These problems would appear in a somewhat different light if at least the main countries adopted a so-called multicurrency intervention system instead of, as in the past, centering their intervention in the exchange markets so largely in the dollar. One of the technical groups is now examining this question.

CONTROLS

Nearly all countries are agreed that there should be a strong presumption that controls on current account transactions would be used, if at all, only in exceptional cases. However, a number of countries see a more prominent role for capital controls. We have taken the view that it is the existence of controls, not their absence, which must be justified. We want a system which would tend toward an international equilibrium consistent with market forces, rather than a balance

achieved only by prolonged use of controls. The effectiveness of controls has, in any event, been demonstrated to be limited in the face of powerful speculative forces.

RESERVE ASSETS

The view is widely held that SDR's, as appropriately modified and perhaps renamed, might take on the role of unit of account, or numeraire, and in time become the main reserve asset in the new system. Consistent with this view, the diminishing trend in the official monetary role of gold would be continued, and currencies should have a much smaller role than in the recent past.

A number of difficult and complicated technical questions need to be resolved in this area concerning the methods of valuing SDR's relative to currencies, the remaining role of gold in the system, and the means of assuring a satisfactory total and composition of reserves. However, I am convinced that workable answers are available to these essentially technical problems.

I am frankly less sanguine about other aspects of the problem where the technical aspects are less formidable, but where there is a wide gulf in philosophy, differences in political perceptions, or large practical problems of implementation.

I am most seriously concerned about the various proposals for linking the creation of SDR's to development assistance, an approach which many developing countries have presented as an essential element in monetary reform. Yet, this approach seems to us to threaten at the very start the chances for making the SDR the centerpiece of the reserve system by creating, at the least, suspicion that the monetary role would in practice be subordinated to the need for aid. The need for reasonable quantities of international development assistance sustained over time seems to me plain. The question is how that aid should be provided, whether in the long-accepted manner by explicit political decisions involving specific legislative consideration, a process which one of these committees is going to be considering tomorrow, or by incorporating aid within the process of international liquidity creation, with the implicit danger that neither objective is well served.

Most approaches to monetary reform implicitly or explicitly assume a large consolidation of existing official holdings of dollars or other foreign currencies in official reserves. Technically, such a consolidation appears readily feasible, by a combination of funding or by conversion of currencies into, say, SDR. However, as the discussions have proceeded, it is apparent few countries wish to see their reserves reduced or made substantially less liquid, and many countries value highly their present freedom to hold, and handle flexibly, currencies. Consequently, the more philosophical attachment to the concept of sharply reduced currency holdings in the system as a whole is diluted by the more practical attachment to the retention of maximum flexibility by individual countries. The possibilities of achieving a solution to this dilemma will need to be explored through detailed investigation with the objective of finding whether specific terms and conditions for consolidation can be found that are acceptable to debtors and creditors alike.

Finally, I should note there is widespread recognition that the structure of the International Monetary Fund should be modified, and that the relations between the Fund and other organizations with international economic responsibilities should be closer, more consistent, and better coordinated. But the Committee of Twenty has yet to give detailed consideration to specific possibilities.

Now, a few remarks here about the interim system. The international economic environment, which forms a backdrop for monetary developments, has in recent months had to adjust to, and absorb the impact of, some serious disturbances. We have experienced rapid worldwide inflation. Widespread and severe shortages of agricultural commodities and energy have developed. We have seen renewed international political turmoil in the form of a war in the Middle East.

Yet, I can report these disturbances have not had a jarring impact on the interim international monetary arrangements introduced last March.

Faced with the large uncertainties arising not only from changes in the economic environment, but also from the necessary adjustments in exchange rates earlier in the year, the regime of floating exchange rates among the major industrial countries has been accompanied by fairly wide fluctuations in the value of particular currencies at particular times. At one point, during the summer, the market became somewhat unsettled. But viewed in its entirety, the flexible new arrangements appear to have proved their worth during this transitional period. They have helped to insulate individual currencies, and economies, from the shocks and imbalances arising abroad during a difficult and uncertain period. Trade and investment have continued to flourish. The atmosphere of repeated and continuing crises has faded. Given the circumstances, could any other arrangement have done as well?

To be sure, during the late spring and early autumn, there were movements in certain exchange rates beyond what most observers felt necessary or desirable in light of basic economic conditions. These movements were not generalized; they were concentrated in the value of a relatively few European currencies. Nor were they entirely unforeseeable or unreasonable, given that underlying payments disequilibria remained large. There was inevitable uncertainty following the very substantial exchange rate realignments which had taken place, and domestic political developments in the United States were receiving wide comment.

Naturally, these movements in the market were the source of some concern. To the extent it could be helpful in maintaining an orderly market and in encouraging confidence, limited official intervention was undertaken. Since July, exchange rates have moved generally in the reverse direction, alleviating these concerns. The change rates between the dollar and the jointly floating European currencies are now rather close to the levels established after our February devaluation, and the dollar is stronger against several other currencies.

A critically important factor in explaining the restored confidence in the dollar and the more satisfactory performance of the exchange markets in recent months is the improvement in the underlying U.S.

balance-of-payments position. Earlier this year, there was a good deal of uncertainty in everyone's mind as to when we could expect to see real progress in restoring the U.S. trade balance. Following the Smithsonian exchange rate changes, we had seen a continued market deterioration in our trade figures, with the trade balance moving from a deficit of \$2.7 billion in 1971 to a deficit of \$6.9 billion last year. Much of this was anticipated. The deterioration of our basic competitive position was deepseated, devaluation initially worsened the trade position, and cyclical developments were adverse. Nonetheless, it was unsettling, and a considerable lag in response could have been anticipated following the February realignment as well.

In the event, marked improvement in our trading accounts has been evident throughout the year. Successive quarters have brought figures \$3 billion to \$4 billion better at annual rates than the preceding quarter. Including a surprisingly strong showing in September, the trade balance was in surplus by over \$3 billion at an annual rate in the third quarter, the first such surplus since the first quarter of 1971. Even discounting the September surplus, the prospect is for continued improvement in the U.S. position. The exceptional strength of our agricultural trade, with the balance rising by \$7 billion to \$8 billion over a year ago, accounted for the great bulk of the recovery in our trade position this year. This will not recur. As time passes, we must count more heavily on extending recent gains in the manufactured goods sector.

Like all the major industrial countries in varying degrees, the United States faces a sharply rising import bill for energy products. Obviously, this will cut into gains in our trade balance directly, as well as place new pressures on the internal price structure. I cannot estimate with accuracy the full impact of this development, but it does plainly underscore the continuing challenge of dealing with our inflation and maintaining a strong competitive position.

If we can succeed in those tasks, then we can anticipate that the U.S. external position will also be bolstered in the period ahead by strong interest in long-term investment in the United States as well as by some reflows of funds which left this country during periods of speculation against the dollar. In the longer run, we should receive a considerable share of the investments of the oil-producing countries, themselves, because of the broad range of attractive investment opportunities available in this country.

Improvement in the U.S. balance of payments and a reasonably strong dollar are indispensable to effective functioning of a reformed international monetary system. But we should not mistake this welcome development, and calmer market conditions, for reform itself.

In the end, we seek—and need—a code of conduct or system of rules, broadly perceived to be in the common interest, to govern conduct when the actions of one nation impinge on another. It is difficult enough to maintain harmonious international economic relations when nations know what is expected of them. Without such rules, the potential for conflict eventually will become unacceptably great.

I would hope that a year from now we will be able to come to the Congress with specific proposals for legislation to implement agree-

ment on reform. I recognize that this is an ambitious target. Turning a general agreement scheduled for the end of July into a detailed legal agreement can be a laborious and time-consuming process. But I also recognize that, at a certain point, a search for perfection in an imperfect world can be an illusion. Our objective must be to get the essential points right, and to move with all deliberate speed to pin down that agreement.

Mr. GONZALEZ. Thank you very much, Mr. Secretary, for an excellent statement.

I wanted to mention that Senator Javits from the other side of the Capitol has joined us. We welcome him.

Senator JAVITS. Mr. Chairman, may I say that if I should have to leave to another executive committee meeting, I appreciate the hospitality of this subcommittee.

Mr. GONZALEZ. Mr. Reuss, should we proceed under the 5-minute rule or should we hear Mr. Huntington at this time?

Mr. REUSS. If I may make a suggestion, I would like to defer to Senator Javits now, because I know he is going to have to leave shortly to his other duties. Perhaps he could examine Secretary Volcker at this time.

Senator JAVITS. Well, Mr. Secretary, I shall just take 5 minutes, and I will appreciate the Chair advising me when 5 minutes are up.

Mr. GONZALEZ. We will so advise you, and incidentally, I might add that if we do proceed on the 5-minute rule, the time-honored custom is that we can submit questions in writing within a reasonable time for the record, if the Secretary is willing.

Senator JAVITS. Mr. Secretary, I just have two points I would like to raise with you. One is the question of gold, how gold figures in this equation. Where do we stand vis-a-vis the French on this issue and where do they stand on the demonitization of gold, which you have very brilliantly described?

Mr. VOLCKER. Well, we foresee, together with the great majority of countries in this group, a diminishing role for gold. Now, that is a very general statement, subject to differing interpretations in practice. We have made some proposals that suggest the simplest way to facilitate the process, not only of diminishing the role of gold but also increasing the importance of SDR's, would be to permit gold to be sold in the private market by central banks, if they so desire, and having done that, little more remains to be done. They can take advantage of the higher market price for gold if they so desire. That gives them an opportunity to sell gold at what appears to be the price the market will bear. If they have that opportunity, you do not have to do a lot more because gold, even now, is not a very large component in world reserves, and it rather sinks to the bottom of the pile. So long as gold is at the bottom of the pile, it does not have to be very actively traded among central banks. It is what they tend to hang on to for extreme emergencies.

Senator JAVITS. Mr. Secretary, would it be helpful to you if in the advise and consent role, the Joint Economic Committee—I would not presume to speak for Mr. Gonzalez' subcommittee—would consider this matter and give the Treasury either support or some other point of view on this key gold question?

Mr. VOLCKER. Well, you leave me with a dilemma. I would be delighted to have you consider it if you are going to support us.

[General laughter.]

Mr. VOLCKER. I have enough confidence in the committee and in our own position so that it could be helpful.

Senator JAVITS. The other question, sir, and again I would like to thank Mr. Gonzalez and my beloved colleague, Henry Reuss, with whom I work so often, for yielding me this time. The other question involved the special problem of the impact of oil on our balance of payments and on other international monetary phenomena. It has been suggested at recent hearings of the Joint Economic Committee by two Brookings economists, that we ought to try to work out some kind of a plan by which these rather windfall oil revenues for the Arab states, for example, should go into the development sector.

Do you see anything in that or any suggestions?

Mr. VOLCKER. Well, some of them do. Some portion of those revenues have been used for development. A lot of them are currently being used for military development, I am afraid, rather than economic development in the area. It is a very difficult problem.

Looking at it from their point of view, of course, they are taking a national heritage out of the ground, a God-given national heritage that they do not want to see dissipated. This is their wealth, and they are not very wealthy countries, by and large. So they are interested in having safe investment outlets, and they want a reasonable amount of flexibility in handling those investments, and that is quite understandable.

Now, the question is how to reconcile that natural interest of theirs with the interest of the world community in not having the investments used in ways that are inconsistent with monetary stability. We have thought about this problem a great deal. I do not feel, no matter how much we have thought about it, that we have ideal answers, but we have had some discussions within the context of the Committee of Twenty. I do not think we can get the whole answer through economic development. You can get a portion of it there, but these countries will be interested in making profitable investments, and they may not see the developing countries as entirely the best outlet for that.

Senator JAVITS. Of course, cycled through, say, a world bank or another institution, they have the full faith and credit of that institution, and therefore the whole world.

Mr. VOLCKER. They already do that. There is a fair amount of World Bank bonds held by some of these oil rich countries. But again, while a World Bank bond is a prime security, it does not provide as attractive a return as perhaps some other investment opportunities. So they would want diversification, I am sure.

Senator JAVITS. But you will evaluate this?

Mr. VOLCKER. We are looking at it. We haven't got any magic answers, but it is a common problem, not just for the United States, of course, but generally.

Senator JAVITS. In the 1 minute I have left, I revert back to gold. It has been said that the SDR's have been invalidated by the gold clause the French cranked into it.

Can you tell us anything about that or how you are now contemplating the dealing with that problem?

Mr. VOLCKER. Well, it is not in any sense invalidated by the gold clause. I think what you must be referring to is that the SDR is defined as a certain amount of gold, just as currencies are, so that if the price of gold were officially changed, this would create a problem. But it is not our intention to officially change the price of gold. In any event, the whole question of evaluation of SDR's is under intensive consideration, and as I suggested in the statement, I think this is a highly technical problem, with some very interesting policy aspects. There is consideration, for instance, of valuing the SDR in terms of a so-called basket of currencies where you make it equal to or better than an average of currencies. You specifically define it in that manner rather than defining currencies in terms of the SDR, which in fact, is the traditional approach—which we have thought satisfactory for the future. This is not a matter of great doctrine or philosophy but rather a question of what is practical and keeps the SDR usable and valuable—but not too valuable, so that people will use it and not hoard it.

Part of the problem here is keeping the SDR understandable. We find in a number of areas of monetary reform that we begin getting so complicated that it is a little difficult to explain—not just to a layman, but even to an informed person. I think that is dangerous. We should have a system that is reasonable and comprehensible, and this is one of the problems you get into in dealing with some of these technicalities in the SDR.

Senator JAVITS. Well, Mr. Chairman, I would just like to say to the Secretary that I hope in making it comprehensible you think about changing the name, too.

Mr. VOLCKER. I share that feeling, and of course, the present name reflects a form of compromise, because there was a feeling among some that it should not sound too attractive, and the name certainly succeeded in that.

Senator JAVITS. Making it unattractive.

Mr. VOLCKER. That is right.

Senator JAVITS. Thank you, Mr. Chairman. Thank you, Congressman Reuss.

Mr. GONZALEZ. Thank you, Senator, for your presence.

Mr. Secretary, how pressed are you for time?

Mr. VOLCKER. I am not.

Mr. GONZALEZ. Well, in that case, is it the consensus of the members that we proceed to hear Mr. Huntington, and then reserve our 5 minute questioning to both?

If so, we will ask Mr. Huntington to step forward and join Mr. Volcker.

STATEMENT OF FREEMAN H. HUNTINGTON, SENIOR VICE PRESIDENT, FIRST NATIONAL CITY BANK, NEW YORK, N.Y.; ACCOMPANIED BY HAROLD VAN CLEVELAND OF THE BANK'S INTERNATIONAL ECONOMICS DEPARTMENT

Mr. HUNTINGTON. Thank you, Mr. Chairman.

I have asked my associate, Mr. Harold Van Cleveland, of our international economics department, to come with me, and I think if he

could join us at the table he could be helpful in fielding some of the questions which we have tried to anticipate.

Mr. GONZALEZ. That would be fine.

Mr. HUNTINGTON. I will go ahead with the statement that I have made.

It is a pleasure to be here this morning and to be able to share with you our views on some of the important underlying aspects of international monetary reform. Congressman Gonzalez, in his recent letter to me, asked me to address myself to these questions. I shall comment on them in order.

Mr. Gonzalez' first question concerns the present condition of the dollar in the foreign exchange markets and the prospects for the dollar in the short run. Since the dollar reached its lowest point against the major European currencies early in July of this year, as noted by Congressman Reuss in his recent statement to the House, the dollar has been on a consistent firming trend against all the European currencies, both those within the joint float, or snake, as it is commonly known, and the pound sterling and the Italian lira. The trend has not been a straight line but rather a winding path which has apparently reflected the misgivings of some European exchange dealers about the seriousness of the U.S. effort to cope with inflation.

In recent weeks, however—and I might add a comment, in recent days, even more—the situation has changed dramatically. The dollar has risen sharply against all the European currencies. The decision by the Japanese Central Bank early this month to raise the rate at which it would intervene to support the yen against the dollar seems to have crystallized a complete turnaround of expectations in the foreign exchange markets. Furthermore, the dollar's failure to react adversely to heightened political uncertainty in Washington and to the Middle East has confirmed the dollar's underlying strength.

The oil crisis has also been an important plus factor for the dollar in the short run, for the markets recognize that the steep rise in oil prices and the potential impact of curtailment of oil shipments by Arab nations will have a much greater impact on the European and Japanese economies and trade balances than on the United States. However, it is important not to lose sight of the fact that the dollar's rise on the exchange markets in recent weeks is solidly grounded on more lasting factors, particularly a rapidly improving U.S. trade balance and, even more important, the basic U.S. balance of payments, which includes the current and long-term capital accounts. These trends were underlined by the announcement, late in October, of an unexpectedly large trade surplus for September. In our opinion, this has gone a long way toward convincing our European friends that the U.S. balance of payments has really turned around.

In the past, with large deficits in our trade and payments balances, it was only logical that foreign investors would require lower and lower exchange rates as an inducement to hold additional dollars. Now, with so substantial an improvement in our trade and payments figures, and with the economic fundamentals in the United States being relatively strong in comparison with those of most European countries, the dollar will, in our opinion, strengthen on the exchange markets at least into the first quarter of 1974.

One should not overlook, however, the close relation between exchange rates and interest rates. Short-term changes in relative interest rates between the United States and European money markets could cause the dollar to weaken sporadically from time to time, particularly at a time when most of the European countries are using tight money which produces high interest rates to cope with inflation, while U.S. money market rates are falling in response to a cyclical slowdown.

As the dollar strengthens on the exchanges, it should be possible to followthrough with the removal of U.S. exchange controls on capital outflows as suggested by Treasury Secretary Shultz earlier this year. Against the background of an improving U.S. payments balance, nothing would do more to enhance the desirability of the dollar as a store of value, at home and abroad, than to remove the present artificial restrictions on its use. I emphasize this. In our opinion, the interstate equalization tax, the Office of Foreign Direct Investment (OFDI) controls and the voluntary credit restraint program have outlived their usefulness and should be terminated.

Congressman Gonzalez' second question asks whether we envision the use of a option to float as an appropriate part of a reformed monetary system. An option of this kind is essential, in my opinion. A country whose exchange parity has come under strong market pressure really has no choice but to float, as the experience of the last few years forcefully demonstrates. Even if the rules of a reformed system made no provision for floating, some countries would be forced to float from time to time in order to safeguard their reserves or to avoid massive inflows of funds that would cause an inflationary expansion of the domestic money supply.

In fact, in present circumstances, there is no real choice to be made between fixed rates and floating rates, so far as relations between the dollar, on the one hand, and the European currencies and the yen, on the other hand, are concerned. In these currency relationships, the economic fundamentals have been far from conducive to exchange-rate stability. Marked differences in monetary policy between the United States, Western Europe, and Japan, differences in rates of inflation, and the existence of a large dollar overhang have all made for considerable instability under the present exchange-rate regime. These economic factors are also responsible for the present undervaluation of the dollar in purchasing-power terms, against the continental European currencies and the yen. These economic conditions make it impossible to maintain fixed parities between the dollar and the European currencies or the dollar and the yen. An attempt to do so would only invite a repetition of the brief, unhappy experiment of the Smithsonian agreement.

Nor do I think that these conditions will soon change enough to make possible an early return to fixed rates for the dollar with respect to European currencies. All the industrial countries are struggling to bring rapid inflation under control. During the next few years, monetary and fiscal policies are quite likely to be of the stop-go variety, and countries will have varying degrees of success in the battle with inflation. Moreover, a far-reaching payments adjustment is now taking place among the economies of the United States, the Common Market, and Japan. Trade balances, investment flows, and the currency pref-

erences of holders of liquid assets are all changing rapidly. In so unstable an environment, exchange rates are unlikely to be stable, whether they are nominally fixed or floating. Oil embargoes and sudden, large price increases are hardly conducive to exchange stability.

In the longer run, a return to stable parities may be possible, not only within the existing monetary blocs, but between blocs.

I recognize, of course, that floating exchange rates or flexible rates of any kind can cause problems. Perhaps the chief danger is that they may be manipulated by official intervention in the exchange markets or by exchange controls in order to obtain a competitive advantage. Agreed rules are therefore needed to make this less likely. Rules of the kind now proposed for the "reformed system" would help, in my opinion.

I doubt that it makes a great deal of practical difference whether the rules of a reformed system do or do not require prior IMF authorization to float. Countries will float if they have to, and they will probably be reluctant to float unless they have to.

In general, governments seem to prefer the additional element of stability which official parities can lend to exchange rates, when the economic fundamentals are conducive to stability. They usually resort to floating only when a pegged parity is not sustainable. In such circumstances, authorization to float could hardly be withheld. Indeed, the mere request for authorization, if it became public knowledge, would set in motion market forces which would clearly justify floating.

Perhaps there is some merit in the formal requirement of prior authorization in that it would at least deter floating where floating is not necessary to forestall or stem massive one-sided movements of funds across the exchanges, but I doubt that the presence or absence of an authorization requirement would make a great deal of practical difference.

Mr. Gonzalez' third question asks for an opinion whether progress is being made on reform or whether a stalemate seems to be developing.

Perhaps I am too optimistic, but I do feel that substantial progress has been and will be made. I am reasonably confident that the principal financial powers will succeed in compromising their present differences and will come up, sometime next year, with an agreed plan of reform.

Such an agreement is highly desirable in my opinion, though not because the reformed system could be immediately put into effect. As long as the economic fundamentals are inimical to exchange rate stability between the dollar and other major currencies, a system such as that contemplated, based on fixed but adjustable parities, will have to wait in the wings. Nevertheless, agreement is useful, in my opinion, because it will serve to ease tensions. It can help to reduce the risk of trade and exchange-rate warfare. These are the chief dangers inherent in the present system of de facto floating blocs.

Meanwhile, the most important contribution the United States can make to international monetary order is to bring its own inflation under control. In the last analysis, a return to exchange-rate stability depends far more on how the major countries conduct their domestic

monetary affairs than on plans of monetary reform or on the institutions of the international monetary system.

Mr. HUNTINGTON. I just might make one comment here, Mr. Chairman, we brought with us several publications which we have on the table over there, which give some background to the present monetary problems, two publications called Money International, and the other one, which is the one that you have in your hand which is a weekly—we publish on a weekly basis which brings us up to date on day-to-day exchange market movements.

Mr. GONZALEZ. Thank you very much. I take this opportunity to thank you for this service that you and your institution have provided in your help and cooperation.

If it meets with the approval of all members, we will proceed under the 5-minute rule, and I will not use my 5 minutes. I have just one general question—and I guess principally directed to Mr. Volcker but by no means limited to him if you care to discuss it also, Mr. Huntington, and then I will submit some written questions here this morning.

During the summer, at the height of the political turmoil here in the country, there was considerable pressure on the dollar in speculation. Everybody was telling us, each individual that came up, that there was a relationship—that one thing that would help stabilize would be if Watergate and everything else subsided, but in the interim, we have had not only a continuation, but a rather intensification of crises. There was the unprecedented resignation of the Vice President, the Middle East war, and no such talk as we heard in August. How do you account for that?

Mr. VOLCKER. Well, I would have to go back and look up what I said when I was before the subcommittee in August, or whenever it was, but my recollection at this time is that when you asked that question, I minimized the influence that Watergate and related developments were having. I recall saying that it was a factor in the background, but that it would not be important if there were not adverse economic, or what were interpreted to be adverse economic developments, going on—particularly, at that time, the inflationary developments that were associated with the food price situation.

If that is what I said then, and I think it was, I think recent developments rather confirm that judgment, that when people are convinced that the economic situation is sound, they are going to be less distressed over the political situation.

I do not mean to ignore the political at all. It is an unsettling factor in the background, but I think people evaluate it quite differently, depending on their economic judgment.

Mr. HUNTINGTON. I think, Mr. Chairman, that you will find in the day-to-day movement in the principal currency exchanges, and I think you have to restrict that more or less to Europe because the Bank of Japan has such a tight control over the movement of the yen, but it does not respond to normal market reactions, that temporary aberrations which were caused—wider fluctuations were caused by the political and tremendous psychological approaches that the professional dealers in Europe develop on a day-to-day basis, but without—as Mr.

Volcker says—without the underlying economic problems they would have little impact.

But the existence of the basic problem in adding to it, some of the professional dealers in Europe are like small children and they live on nothing but rumors and you get some of the wildest rumors over the telephone about 10 o'clock in the morning, it will force 5 or 6 pfennig, changes in the dollar market rate.

That would not happen if there were an underlying factor, and that factor—as I tried to point out in my statement—the trade figures of September appear to have been the greatest single thing that have changed the thinking of the Europeans.

Mr. GONZALEZ. Thank you very much. I will submit my other questions in writing to Mr. Volcker.

[The following are written questions submitted by Chairman Gonzalez to Mr. Volcker, along with Mr. Volcker's answers:]

Question 1. What was the chief accomplishment of the Nairobi meeting in terms of monetary reform?

Answer. I consider the chief accomplishments of the Nairobi meetings to be the following: the establishment by Ministers of the Committee of Twenty of a deadline for the completion of basic agreement on reform by July 31, 1974; the agreement on procedures for facilitating the Committee's negotiations; and the publication of a First Outline of Reform. Taken together, these actions provided a new thrust to the monetary reform negotiations and reflect the existence of the political determination which is necessary to bring the negotiations to an early conclusion.

Question 2. At our hearings on July 19, Mr. Volcker, you said that you thought that the dollar was undervalued. Do you still think that it is?

Answer. The Subcommittee's hearings in July occurred when the dollar was at a low point against a few of the European currencies, although the dollar rate had been steady against the currencies of the great bulk of our trading partners.

I told the subcommittee then that I thought that the appreciation of certain currencies vis-a-vis the dollar had moved farther than warranted to restore long-term international payments equilibrium. Since that time, many of the rates have moved back toward the levels established in February, which we continue to believe is a basically appropriate rate structure.

Question 3. Is monetary reform really needed *right now*? If it were needed that badly wouldn't we be seeing it sooner?

Answer. We are, of course, pleased that the present interim monetary arrangements have worked as well as they have in a period of great difficulty and uncertainty. But neither we nor others feel that the present arrangements represent a satisfactory or sustainable system for the long term. What are missing are established and accepted codes of international behavior, to provide guidance for nations' conduct, particularly as they approach points of potential economic conflict. Establishment of such codes is the essential task of reform, and that effort is not made less necessary by the ease or calm of the immediate situation.

The U.S. and others thus believe it is important to move ahead with the negotiations on long-term reform of the international monetary system. These are complex, difficult negotiations, not susceptible to being resolved overnight, and we should take advantage of the present crisis—free atmosphere to push ahead with them.

Question 4. Just how important is the fight against inflation world-wide to monetary reform? Does it really make any difference so long as everyone has inflation?

Answer. Worldwide inflation is simply not compatible with a stable international monetary system. Granted, there might theoretically be a situation in which rates of inflation, and the responses of governments to that inflation, were harmonized in a manner such that large imbalances placing strains on the monetary system would not arise. But in practice, such a situation is just not going to develop. Consider the recent increases in commodity prices. These tended to create inflationary pressures world-wide. But the impact of these pressures

on countries' balance-of-payments varied considerably—improving, for example, the balance-of-payments of important commodity exporters such as the United States and adversely affecting the balance-of-payments of important commodity importers such as Japan and the United Kingdom. Then, too, the responses of governments to inflation vary. In particular, some countries place greater reliance on monetary policy than on fiscal policy to fight inflation, while others may be able to use fiscal policy relatively more flexibly. Since monetary policy tends to have a more direct and immediate impact on the balance-of-payments—particularly on capital flows—than does fiscal policy, different policy mixes can be disequilibrating. So, all-in-all, there is in practice no real chance of a stable monetary system in an inflationary environment, even if most or all countries are inflating at about the same rate.

Question 5. It seems that the least talked-about facet of reform is consolidation and funding of the dollar overhang. What can you tell us about this facet?

Answer. Consolidation is one of the subjects to be dealt with in the process of reform but has not, as you note, been a central part of the discussion to date. This reflects the fact that the issue is really secondary to difficult questions that have preoccupied the negotiators thus far—the working of the adjustment process and the exchange rate regime, and the nature of future convertibility arrangements.

From the point of view of the U.S., the preferred technique for dealing with outstanding dollar holdings would be for the U.S. to earn some of them back. To the extent this could be accomplished the problems of the “overhang” would be diminished. In fact, as the U.S. payments position has strengthened in recent months, some reflows of funds to the U.S. have begun to appear.

Beyond what reflows could be expected, however, we recognize that some form of consolidation may be desirable at the time a reformed system is implemented, provided that mutually satisfactory terms can be agreed upon. We are participating in C-20 technical groups which are considering both a “funding” of part of existing balances of foreign exchange into a longer-term, less liquid asset; and a “substitution” of SDR's for part of the balances through a special facility in the IMF.

Question 6. Can you give us an evaluation of the current energy problem in terms of the international monetary system, for the U.S. and the other large oil importers? What is the energy problem going to do to the dollar in the short-run and in the long-run?

Answer. The increases in price and restrictions on production and shipment of petroleum recently announced by major producers have injected an unprecedented degree of uncertainty into the international monetary picture. It has been estimated by the Secretariat of the OECD that if the oil importing nations were able to import petroleum in 1974 in the quantities normally required, but paid the prices recently announced by the exporting countries, the increase in their oil import bill would be in the neighborhood of \$17 to \$18 billion. About \$15 billion of this increase would be experienced by the industrial countries and \$2 to \$3 by the developing nations. While a significant percentage of this sum could be expected to come back to the industrial countries in the form of increased exports of goods and services to the oil-producing nations, much of it would not. More than half of the increased revenues would be accruing to nations with relatively small populations whose foreign exchange earnings are already more than ample to cover any imports which might be desired. These remaining funds, however, are likely to be invested somewhere outside the oil-producing states.

At present, of course, it does not appear that the producers will make available the quantities of oil envisaged in the foregoing scenario. We do not know how much they will make available. The oil that they do produce may be directed to consuming nations in accordance with patterns influenced by political decisions of the producing states rather than the normal economic considerations. There have also been suggestions of further increases in price.

Since the amounts of money involved are extremely large in relation to the normal trade and payments balances of individual nations, and the availability of petroleum is crucial to levels of industrial output, the decisions made by the oil producing states could substantially alter both the growth prospects and the payments prospects for individual nations.

Nevertheless, there may be a tendency for markets to overreact in this situation. Whatever oil revenue the producing states do not spend on imports of

goods and services they will presumably invest. While some of the funds may go into direct or portfolio investment in individual countries, much of it may be placed in Euro-currency markets where it will become available to all countries. But regardless of where these funds are placed initially they will replenish the supply of funds available for borrowing by entities in countries which find themselves in need of capital as a result of the higher oil import bills. The trade balances of the industrial countries—as a group—will weaken as a result of the higher oil prices. They will, in effect, find themselves borrowing from the oil-producing states, but the funds will be available to borrow.

In this situation the United States may be more fortunate than some other industrial countries. We are relatively less dependent on imports for our energy. It now appears that we will not be able to import as much oil next year as consumers would be prepared to purchase, even at the higher prices. Consequently our import bill may not be as high as we would have expected in the absence of embargo. At the same time, we would not expect the shortage of oil in the U.S. to have more than a marginal impact on our ability to produce for export. Furthermore, investment opportunities in the United States are flexible and diverse, and I would expect that a goodly share of the capital flowing from the oil-producing states would end up in the U.S. either directly or indirectly. Thus, I see little likelihood that the dollar will be adversely affected in relation to the currencies of the other industrial states. I expect the dollar to be strong. Developments in the foreign exchange markets in recent weeks suggest that the market shares this view.

Question 7. Is there any new thinking on linking SDR's and aid? What role does the success of the IDA replenishment play in the outcome of the SDR-aid link controversy?

Answer. We continue to believe it would not be desirable to establish a link between the SDR and development assistance. Our position is that the normal budgetary processes—such as those involved in the IDA replenishment—are much preferable to some kind of link for decision-making on development assistance. Failure of the IDA replenishment would, in our judgment, increase pressure for the SDR-aid link, and contribute to an impasse on this issue since many developing countries would question our willingness to provide aid through the established channels.

Question 8. One rationale for SDR's has been that there is a need for additional liquidity for international commerce. Do we really need more liquidity now?

Answer. The basic arguments for establishment of the SDR facility were that the system needed a means of changing the volume of international liquidity over time in response to changes in the volume of international commerce and other factors, and that the two major elements of world liquidity—gold and foreign exchange—did not provide a satisfactory basis for future liquidity growth. This does not mean that additional SDR creation is needed now, unless there should be a very large reflow of dollars from reserves. In view of the large liquidity growth that had occurred in 1971 and 1972, the IMF membership decided not to make new allocations of SDR's this year. The timing and rate of SDR allocations will depend on the international liquidity situation and prospects. As part of the monetary reform exercise, study is being given to techniques for determining future liquidity needs.

Question 9. It looks to me like the floating system has saved the U.S. and Europe a lot of grief. Under the old system, as President Nixon's troubles grew, speculators would have moved against the dollar and we and the Europeans would have had a rough time defending it. As it is, the speculators haven't had a target to shoot at. What do you think of this line of reasoning?

Answer. We believe the present floating arrangements have been most appropriate to the situation of very great uncertainty that has prevailed during much of the year, and have probably worked better than other arrangements that might have been devised. As you suggest, this is due in part to the ability of a floating system to absorb and diffuse speculative pressures. There is a considerable view that the added uncertainties related to the energy situation reinforce the wisdom of maintaining present arrangements for the immediately foreseeable future.

Question 10. What effect is there on monetary reform of the problems with the U.S. trade reform legislation?

Answer. In the broadest sense, I think it is important to the functioning of the monetary system to maintain a thrust toward liberalization in the trade

field. The problem of adjustment, which are central to the operation of the monetary system, are more easily solved in a framework of liberal and expanding trade.

There are also some specific provisions in the trade legislation which are important to the monetary reform negotiations. For example, the Administration's proposed trade bill calls for revision of the balance-of-payments provision in the GATT articles so as to recognize import surcharges as preferable to quota restrictions as a means by which industrial countries may handle balance-of-payments deficits insofar as direct import restraints are required. It also provides authority for the U.S. to utilize an import surcharge in certain situations, including those in which the U.S. would be expected to cooperate with other countries in correcting an international balance-of-payments disequilibrium. These provisions are important to a reformed monetary system as we envisage it.

Question 11. It looks to me like the longer we wait on monetary reform the better bargaining position the U.S. is in. Yet I do not see this Administration having an overall, rational international economic policy. Are we just riding on blind luck, or is there an international policy we don't know about yet?

Answer. As we discussed during my testimony, there are considerations which tend to lead in both directions on timing in a narrow bargaining sense. But the overriding need for reform should be kept in mind: we believe there is a need for agreed international rules of conduct for the longer term regardless of the advantages or disadvantages a particular immediate situation may seem to present. We thus support an early agreement on reform—the July 31, 1973, target date is not unreasonable—and are working to achieve that agreement.

We do believe the Administration has presented a comprehensive, overall foreign economic policy, in which reform of monetary, trade and investment practices, as well as development assistance, all play a part. This vision and policy take as a fundamental point of departure the desirability of open trade and financial relationships among nations within a framework of commitments to agreed codes of conduct. We want to see a fair competitive balance among nations, and a reduction in barriers to the free flow of goods, services, and money. We recognize that in some areas, such as energy and agriculture, special problems have arisen that require changes in existing institutional arrangements. In the development area, we seek a mixture of bilateral and multilateral assistance that will help speed the growth of poorer nations, while recognizing that the main ingredient of that growth rests upon the efforts of the developing countries themselves and that private capital can also play a large role.

The general policy has been spelled out in some detail in the President's Reports on Foreign Policy and, briefly, in his speech to the IMF in 1972.

Question 12. Were there any signs that the Arab nations were using dollars in the foreign exchange markets as a weapon against us, during this current Middle East problem?

Answer. I have seen no such indications.

Question 13. It seems to me that the use of objective indicators is the key question for monetary reform. Would you agree with this. Can you go into more detail on the ramifications?

Answer. A major improvement of the international adjustment process, and the introduction of objective indicators to provide guidance and "backbone" to that process, are certainly of key importance to successful monetary reform. In the context of a convertibility system such as the U.S. has proposed, the pressures for adjustment are haphazard and are borne inequitably by countries in deficit. We believe the future system must provide a) a greater certainty that adjustment will take place when it is needed; and b) a more balanced distribution of adjustment responsibilities among countries in surplus and those in deficit. Our reserve indicator proposals are designed to provide that certainty and equity. We can look back and see that international consultations alone have not sufficed in the past to bring about adjustment, and so we are seeking to reinforce subjective assessment with objective indicators. Our views have been spelled out in great detail in material submitted to the Committee of 20, which is available to you.

Mr. GONZALEZ. Mr. REUSS.

Mr. REUSS. Thank you, Mr. Chairman, and thanks to both our excellent witnesses.

Mr. Huntington, would you agree with the view, which I have expressed several times, that the international monetary reform, which Secretary Volcker hopes will be up before the Congress within a year, should include an option for countries, including, particularly, the United States, to elect floating rates under internationally agreed guidelines? An option that does not carry any stigma and which he exercised at our own discretion.

MR. HUNTINGTON. Very definitely. I think the events of recent months have been shown that, and if we want to take one currency as an example, I think that the pound sterling would have been much worse off today if it had elected to—we have two alternatives, either the pound sterling would be worse off than it is today if it had gone in the snake or in the joint float; or the joint float would have blown apart. The real pressure in Europe, one of the things to recognize today, is there is strength in the dollar. One of the reasons being that in the day-to-day movements in the exchange markets, is that it is no longer a completely dollar-mark or dollar-Swiss franc crisis. Would you not agree then it is now a crisis within the operation of the joint snake, in order for them to maintain the parities which they have elected to establish for the operation of the snake. It is only because of the willingness of the Deutsche Bundes bank to absorb tremendous amounts of currencies other than dollars that has kept the snake going at this moment. But, if we lived in a perfect world, then it would not make any difference whether we had freely floating exchange rates or rigidly fixed parities.

We do not live in a perfect world, as all of us recognize and each country, in protecting its own domestic affairs builds up either uninflation rates scenario, which has an immediate impact on the exchange rate so that it must be—there must be a provision for floating, but it must be surrounded with some guidelines or some rules and regulations which will make it follow an orderly—permit it to be an orderly, rather than a disorderly market. There is nothing worse than a disorderly market.

Mr. Reuss. Let me then turn to Secretary Volcker. Secretary Volcker, will you do your best to see that a year from now, or whenever the proposed international monetary reform comes up to the Congress, it includes for the United States and any other countries who so elect, an option to let their currencies float under internationally agreed guidelines, without any stigmas being attached to this choice, and without any veto powers being assigned to the IMF or to other countries?

MR. VOLCKER. I do not think that there is any question that the reform will include a floating option.

MR. REUSS. The trouble is the present Nairobi floating option requires one to wear the scarlet letter and implies that you have to ask for leave from somebody else. It is definitely second-class citizenship as I read it. Indeed, you yourself this morning said on page 8, "Our own reform proposals and those of others contemplate that most countries, including the largest nations, will want to maintain established exchange rates. In other words, that par values will remain the center of the gravity of system." I would hope that the United States has not made that subjective determination, because in my view, a float

for the dollar under internationally agreed rules seems to me the least discombulating way of conducting ourselves. I understand that Mr. Huntington agreed with that position?

Mr. VOLCKER. I think that is true at the moment. I do not think you will find any basic disagreement internationally that, in the immediate situation and for a foreseeable period ahead, that the present arrangements are reasonable and will continue. We are looking here now for a vision that runs a good many years ahead.

Mr. REUSS. All I am asking for is the option, for as far into the future as the human eye can see. I would not want that option foreclosed.

Mr. VOLCKER. I am sure we will have the option. The reform will include an option to float. We have been working hard to make sure that that option does not have the kind of scarlet letter attached to it that you are suggesting. I do not think that that is really explicit in the present draft outline.

Mr. REUSS. They use words like "surveillance" and "in particular circumstances." They say "subject to fund authorization." All of those things spell a phony option as far as I am concerned.

Mr. VOLCKER. Well, all of these are interesting words, and I do not think they necessarily add up to a phony option. But we have been concerned that we not make the option so constrictive it is not usable in appropriate circumstances. Now I do not object to "surveillance." I think that a country operating on a floating rate should be subjected to some international rules and surveillance.

Mr. REUSS. A country with a fixed rate should be subjected to surveillance rules.

Mr. VOLCKER. I agree, so it is not in a pejorative context that surveillance over floating is used, in my mind, in that language.

Mr. REUSS. But what about authorization?

Mr. VOLCKER. Well we have argued that you should not need to go through some particular process of authorization. On the other hand, of course, there are degrees here. You could have technical authorization under the equivalent of an open general license, so to speak, and the distinction could become rather meaningless. In any event, what we do not want to do is to circumscribe the option so closely it cannot be used when it is appropriate. We do not want to try to imagine some limited set of circumstances where floating might today, in somebody's mind, be justified and write a series of definitions that would, in fact, perhaps make the option not very useful at some time in the future. We think it should be a real option.

Mr. REUSS. My time is up, but I would just say this. You are, I know, familiar with my views on this because you have been kind enough to read speeches I have been making. You will have an opportunity to present those views to your negotiating partners as my views and an indication, perhaps, of the attitude of some of us in the U.S. Congress on whatever you will bring back to us.

Mr. VOLCKER. Well, I will do that, but they are already familiar with our views in making a floating option a reasonable one. Now that is not to say that the United States enters into the negotiation with the intention of continuing to float forever. That is not the intention.

Mr. REUSS. Thank you very much, my time is up.

Mr. GONZALEZ. Thank you, that was about 7 minutes, but making up for my lag, we are still on time.

[General laughter.]

Mr. GONZALEZ. Mr. Johnson?

Mr. JOHNSON. Thank you, Mr. Chairman. I have had a practical application of the decline of the American dollar. I returned in September from attending the King's funeral in Sweden and was talking to the naval attaché in Sweden, representing the United States. He wanted to buy a boat for recreation during his stay in Sweden and he of course is paid in dollars, and in order to buy the boat it would cost him \$800 more than it would have had the dollar not shrunk in value. So, he took his dollars and went to the bank and borrowed the money and gave his dollars as collateral. Well, the ore was 3.75 to the dollar then. When I was there in September it was 4.15 and he told me he was very confident that by the time he got ready to pay off his loan he would save the \$800, and today it must be very reassuring to him that our dollar is strengthening abroad.

Then I was talking to the Finance Minister of Sweden, his name is Mr. Strang, and he said one thing we like about the United States now, your balance of payments is improving, and what he said bears out what both of you have said today that perhaps one of the real reasons for the strength of our dollar abroad is the increased—that is the improvement, strong improvement, in our balance of payments.

Now, I was on this Banking Committee and went into a flip in August of 1971, when we devalued the dollar by 8.59, I was not quite as excited as when we did it again at 10 percent. I thought that was a step in the right direction and now I am just wondering whether the big reason for the improvement in our dollar is the fact that we have devalued the dollar twice; and also the fact that inflation in Europe is greater than it is here. Those combined together is what has really made the improvement in our balance of payments.

So, when you are talking about all this, dollar reform and so forth, you get right down to the economics of the devaluation of our dollar and inflation abroad. Is it not true that if we can control our inflation plus the fact that we have devalued the dollar twice, that you are going to see a substantial continued improvement in our balance-of-payments position?

Mr. VOLCKER. Yes. I think you have hit upon the fundamentals. I do not think that that means you do not need reform—we do not want to see all of these gains dissipated through malfunction of the international monetary system. You have to have some rules of the road, so to speak, as to when it is appropriate to devalue or depreciate, and when it is appropriate to appreciate, to maintain an equilibrium among competitive positions of the United States and other countries. That is really what it is all about—what the rules of the road should be.

Mr. JOHNSON. Would you like to comment on that, Mr. Huntington?

Mr. HUNTINGTON. I would like to ask Mr. Cleveland to do that, particularly in connection with the inflation in the European countries. This is his field, and he has done a lot of work on it. Would you like to comment on it?

Mr. CLEVELAND. I would be glad to. Mr. Johnson, I think it is very clear that what you say is entirely correct. That the degree of the dollar's devaluation which has been very great is still very great in spite of the strengthening of the dollar, plus the fact that inflation in Western Europe generally accelerated very fast last year, and the beginning of this year. Those two factors together have put the dollar and dollar goods and services, into a very strong competitive position. This fact is certainly a very large part of the reason the improvement of the U.S. balance of payments so far, and will be even more important, I think, in the future.

I would also associate myself with Paul Volcker's comment that it is important to have rules of the game which would prevent the Europeans from offsetting too much, the effect of our improved competitive position by competitive depreciation of their own currencies. I think that is not an immediate threat, or an immediate problem, but it could become a problem in the future.

Mr. JOHNSON. I have 1 more minute.

Mr. VOLCKER. If I might just add one more thing about inflation, without taking your minute. We are fond of saying that we do better on inflation and have more price stability than Europe. I am fond of saying that this is a nice thing to say, and it was true for many years, but right now the only trouble with the statement is that it is not true at the moment. In recent months, by and large, we have been doing about as badly as the Europeans have been doing. I just mention this because it is important that we get back in the posture of doing better than they are doing.

Mr. JOHNSON. Let me ask one question. When you come to the monetary meeting, you say in July 1974, or thereabouts, if our balance of payments has improved, the \$4 billion that you forecast, will you not be playing from a much stronger hand than if you were back into those meetings where we were \$4 billion in deficit?

Mr. VOLCKER. Well, I am not honestly sure, Mr. Johnson. Obviously the dollar would look better. I do, by the way, not recall making a forecast of that particular type.

Mr. JOHNSON. In one of these speeches today it says—

Mr. VOLCKER. I said the trade balance was improving by \$3 to \$4 billion a quarter at an annual rate, but that was an historical statement, not a future projection. In any event, in some ways it would put you in a better position. But in other ways it would not, in the sense that sometimes you can make a point better when the problems are laid on the table than when the dollar is strong and the problems do not seem so evident. So there are some advantages in negotiating in both circumstances, and I am not sure where the balance lies.

Mr. JOHNSON. Thank you very much.

Mr. GONZALEZ. Thank you, Mr. Johnson. I might just comment that Mr. Huntington—to Mr. Huntington that they would like to know whether they borrowed from his branches over there, that is one way of getting around your own window.

Mr. VOLCKER. That is a good indication of the difficulties of controls.

Mr. HUNTINGTON. Well he did not get it from us, Mr. Chairman, because unfortunately Sweden is in one of the countries that does not allow us to open up a branch.

Mr. GONZALEZ. Mr. Hanna?

Mr. HANNA. Thank you, Mr. Chairman. Mr. Volcker, I happen to be one who has a firm belief that we are not going to have the report from you that you projected a year from now and I happen to believe that it is not going to happen because we are going to move from the instability you have noted because of international affairs, to instability that is going to be present in the domestic economies of Europe, Japan, and the United States.

I suggest to you, gentlemen, that we are not going to have to worry about inflation like we used to because we are going to be worrying about something much more serious. I suggest to you that what is likely to occur is that the United States will be moving toward 6 to 6½ percent unemployment throughout 1974, and if we do not find some methodology for answering the energy problem it is likely to be much higher.

It seems to me rather a sound position to suggest that in a phase of extreme instability, there is not a likely climate for coming down on an agreement for a new system—for a reform system—and I think that is entirely a correct attitude to take.

I would hope that in your approach you would take the advice of Mr. Huntington referred to on page 5 of your statement in saying the problems of the float are these: That there is likely to be intervention that is not justified or a change in controls of exchange which gives an unusual advantage; or that we may move into other aspects of trade and monetary wars. I would think that is where we ought to settle on if we are not going to total reform, which I do not think we are going to get.

I think the discussions ought to be very strongly oriented, not only to the choice that you can float, but also to include some kind of restraints on these things which to me are obviously the biggest risks if we just rely on the float alone. Mr. Reuss, I have been very supportive of your position in terms of keeping the float, but I also believe that there has to be something not to make it onerous, but to make it operable and practical in terms of keeping our trade progressing. I do not know whether that is a kind of a gloomy view, but that is the view I have. I am not worried about what is going to happen with the money the Arabs have, because the Arabs are not going to take that money. They already told me that.

I talked with the minister of finance, and I have talked with their ministers of oil, and they said they do not want the money unless there is some intelligent program for their rational absorption of the money. If the money was going to cause the problems that we foresee, they are not going to take it. So I think our problem is going to be to zero in on more of the problems that occur in the domestic economies because of the lack of fuel. Now, you can comment on that, Mr. Volcker.

Mr. VOLCKER. Well, I am not sure whether your rather gloomy prognosis for the economy is based on the fuel situation pretty largely or—

Mr. HANNA. Well, I think it goes beyond that. There is a lot of interacting situations that are present, which, just like you said before how some things appear larger, simply because there are underlying

other causes. I happen to think there are underlying causes, and the energy thing is beginning to—well, it is sort of a dramatic high profile upon which these other things rest.

Mr. VOLCKER. Well, let me just make a couple of comments that occurred to me as you made your statement.

I basically agree with your conclusion that we need rules for floating. I think the best chance for getting these in a rational and intelligent way is as a part of a broader reform, rather than just saying we want rules for floating in a limited context. I would feel rather strongly about that. The best chance of getting just what you want and what I think is needed is by putting it in the context of a more total reform.

I also agree, I think, with the general gist of what you were saying earlier about new conditions in which floating takes place. We have had a lot of disturbances in the international monetary area. It has been in the context of a relatively favorable economic climate. You have had a boom all over the world, and people worry less about these things if the domestic economies are essentially prosperous, even though they do worry a lot, and should worry a lot, about inflation.

Now, if you had a sharply different climate in that respect, you might get a different functioning of a floating system. It has not been tested in that kind of a situation, but there would be greater temptations that at present to break the rules of commonsense, which are all that exist now.

So, the problem becomes both more difficult and more pressing in the kind of scenario that you suggest. Now, I do not happen to be so pessimistic as some of the figures that you suggest. But on the other hand, I think it is clear that the world economy could go in the direction of slowing down next year—and probably will go in that direction. So it is a matter of degree. As I said, we have not tested the waters in that kind of environment yet. So I accept fully your strictures about the importance of getting some rules of good behavior about floating. All I add to that is, that I think as a practical matter it is going to be easier to get such rules, and maybe the only way to get them is, in the context of a more general reform. So I go back to the urgency of a general reform.

Mr. HUNTINGTON. If I might say one word.

As I said before, if we lived in a perfect world it would not make much difference. But since we are in a floating world we recognize fully the need for the adoption of rules that fit into an overall monetary reform, some rules and guidelines which respect to floating. Because what you have at the moment is, you have what is belovedly known in Europe as the dirty float. That is the system where everybody makes their own rules, which is certainly an unacceptable situation which cannot continue. Each central bank makes its own rules, when it intervenes, when it does not. It is a guessing game.

Mr. GONZALEZ. Mr. Hanna, your time is up.

Mr. Stanton.

Mr. STANTON. Thank you, Mr. Gonzalez.

Gentlemen, I do not think I can be quite as pessimistic as my colleague from California either on the economy or on the prospects for the possibility of reform.

I want to ask you a question, Mr. Volcker. You heard Mr. Clausen speak in Nairobi at a breakfast one morning. He said that the Secretary may have misinterpreted some of the remarks of what he said. I wondered if you basically agree with Mr. Huntington's statement this morning. Have you read his statement?

Mr. VOLCKER. Well, I certainly read along and listened to him as he was speaking. There was certainly a great area of overlap between what he said and what I said.

Now, I do think that there is some difference of emphasis. I do think it is important to get along with this organized reform, if I may call it that, and get that resolved. I think that is the way to get general rules, which he emphasized and which I emphasized, not only for floating, but for a system more generally, and in an agreed way. It is important for the harmonious conduct of international economic relationships, and I think we agree upon that point.

Mr. STANTON. I, certainly for one, would want to emphasize that the Congress does, too. Mr. Reuss would have to agree and we all agree that you float today because you have to float. But let us look down that road, and as you say—I do not want you to get the opinion that Mr. Reuss' opinions also are those of the Congress, but if there are any basic differences of opinion when you explain Mr. Reuss' views to the Committee of Twenty, you should make that perfectly obvious.

Another thing I wanted to add is it becomes obvious in getting the new ground rules for world economy that it will not in its present form include all of the world. Could you tell the subcommittee, do you see any change, or has there ever been any change in the interest of the Russians in regards to joining the IMF?

Mr. VOLCKER. Not that we have detected. They have been very pat on that score, and there are no active inquiries or investigations that I know of.

Now, Romania did join the Fund very recently, and that is the only Eastern bloc country that is involved at this time.

Mr. STANTON. Mr. Huntington, with all due consideration to one of your competitors in New York; I do not know, are you in Russia?

Mr. HUNTINGTON. We have authorization from the Russian Government to open an office. I understand that we now have space, which seems to be the most difficult part of the whole proceeding, and as opposed to our friendly competitor in New York City, we have an officer who will head our Moscow office who is completely fluent in Russian, which we find to be a certain advantage. I think it is a long, hard row to hoe before we are going to show many positive results from that office. However—

Mr. STANTON. A last question. Mr. Cleveland, you are an expert in this field. As we look to the near future and this question of inflation, I was not sure, in your answer to Mr. Johnson in comparing our rate of inflation, which we hope is temporarily out of focus; do you see, in Europe where inflation is going to continue to be a problem in the future?

Mr. CLEVELAND. Yes; I think very much so, Mr. Stanton. I think that, although in Germany the rate of inflation has diminished quite markedly in the last few months, this is not the case in any lasting

way. I think in the United Kingdom, or in France, I would guess that rates of inflation there will continue to be very high, although they will probably respond favorably to the slowdown in demand that we have been talking about in Europe, just as our inflation here will presumably respond to some extent to the slowdown in demand that is now imminent, or, actually, in progress.

But the process of getting rid of inflation is not the work of 1 year, or even of 2 years in any country. You get built-in expectations of a high rate of price increase, which is then reflected in all pricing and wage decisions, so that it takes a considerable period of time of slack demand to work any major slowdown in inflation. So I think that the present worldwide inflation is a problem that is going to be with us for several years, and maybe for even longer than that.

Mr. STANTON. Thank you.

Mr. GONZALEZ. Thank you.

Mr. FRENZEL?

Mr. FRENZEL. Thank you, Mr. Chairman, and thanks to both of our witnesses.

Mr. Secretary, in your statement on pages 9 and 10, you kind of take a look, or at least mention, the problems of volatile capital movements. We have a bill pending before this House now which would tend to restrict capital movements into this country by prohibiting foreign ownership of American companies. It is what I call sort of an inverted Burke-Hartke bill. I wonder if you would comment on that kind of measure, and eventually how it might affect the completion of the reforms that you are seeking to accomplish.

Mr. VOLCKER. Well, I must say I think that kind of bill you are referring to, the Dent bill, I think it was——

Mr. FRENZEL. Right.

Mr. VOLCKER [continuing]. Goes in precisely the opposite direction that we are trying to move.

Mr. FRENZEL. I thought you might say that.

Mr. VOLCKER. We are in a posture, and should be in a posture, of welcoming foreign investment. As the chairman said at the beginning, I do not see any threat to this country of foreign control or dominance of industry that would be adverse to our interests. I think foreign investment has healthy competitive influence, in addition to being of direct help to the balance of payments.

Mr. FRENZEL. Well, does it not also help relieve the overhang?

Mr. VOLCKER. It helps relieve the overhang, it helps create jobs and employment for American workers. Some people have sat here—I do not mean in this subcommittee, but in the Congress or in the country—and complained about American investors taking jobs overseas. Well, I would like to see some of that investment coming back here, and some of it does bring jobs. I am delighted that Volvo is coming in to build a factory in the United States, and I think it will be a healthy competitive influence on the American automobile industry, apart from the money they bring with them.

On the broadest kind of political grounds, I think this kind of investment is healthy. We have, in direct investment at least, an extreme imbalance, as the chairman suggested, between American investment abroad and foreign investment here. In the 19th century, investment

came to this country, but then the tide moved the other way. I think having a better balanced situation would be healthy for both sides, and I do not look at the kind of bill you referred to at all happily, as these remarks suggest, and would hope the subcommittee and the Congress would rather join in the kind of attitude that the chairman expressed at the start.

Mr. FRENZEL. What does the effect of that kind of legislation have upon reform? Any?

Mr. VOLCKER. Yes. I cannot honestly say that that particular proposal has attracted any attention. If it did, and if our trading partners abroad thought the Congress was going to take this seriously, there is no question it would have an adverse effect, because we have rooted ourself philosophically in these negotiations on free markets, absence of controls, and the desirability of two-way flows of investment and trade. To have a philosophical underpinning pulled out from under our arguments would be distinctly deleterious in terms of the whole negotiating climate.

Mr. FRENZEL. It seems to me that it would run counter to all the negotiating efforts. I wonder if it would not be an example of a type of what Mr. Huntington called competitive depreciation.

Mr. VOLCKER. I do not know whether I would call it competitive depreciation, but it is an example of the kind of practice that we are trying to get away from in the international community. Competitive depreciations are one kind of interference with the normal market process. This is another kind.

Apart from these monetary reform negotiations, we have, with very considerable effort, launched negotiations in the investment area directly designed at removing some of the distortions and inhibitions, in this area. Investment controls can be used in a manner directly analogous to competitive depreciation.

Mr. FRENZEL. I agree. Now, Mr. Huntington has suggested we get rid of OMDIC and get rid of the interest equalization tax. Do you support that?

Mr. VOLCKER. Yes, we have said so. He is supporting our suggestion, if I may put it that way. It is a question of time and pace, that is all.

Mr. HUNTINGTON. In fact, if I may say, I left one thing out which was mentioned already this morning, and that is the withholding tax on dividends, which in itself is an inhibiting factor to investment in the U.S. equity market, period. There is no question about it in the minds of Europeans; you would have help on the dollar overhang if the withholding tax—you do not even have to eliminate it, if you can make it a minimal tax. Don't you agree, Mr. Van Cleveland?

Mr. VAN CLEVELAND. Yes.

Mr. FRENZEL. Secretary Volcker, you indicated that inflation is about at the same rate of European inflation in recent months, and maybe that is true for August, but I doubt if it is true for the subsequent months. But can you explain why inflation in this country, which has historically lagged behind that of other countries, and which you might say now is the equal—let's just say it is no greater than theirs—why does that always tend to depreciate our currency, when we are doing better, or no worse, than those gnomes, or whoever it is, that are playing in those currency exchanges?

Mr. VOLCKER. Well, that is an interesting question, for which you can only get a fairly complicated answer, because it has preoccupied economists in the past.

If you look at a reasonably long period of time, a decade, or longer than a decade, in the fifties or sixties, you will find that American general price experience was distinctly better than that of almost any other industrialized country—probably better than any other industrialized country, and distinctly better than most of them. So you ask, well, why was our competitive position not improving during this period, and why did we ever have to devalue in the end, and all the rest?

There is more than one answer, but part of the answer, I think, for these purposes, is that it is a little misleading to look at general price indices, which include a lot of consumer services and a lot of nontraded goods.

This is most starkly shown in the case of Japan, which has had a pretty high level of inflation, judged by the Consumer Price Index, consistently for a long period of time. Yet they had actual declines in prices in the manufactured goods sector, and particularly in export prices, because these were the high-productivity industries. They were making enormous gains in productivity through the late fifties and sixties in their big export industries. Despite the fact that wages were going up 10, 12, 15, and 20 percent a year, their productivity increases were running 15 to 20 percent a year. So they were able to have declines in prices in these critical industries for internationally traded goods, even while their Consumer Price Index—food prices, land prices—were doing very poorly.

So, if you just looked at the general price index, you would say Japan was inflating itself into devaluation. But if you looked at price indices appropriate for international trade you could see that their competitive position was improving very markedly.

We in the United States have a relatively mature industrial structure. We do not get gains in productivity of 10, 12, or 15 percent in manufacturing industries. It is hard to do so when you are ahead of the game, and that is part of the answer.

I think another part is simply that the exchange rates that we lived through during the fifties and sixties were essentially set in the late forties and early fifties. When we were the only producer, it did not make much difference what the price was. Thus you had exchange rates which, after the passage of a decade or two and other countries were built up, were essentially not competitive.

Mr. FRENZEL. If I can interrupt—on your first point, of the manufacturing—

Mr. GONZALEZ. Excuse me for interrupting you, Mr. Frenzel. We have exceeded the time. I am going to take the liberty of going ahead and not interrupting you, but asking you to keep it at least within a minute.

Mr. FRENZEL. I would just respond to his answer, and maybe he can do it in the record. While Japan was increasing its productivity of manufactured goods, our country, whose principal export was foodstuffs, was expanding its productivity in the foodstuff area, and in

addition, that expansion was occurring in the areas of greatest inflation among our customers. So, it seems to me that that outweighs the point that you are making.

Mr. VOLCKER. Well, that is a good point. I do not know if the effect is offsetting, however, because the agricultural sector is not as big. But it is true that we had very large productivity increases in agriculture, reflected in low prices. We ran into a few trade barriers abroad to making that productivity-price performance in agriculture effective in world markets, and so we had shortages in this past year or two. Thus we had the gain in production and good price-performance in that area, but we were not as effective in world markets, because we ran into controls.

Mr. FRENZEL. I thank the chairman.

Mr. GONZALEZ. Mr. Burgener?

Mr. BURGNER. Thank you, Mr. Chairman.

I would like to leave the float for a minute, and ask about domestic inflation, on the assumption that it is important to international finance. So I want to ask him some questions about money policies on our domestic economy, and I would like anybody to comment. I think I have three questions. I will read them all because I hope they relate to each other.

No. 1: Tight money—I assume tight money and high interest rates are one and the same. Maybe I am wrong; maybe you could have tight money with low interest. I would like someone to comment on that.

No. 2: Does tight money really fight inflation, and generally how; and No. 3, coming to the point, it is my impression that tight money causes pockets of unemployment. It certainly does in my country, in the building industry, pockets of unemployment. So what do pockets of unemployment do for, or against, inflation?

That is kind of a complicated set of questions. I will repeat them. The first one was about tight money and high interest rate; is that one and the same?

Mr. VOLCKER. Well, that is a semantic question, which economists have not resolved in 20 years of discussion about it. It seems to me, some people will tend to identify tight money with high interest rates, but the question can be approached somewhat differently. High interest rates can be affected by a shortage of money, so they are linked together, obviously. On the other hand, other things affect interest rates, including the general rate of inflation in the country. If people are expecting prices to rise, they will demand bigger return for their money. Let's suppose that interest rates are high, in large part or in substantial part, because of expectations of higher prices, and those expectations are being fed, in part, by big increases in the money supply. In these circumstances, it is a little hard to say that high interest rates are the same thing as tight money. They might have been created, in a sense, by money being too loose.

So, all I am giving you is an elaborate answer. It is that the answer to that question depends upon how you define it.

Mr. BURGNER. Well, why do we not move on to the second one? Does tight money, in your opinion or Mr. Huntington's, really fight inflation, in whole or in part?

Mr. VOLCKER. Well, I think it does, in most circumstances. How effectively it fights it depends partly upon what the nature of the inflationary process is at the time. It tends to fight more directly and effectively a demand-inspired inflation, where there is just an excess of spending in the economy. If you can shut off, by high interest rates and tight money, a certain amount of spending, you will have a directly favorable effect upon the inflationary climate. To the extent—to oversimplify—inflation is caused, pushed, and it is, let's say, coming from a big surge of higher wages, it may still have some impact. But it is going to be less direct and less immediately effective, at any rate, because you have to work through the labor market. Eventually, if you reduced demand, the tight money would work; but reducing demand essentially, you may ease the labor market and have some impact on wage bargains. But that becomes a more difficult process than when you have a straightforward situation of excess demand, where tight money is going to be offsetting—

Mr. BURGNER. The opposite of tight money must be loose money, and that must mean there are more chips in the game, and more things with which to bid.

Mr. VOLCKER. With more chips with which to bid, you get more inflation.

Mr. BURGNER. Now, on the pockets of unemployment, specifically in the building industry, now, what does that do? Maybe overall unemployment is not grossly affected, but it has got to be affected to some degree.

Mr. VOLCKER. Well, it has to be affected to some degree, and as it is affected, it may hit some industries more than others. That is what you see in your district and in the building industry at the moment. You do run into areas, when you have a general impact, on which some impact is concentrated more than on others. We have gone through all sorts of contortions, historically and presently, to even out this impact. But some unevenness inevitably remains.

You know, you can always look at this the other way around. People worry about—and properly so—tight money having a differential impact on building when you are in a restrictive cycle. But it also has a differential impact when you are in an easy money cycle, and you have an exceptional boom in those industries. You do not hear many complaints then about their having an exceptional pocket of over full employment, but that is what happens.

Mr. BURGNER. But if we could take out the peaks and valleys, the scarcity of money is now grossly uneven and inequitable.

Mr. VOLCKER. Well, some are more willing to pay high interest rates, for instance, for a period of time, than others are. In the building industry, where the commitments are rather long term, high interest rates tend to have a more of an impact.

Mr. BURGNER. Well, thank you, Mr. Chairman.

Mr. GONZALEZ. Thank you, sir.

Mr. Reuss?

Mr. REUSS. Thank you. I have one question for Mr. Volcker, which, I will want answered for the record, because I am sure he does not know anything about the matter I am about to discuss.

You say, on page 18, and I surely agree with you, "In the longer run, we should receive a considerable share of the investments of the oil-producing countries themselves, because of the broad range of attractive investment opportunities available in this country."

Recently, in Nairobi, I had a long conversation with a gentleman named Ibrahim Ibrahim, who is the portfolio manager for the Kuwait Investment Bank. He told me that they had \$1 billion in reserves earmarked for investment, and he had decided in September to take a tour of West Germany, France, and the United States to place this \$1 billion.

He went in Kuwait to the German Embassy, which gave him a visa on the spot, the French Embassy, which gave him a visa on the spot. Then he went to our U.S. Embassy, and they said—

Mr. VOLCKER. Have you got any money?

Mr. REUSS. No; they said, come back in a week or so. We will see what we can do about that visa. In unprintable Kuwaitis he told them what he thought of that, and he told me that they just were not coming to the United States, that there were other places where they could invest their money.

Now, thus spoke Ibrahim Ibrahim, and it sounded fairly formidable to me. Would you, through the National Advisory Council, which includes the State Department, find out just what happened last September?

More importantly, what is our general practice? Certainly, when the foreign equivalent of a Rockefeller puts in for a visa, we should not have to go into endless screening arrangements on him. I say this without criticism of our Embassy or diplomatic establishment in Kuwait. There may be some reason for this, or some explanation, but it certainly is not a good way to get this desirable reflow of investment funds.

Mr. VOLCKER. Well, I obviously agree with you, Mr. Reuss, and I have had varying complaints of this sort. I am told that the situation is improving, is not getting worse. But I continue to hear discouraging stories of this sort.

Mr. REUSS. Maybe if you could run this one down, both in general and specifically, it would help.

[The following material was submitted for the record by Mr. Volcker at the request of Mr. Reuss:]

REPLY RECEIVED FROM MR. VOLCKER

The Department of State advises that current U.S. visa regulations require that, for clearance purposes, the Department is to be informed several days in advance, with several very limited exceptions, of the issuance of visas to certain applicants. In September 1972, following the Munich massacre and other actions of international terrorists, the Department initiated this procedure with an eye

to the protection of American lives and property as well as those of foreign diplomats, dignitaries and businessmen in this country. The procedure requires special screening of the visa applications of applicants of several nationalities, but exceptions to the prior screening requirement include instances in which the applicant is well and favorably known to the Embassy or Consulate, or if he must travel to the U.S. on a humanitarian emergency or urgent business basis. The provision of these exceptions are intended to avoid unwarranted delays on the applicant.

The Embassy in Kuwait reports that Mr. Ibrahim al-Ibrahim, an official of the Kuwait Foreign Trading, Contracting and Investment Company (KFTCIC), applied for a non-immigrant visa on August 12, 1973. He was advised that under current procedures a visa could not be issued to him for several days, unless he was well and favorably known to an Embassy official or had to travel to the U.S. on a humanitarian or business emergency basis. In this particular case, the applicant knew no one at the Embassy, did not represent that his travel was of an emergency nature, and had no specific obligation to be in the U.S. on any particular day. The Embassy thus handled the application in a normal manner, given the current regulations. When the Embassy, several days after receiving the application, told Mr. al-Ibrahim that it was ready to issue the visa, he said that he was no longer interested. The Embassy reports further that from its subsequent contacts with KFTCIC, it is obvious that this visa incident has had no effect on the firm's investment policies.

Despite the provision for some exceptions to the normal handling of visa applications, which do entail a delay, it is obvious that instances can arise that may be irritating to the applicant. In the case cited, Mr. al-Ibrahim, despite his responsibilities, was not known to Embassy officials, nor did he cite urgent business. Thus, the normal procedures were followed—procedures designed for the protection of many. The Kuwait Embassy, as well as our other diplomatic and consular missions abroad, knows that the U.S. welcomes foreign investment in this country, and it will continue to make every effort to facilitate visa issuances in appropriate circumstances. The Ambassador or Deputy Chief of Mission should normally be informed of important visa cases and, in the instance cited, in retrospect, it would plainly have been useful if the Kuwaiti authorities or Mr. al-Ibrahim had made known to the Embassy the nature of his position and interest in advance. The possibilities of unnecessary irritation in these cases can be minimized only by understanding by both applicants and Embassy staff.

Mr. REUSS. Then I have another question which I will submit for the record. That will be it, Mr. Chairman.

[The following is a written question submitted by Mr. Reuss to Mr. Volcker along with Mr. Volcker's answer:]

Question. What are your expectations about the volume of investment in the United States by the Arab oil producers? What inducements do you expect the U.S. will offer to attract these investments?

Answer. We foresee that the receipts of the Arab oil-producing nations from petroleum exports will very substantially exceed their likely expenditures for imports of goods and services. Except to the extent they choose to use their funds for aid to other Arab states or to developing nations, the bulk of this surplus of receipts will, almost inevitably, be invested initially in the industrialized world. It is my general assumption that, given the relative size and dynamic role of the U.S. in the developed world economy, this country will directly and indirectly be the recipient of considerable Arab investment flows.

The large, highly developed, and open capital market of the United States is a natural outlet for Arab countries that have a need to invest profitably substantial amounts of funds. Such investments might be placed directly or through portfolio managers in Switzerland and other countries whereby the identity of the owners might be cloaked. Furthermore, our productive and diversified economy is also in an excellent position to attract resources that the Arab oil countries may wish to place in the form of direct investment, such as in downstream energy facilities and in the acquisition of ownership shares in petroleum-producing companies.

It is also assumed that a significant portion of increased Arab investments will be channeled to the Euro-markets. Such investments, as well as Arab investments in third country markets, can also have a positive effect on these

United States balance-of-payments position. Some of these investments can be expected to be re-invested in the U.S. by Euro-market intermediaries or agents. More indirectly they should also tend to expand lendable resources in Europe or elsewhere for projects in the developing nations which might otherwise be financed in our market.

As implied in the foregoing, an increased flow of Arab investments to the U.S. should develop as a natural consequence of market forces. I do not believe that it is either necessary or desirable for the U.S. Government to offer special inducements or incentives designed specifically to attract Arab investments to this country. We are, however, continuing to review U.S. policies and regulations, such as the withholding tax, that may act as deterrents to foreign investment. In this connection we believe that the forthcoming removal of controls on the outflow of capital from the U.S. will be beneficial in enhancing the psychological security of foreigners investing in the U.S. Finally, it should be noted that the Committee of Twenty in formulating improvements in the international monetary system is discussing adaptations needed to accommodate the special situation created by the growing investments of the oil-producing nations.

Mr. HUNTINGTON. Mr. Chairman, if I might make just a short aside to Mr. Reuss' statement, this is not privileged information, because we were not parties to the transaction, so the SEC will not be after me tomorrow morning in the Zurich exchange market, which is one of the most active in Europe.

On Thursday of last week, the largest buyers of dollars were the Kuwaitis. That just happens to be interesting, despite oil shutoffs and everything else. The largest single buyers of dollars in the market were the Kuwaitis.

Mr. GONZALEZ. We will come back, then, to Mr. Frenzel, and let him finish his line of questioning.

Mr. FRENZEL. Thank you, Mr. Chairman.

I am going to try a little different line. Mr. Secretary, do you want to give us an estimate of what the balance of payment final figures in 1973 might be?

Mr. VOLCKER. I do not really want to, but I think we have got a clear chance with that extraordinary September figure, now of having a surplus in our trade accounts. I would not have believed that 6 months ago, but it seems to be true.

The overall balance of payments, in terms of the so-called official settlements position, is a highly volatile figure. We had a \$10 billion deficit in the first quarter, a surplus of something in the neighborhood of \$750 million in the second quarter, and then, I guess, a surplus of something in the neighborhood of \$1 billion or less in the third quarter before seasonal adjustment. What that could be in the fourth quarter, I don't know. I would expect it to be on the surplus side again, but we are going to have a deficit for the year, I would still anticipate, in that overall measure of our balance of payments. The so-called basic accounts—the trade and current accounts and the long-term capital—were still running in deficit in the first half of the year. We get these figures very late, but I think it is possible that we will move out of deficit for this year.

Mr. FRENZEL. How about for 1974?

Mr. VOLCKER. For 1974? Now, this oil situation has introduced a big new uncertainty in the picture. It is going to cost us quite a lot on trade account. It is also going to cost other countries quite a lot on trade account, assuming the oil flows. If the oil does not flow, it will

not cost us in the oil trade, it will cost us in other ways. But I would really hope and expect that we will have a trade surplus next year even with the impact of the oil situation.

Mr. FRENZEL. So would I, but now about balance of payments?

Mr. VOLCKER. I would expect a surplus in the overall balance of payments next year.

Mr. FRENZEL. A modest one?

Mr. VOLCKER. Well, I am not going to be pinned down too closely.

Mr. FRENZEL. You certainly have not been. [Laughter.]

Mr. VOLCKER. It is impossible to make these forecasts with any sense of accuracy. I can now make a forecast for this year, but 6 months ago I could never have made a forecast for this year. The agriculture situation that came up, and produced \$7 or \$8 billion in a way that could not have been anticipated a year ago anyway. Against that kind of background, I am a little cautious.

Mr. FRENZEL. Are you still expecting that we will begin to see heavier capital movements inbound next year, as a result of the devaluation?

Mr. VOLCKER. I think we already see some signs of that, and I would expect, yes, it would continue next year, and it could at some point become quite heavy. I am just talking in terms of long-term capital. The short-term capital is very volatile, but I hope we get a substantial reflow of short-term capital. That would be a very temporary kind of phenomenon. The chances are good we will have some overall surplus in our so-called basic balance next year, even with the oil situation, assuming that the oil is flowing and that the economies are not in quite the shape that Mr. Hanna was suggesting earlier.

Mr. FRENZEL. Thank you, Mr. Chairman.

Mr. GONZALEZ. Of course, you had a caveat about not expecting the same thing in the agriculture section.

Mr. VOLCKER. No, I think we have had it, in a sense, in agriculture. It does not mean we are going to do poorly next year, but we cannot expect another increase in agricultural exports of the sort that we have had. We have come up to a very high level, and I would think that that would be well sustained next year. At some point, agricultural exports are going to drop off, but our anticipation would be that they would be well sustained through most of next year. But they are just not going to increase the way they have been increasing, so the gain has to come in the manufactured goods area.

Mr. GONZALEZ. Mr. Burgener?

Mr. BURGNER. No further questions.

Mr. GONZALEZ. We are honored with the presence of the distinguished ranking minority member of the Banking and Currency Committee, William Widnall. Do you have any questions, Mr. Widnall?

Mr. WIDNALL. No. I have been sitting back here listening, and it is a very enjoyable thing to do once in a while.

Mr. GONZALEZ. Well, if you have questions, we will be glad to recognize you.

Mr. WIDNALL. Mr. Volcker, I certainly want to join in welcoming you before the subcommittee. I have known you for many, many

years, and I know how dedicated you are toward doing the job for our country, and I appreciate the fact that you are very much in the leadership of trying to improve conditions for us all.

It is very heartening to see, now, a rise in the value of the dollar, when it has been taking such a beating, part of it because of some things you have already testified to, and part, I believe, because of restoration of confidence in the United States, and our ability to accomplish certain things.

Is it not true that other nations have been very pleased to—maybe this is an unfair question for you, but—other nations have not been displeased by the predicament that we have been in? We have not had too much cooperation from other nations.

Mr. VOLCKER. Well, I think we have had some cooperation from other nations. They did permit some exchange rate changes to take place that were not in their immediate competitive interests, in a sense. I do think there is always a conflict in their minds, and I suppose, in other circumstances, in our minds, between what, in concept, we all welcome—namely a better payments equilibrium and in this case, a better competitive position for the United States and an improved balance-of-payments position. At that level, the concept is widely welcomed, but it is one that has repercussions on particular countries at particular times. It then can become uncomfortable, I do not think we have really reached the stage where it has become particularly uncomfortable for any country, because we have been in an atmosphere of boom, as we were discussing earlier, and in many cases a decline in their external competitive position has been positively welcomed as another anticyclical policy, if you will. But we will be entering into a period, a kind of testing period, where we will see whether the adjustment can be completed in an orderly way, and whether there is a willingness to permit it to be completed.

Mr. WIDNALL. Well, certainly, the other countries must have noticed for instance, the improvement in our employment condition here in this country, and other very salutary things that have been taking place. But that has been given little notice in the American press, as far as improvement of our own economic conditions in this country.

Mr. VOLCKER. Also at the moment—I think that is true—they are also conscious that they have problems of their own, in the inflationary and the energy areas. As they are impressed with their own problems, some of the merits, in a relative sense, some of the strengths of the United States, impress themselves more firmly upon their minds.

Mr. WIDNALL. Well, I think that certainly the energy problem we have, as well as many other nations in the world, can be a cause to bring us together to face a common problem where we have been divided in the past. We ought to be able to look toward far better cooperation.

Mr. VOLCKER. Well, it may tear us apart. It is like the monetary system.

Mr. WIDNALL. Well, now, why do you say that?

Mr. VOLCKER. Well, if everybody wants to go their own way in trying to build a little defense of their own, it is a dangerous situation, and you can see symptoms in both directions here.

Mr. WIDNALL. Well, it is perfectly possible that that will happen, but it certainly does nothing to solve any problems at all.

Mr. VOLCKER. I agree.

Mr. WIDNALL. It is like 435 Members of Congress voting a different way, and charging up the Hill with their own ambitions, and forgetting the good of the whole.

Mr. VOLCKER. I agree.

Mr. WIDNALL. Well, thank you. I regret I was unable to be here earlier, but I will read your testimony, and I appreciate your being here.

Mr. GONZALEZ. Thank you very much.

Mr. Volcker and Mr. Huntington, we deeply appreciate the time and the courtesy in appearing here today, as well as you, Mr. Van Cleveland. Thank you very much.

The subcommittee will stand in recess.

[Whereupon, at 12:05 p.m., the subcommittee was recessed, to reconvene at 10 a.m., Wednesday, December 5, 1973.]

INTERNATIONAL MONETARY REFORM

WEDNESDAY, DECEMBER 5, 1973

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
COMMITTEE ON BANKING AND CURRENCY,
AND CONGRESS OF THE UNITED STATES,
AND SUBCOMMITTEE ON INTERNATIONAL ECONOMICS
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Henry B. Gonzalez [chairman of the subcommittee] presiding.

Present: Representatives Gonzalez, Reuss, Young, Stark, Johnson, Stanton, Frenzel, Conlan, and Burgener.

Also present: Representative Widnall.

Mr. GONZALEZ. The subcommittee will come to order. We will come to order so that we will not delay unnecessarily. I have permission from the minority counsel to begin because some of the members on the minority side are on their way. We do have some preliminaries that we can get out of the way.

I would like to ask unanimous consent to proceed with a very brief introductory statement giving the reasons for this hearing. It is a continuation as you know, of the hearings that this subcommittee initiated before the first devaluation. The Congress is extremely concerned. We realize that this is an area in which the leadership, the primary responsibility for money management is in the executive branch. But we, nevertheless, feel a deep sense of responsibility.

Speaking for myself, I look upon you, Dr. Burns, as a general. I come from a key defense-oriented district. It was considered fatal for me not to be assigned immediately to the Armed Services Committee, when I first came here, and my reply to that was that I was fortunate to get assigned to a standing committee such as the Banking and Currency Committee because I said that unless we have a good dollar, we are not going to have a good defense. I have said since then that though we may have lost the battle on the battlefield in South Vietnam, we cannot afford to lose the battle at the money tables. I think this concern is shared with every single Member of the Congress that I know, and we know ultimately that we are going to be called upon to take legislative action. I feel it is always bad public policy to wait until a crisis emerges and then respond. I believe in anticipation and contingency action, and therefore part of this is for us to be fully informed.

At our hearings in July of this year we stated that the dollar, and you agreed, was grossly undervalued, that it was continuing to depreciate against virtually every other currency in the industrial world. Apparently, at this point, the reverse is happening. The dollar appears to have risen considerably since July. According to the foreign exchange dealers, this rise can be attributed in part to U.S. balance-of-payments figures and the oil crisis in Europe. The dollar has now reached the highest level in 8 months and has done very well against most of the currencies of the industrialized nations. I hope we will be able to be advised today whether you feel that the dollar will continue strong or whether this improvement is temporary and illusory, and if there is anything we should be doing over on our side of Capitol Hill.

There is still need for reform according to everybody involved. I have three specific questions I hope to ask later, with respect to this and what our role perhaps could be. One item raised in the press reports which I think is of interest to every one of us, is that there is some talk that the value of the dollar is being held down by the central bankers. I believe that it is an area in which perhaps this meeting can clarify the subject. Also, I am interested in what the improvement of the dollar does to the monetary reform talks. Does it improve our bargaining position, or weaken it? Does it make reform easier? I hope we can cover these points today.

We seem to be continually going through the popular line, first, the good news, then, the bad news. The dollar has improved but we may freeze to death this winter. Perhaps our distinguished witness today can elaborate on the effects of the energy crisis on the economies of the world, the dollar, and the monetary reform.

We are very pleased to have this very special, and what I consider to be most important and distinguished witness. He has recently announced, as our central banker, what I consider to be a major achievement. It is our opportunity, thanks to his generous willingness to appear here this morning.

If it is in order and any other member of the subcommittee wishes to make any prefatory remarks, certainly the Chair will recognize him for that purpose.

Mr. JOHNSON?

Mr. JOHNSON. Well, yes. I, too, want to welcome Dr. Burns here today. It is always very, very refreshing to have you here. I cannot help but think, in looking back to last January, February, and March, at a time the dollar was under a frightful pounding of the brilliant moves that you made, the tremendous skill that you displayed in getting us out of that frightfully dangerous situation, and it is very heartening and very thrilling today to have you here at a time when we are proud of our dollar. As many of us always said, we think the dollar is the best currency in the world, and as far as I am concerned I will take all I can get of them. Thank you.

Mr. GONZALEZ. Mr. Reuss?

Mr. REUSS. I think not.

Mr. GONZALEZ. Mr. Stanton?

Mr. Young?

Mr. YOUNG. No, thank you.

Mr. GONZALEZ. Mr. Frenzel?

Mr. FRENZEL. I would rather hear from Dr. Burns.

Mr. GONZALEZ. Mr. Burgener?

Mr. BURGNER. No thank you.

Mr. GONZALEZ. Fine. Well, Dr. Burns, you are free to proceed. I know you have a statement but you may proceed as you see best.

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Dr. BURNS. Thank you, Mr. Chairman.

I am pleased to appear before this subcommittee to discuss recent development in foreign exchange markets and in the balance of payments.

This year has been characterized by alternating periods of turbulence and stability in exchange markets. You will recall that, following several weeks of severe disturbance in exchange markets, the dollar was devalued for a second time on February 12. At that time, Italy and Japan chose to float their currencies, thus joining the Canadian dollar, British pound, and Swiss franc—which were already floating. New pressures in exchange markets developed in late February and early March, and led to a further extension of floating among major currencies.

Over the next 2 months, the average dollar price of 10 major currencies—those of Japan, Canada, and 8 European nations—stabilized at a level some 20 percent above the exchange parities that prevailed in the spring of 1970. In mid-May, however, the dollar again began to decline sharply, so that by July the average dollar price of these 10 currencies increased an additional 10 percent.

This further substantial depreciation of the dollar did not seem consistent with international price levels or with longer term prospects for our balance of trade or payments. Moreover, fluctuations of exchange rates from day to day and hour to hour had become more pronounced. In these circumstances, and after full consultation with the Treasury and representatives of other countries, the Federal Reserve began on July 10 to intervene in the exchange market. Through the month of October, the System sold a total of \$512 million of European currencies, mainly German marks, drawing on the swap lines to finance this intervention. By the end of that month, enough marks, French francs, Belgian francs, and Dutch guilders were purchased in the market to repay in full these earlier swap drawings.

After our intervention in July and the release of favorable U.S. trade and payments figures, the dollar strengthened by about 3 percent during the first weeks of August. There was little further change in the dollar's value until late October, at which time the announcement of a large trade surplus for September triggered another sharp advance. In recent weeks the dollar has strengthened further in relation to the major European currencies and the Japanese yen. The appreciation of the dollar against the yen would have been even greater if the Bank of Japan had not intervened in the market by making

large sales of dollars. By the end of November, the average dollar price of the 10 major currencies mentioned earlier had returned to the level that ruled between mid-March and mid-May; in other words, it was again some 20 percent above the exchange parities prevailing in the spring of 1970—or slightly above the level in the week following the February 12th devaluation.

Some market observers have pointed to anticipations of the impact of oil restrictions by Arab countries as a factor contributing to these developments in recent weeks. Others have cited the stabilizing effects of official intervention by the Federal Reserve and other monetary authorities. There is no doubt in my mind, however, that the basic factor has been the decisive turnaround in the U.S. balance of payments. New evidence of this fundamental improvement in our payments position has been accumulating with each passing month.

Our exports have been rising at an extraordinary rate this year. Measured in current dollars, exports in the third quarter were 47 percent above their level in the third quarter of 1972. Much of this increase is accounted for by rising prices. But even in real terms, exports grew 23 percent over this period. The big increase in our agricultural exports—from an annual rate of \$9½ billion in the third quarter of 1972 to some \$19 billion in the third quarter of this year—has received a great deal of publicity. It is less often appreciated that nonagricultural exports, which account for about three-fourths of our total exports, have been expanding at extraordinarily rapid rates as well.

Part of the strong showing of exports is attributable to last year's poor harvests abroad and the current worldwide industrial boom. But the improvement also reflects a lesser rate of inflation in the United States than in other industrial countries and, far more important than this, the cumulating effects of the depreciation of the dollar since 1971.

The changes in our international competitiveness resulting from the depreciation of the dollar are having an effect on our imports as well as on our exports. In real terms, imports actually declined between the first and third quarters of this year, despite the strength of domestic demands. The value of imports did increase at an annual rate of 14 percent during that period, but only because of increases in their dollar price.

As a result of these developments, the trade balance has moved from a deficit of nearly \$7 billion in 1972 to a surplus at an annual rate of \$3 billion in the third quarter of this year. The trade balance continued to be in surplus at a substantial rate in October. It therefore now seems likely that the United States will have a trade surplus, albeit of modest size, for 1973 as a whole.

The balance of international flows of long-term private capital has also moved in our favor this year. Outflows of capital have moderated since the first quarter and are estimated to have slowed sharply in the third quarter. Prior to the recent decline in stock market prices, renewed confidence in the dollar helped to stimulate foreign purchases of American securities. Foreign direct investment in this country has also been substantial this year. These developments reflect, among other factors, the improved profitability of producing internationally traded goods within the United States relative to production abroad.

The basic balance—that is, the aggregate of all current international transactions and long-term capital flows—has been strengthening throughout this year. The improvement in the third quarter was dramatic enough to produce a large surplus—the first quarterly surplus we have experienced since 1969. Net flows of short-term capital have also been favorable to the United States since the first quarter. As a result, the official settlements balance was actually in surplus during both the second and third quarters. Preliminary data for October and November suggest that the surplus has continued into the present quarter.

Short-term prospects for the balance of payments have become clouded, however, by recent developments in the oil situation. The price of our oil imports has risen spectacularly, from an average of \$2.75 per barrel in the first quarter of 1973 to over \$5 currently. The boycott by Arab producers has begun to reduce our petroleum imports and, if continued, would reduce our imports next year by some 3 million barrels per day below the amount that had been expected to be available. Even so, in view of the recent sharp price increases, our total payments for oil imports in 1974 would probably exceed by a substantial margin the \$8 billion paid in 1973. Of course, if world trade in oil were to resume a more normal pattern at these astronomic prices, the cost of our oil imports would rise still more steeply. However, the net impact on our overall balance of payments would be substantially less or could even be favorable, since a good part of the increased payments for oil by the United States and other countries would find its way back to this country, directly or indirectly, in the form of increased exports, or capital inflows, or income receipts.

Whatever effects the oil shortage may have on our balance of trade and payments, a more immediate concern is the impact on domestic production and employment. A reduction in imports of crude oil and petroleum products by 3 million barrels per day amounts to a shortfall of more than 15 percent from estimated demands for this source of energy. Only a small part of this shortfall could be made up during 1974 by increased domestic output of crude oil, or by substitution of other fuels for petroleum products. In the short run, there are only limited possibilities for substituting other fuel for oil in industrial plants, or for altering techniques of production in ways that reduce dependence upon petroleum products.

The President's program to conserve fuel recognizes this basic fact, and is therefore oriented toward economizing end-product uses—such as reduced consumption of gasoline in passenger cars, and reduced amounts of oil for heating homes and commercial and industrial buildings. To keep the oil shortage from generating major economic dislocations, our citizens will have to go to some trouble and put up for a time with various inconveniences. There is no practical alternative for the immediate future if seriously adverse effects on production and employment are to be avoided.

At best, a prolonged embargo on Arabian oil shipments to the United States will result in some economic dislocation next year. The demand for new cars, for tires and other auto parts, for suburban housing for recreational vehicles, for restaurant meals and other travel-

related expenditures will be adversely affected; commercial airlines will reduce their purchases of jet aircraft; and fewer motels and vacation homes will be constructed. These developments will be offset in part by larger activity in other trades—ranging from coal to blankets and sweaters, and from drilling machinery to bicycles and buses. Our inflationary problem, meanwhile, will be aggravated by rising gas and oil prices.

The situation in which we find ourselves is obviously very difficult, but I believe it is manageable. The underlying strength and resilience of our economy must never be underestimated. Capital spending plans of business remain strong, and so are inventory demands for a host of materials and components that have been in short supply for many months. Our principal asset—the resourcefulness of the American people—remains entirely intact. As 1974 moves on, I would expect the domestic output of crude oil to gradually increase, electric utilities to shift to greater use of coal, auto manufacturers to concentrate more of their production on the smaller cars demanded by consumers, and other adjustments to be made in the thousands by ingenious businessmen across the land.

The longer run economic implication of the cutoff of Arabian oil supplies should not leave us in any doubt. The United States can no longer afford to lose time in working toward an independent ability to meet its energy requirements. We must now move forward with determination on many fronts—nuclear energy, solar energy, coal conversion, exploration for oil. Recent events should teach us that, even with a relaxation of the current boycott, we cannot remain so heavily dependent on oil supplies from foreign nations.

Some months will need to elapse before the long-run implications of the oil problem for our balance of payments clarify. So far at least, the restrictions on oil supply appear to have strengthened the world's confidence in the dollar. But even before the Middle East conflict erupted, the dollar was viewed with renewed esteem. The dollar is again a strong currency, and we can expect further support to our foreign trade and payments from the lagged effects of past exchange-rate changes.

Continued strength in the balance of payments will require, however, a satisfactory domestic price performance relative to other countries. A year or two ago our rate of inflation was substantially lower than that of other industrial countries. Unfortunately, a large part of this margin of competitive advantage has eroded in recent months. In October, the Consumer Price Index was 0.8 percent above September, and 7.9 percent above October 1972. Clearly, the dangers of inflation remain very much with us. At the same time, as I have already noted, the oil shortage will cause shifts in the structure of industry and have adverse effects on overall production and employment. Economic policy in the months ahead thus faces the extremely difficult task of contributing to the objective of regaining price stability, while at the same time minimizing the risk of any extensive weakening in economic activity.

In the remainder of my comments this morning, I would like to share with you my impressions of the recent evolution of the world monetary system.

In the past several months, a large number of economic, political, and military events occurred that had potentially disruptive implications for exchange markets. Despite these disturbing events, orderly market conditions and general stability have prevailed. The official intervention that was undertaken has given us helpful experience in managing a system with exchange rate flexibility in a way that preserves orderly markets without frustrating desirable adjustments. Although I remain skeptical of the longrun viability of a floating exchange rate regime, this experience supports the continuance of the present exchange rate arrangements for the immediate future.

For the longer run, we must rely more heavily on rules of international law in the monetary area. Such a reform is the objective of the Committee of Twenty, which has been meeting periodically throughout 1973, and will continue its work into 1974. Considerable progress in clarifying issues has already been made, as evidenced by the Nairobi report of the Chairman of the Committee of Twenty and the associated "First Outline of Reform" presented by the Chairman of the Committee's deputies. I expect further clarification and further convergence of national views in coming months.

But it is important to avoid unrealistic expectations. Some of the reform issues are extremely difficult, progress in reaching agreement will continue to be gradual, and new developments may cloud the situation—as the energy issue has done in recent weeks.

Moreover, I have in recent months come to think of international monetary reform as an ongoing, evolutionary process—not just as the final outcome of formal negotiations. In view of changing objective circumstances and continuing divergence in some official views, it is hardly practical to think of monetary reform in terms of a finished blueprint that is to be implemented in its entirety some morning after a final meeting of the world's finance ministers and central bank governors. Even while discussions continue in the Committee of Twenty and other forums, it is both possible and desirable to adjust some parts of our international financial machinery.

One such step in this evolutionary process has been the recent termination of the March 1968 agreement with regard to official gold transactions. That agreement, which established the so-called two-tier gold market, was born of the 1968 gold crisis. Developments in the private gold market were then threatening to undermine the international monetary system by draining it of gold—which at the time was the world's principal reserve asset. To deal with this difficulty, the central banks of Belgium, Germany, Italy, the Netherlands, Switzerland, the United Kingdom, and the United States agreed that they would no longer buy or sell gold in the private market.

In view of the suspension of convertibility of dollars into gold since August 1971, the 1968 agreement had become an anachronism. Its termination removes an obstacle to official sales of gold in the private market, and will thus permit greater flexibility of action in the future. Official sales of gold can be useful in preventing wide fluctuations in the gold market that at times generate instability in currency markets.

In due course, the United States and other countries will make decisions about possible sales in the gold market. In doing so, our Gov-

ernment will comply fully with article IV, section 2 of the IMF Articles of Agreement. That article states in essence that no member of the IMF shall sell gold below its official price or buy gold at a price above its official price. I am confident that most, if not all, foreign governments will also respect this Fund article. Hence, while they may sell gold, which now fetches a price in the market that is far above the official price, they will not buy gold either from the market or from each other in the foreseeable future.

The termination of the 1968 agreement will make possible a further reduction in the role of gold in the international monetary system. With the establishment of the SDR facility, which was not available in 1968, we now have an alternative primary reserve asset. It has therefore become practical to consider steps that may gradually move gold out of official reserves.

Policy with regard to intervention in exchange markets is another area in which progress is beginning to be made in the evolution of the international monetary system. Under present exchange-rate arrangements, authorities of major countries are consulting and cooperating as they make decisions on intervention. This experience, and the experience to be gained in coming months, will be of great value in the effort to establish more formal exchange-rate arrangements for the longer-run future.

At the present time, with many currencies floating in relation to the dollar, official holdings of U.S. dollars will only be reduced through market intervention by foreign central banks. A substantial reduction of dollars presently held in foreign official reserves—the reserve liabilities of the United States amount to some \$70 billion—is clearly desirable as a long-run objective. Progress in this direction has been most marked in the case of Japan, where dollar reserves have declined sharply in recent months. At the end of November, Japanese official reserves were reported to be some \$6 billion below their level at the end of February. It would be desirable for other countries with excess reserves also to sell dollars gradually when market forces are serving to appreciate the dollar substantially against their currencies.

The controls imposed on capital flows may be a third area of international monetary arrangements where evolutionary steps can be taken. Starting with the measures adopted in 1963 and expanded in 1965, our Government has administered a system of restraints on capital outflows in order to protect the balance of payments and avoid disturbance to international markets. These measures—the interest equalization tax, the foreign direct investment regulations, and the voluntary foreign credit restraint guidelines—have been adapted over the years to changing economic conditions, but it has been the objective to remove them when they were no longer necessary. Other countries have similarly imposed new controls, or tightened existing controls, to deal with capital flows considered to be temporary or reversible.

Early this year, the administration announced its intention to phase out our controls by the end of 1974, but noted that the timing of liberalizing steps would depend on balance-of-payments developments. In view of the recent strengthening of the balance of payments, it may be feasible for the agencies administering the controls—the Treasury Department, the Department of Commerce, and the Federal Reserve

System—to move forward over the coming months with an orderly reduction of those restraints. Similarly, it may prove feasible for other countries to relax some of their earlier-imposed restraints on capital inflows.

In conclusion, I would like to note once again that the strengthening of our balance of payments and the restoration of confidence in the dollar in exchange markets stand out as this year's major economic achievements. These developments have served to bolster confidence in our Nation's future at a time when we have been besieged with all sorts of unhappy economic and political news.

In fact, these foreign exchange developments have transformed the atmosphere in which international financial problems are being discussed. We no longer hear voices from abroad about inflation being exported from the United States. There is no longer so much complaining about a world flooded with dollars. Even complaints about the "dollar overhang" have become muted.

We must, of course, be careful and not exaggerate the extent of the dollar's recovery. There is much unfinished work ahead of us. Nonetheless, it is gratifying to be able to draw your attention to the improvement that has occurred in our balance of payments, and to advise you that the dollar is today a respected currency in financial circles both here and abroad.

Confidence in the dollar is essential both to a healthy domestic economy and to a successful evolution of the international monetary system. Looking to the future, we must strive to conduct all our economic policies—domestic as well as international—in such a manner that they will maintain, and indeed strengthen, that confidence.

Thank you, Mr. Chairman.

Mr. GONZALEZ. Thank you, sir, for an excellent statement and most modest restatement of accomplishments. As I said earlier, I think your ability to negotiate and bring about the change in the two-tier system was a personal accomplishment.

Dr. Burns, with respect to the controls that were imposed on foreign investments your remarks confirm a staff study that was made by our staff not too long ago, several weeks ago, and I do not know if we had the thoughtfulness of forwarding you a copy of that study, but if we have not, I think we should because I am kind of proud of this subcommittee staff and the work they did in that area.

My question, and I am going to limit it to one question, so that we will have a chance for each member of the subcommittee to have one go-around and perhaps more time later on, in view of your success, which proved to me that you still have some viable international organizational cooperative effort, and so many people have considered IMF, Bretton Woods, as dead and everything and something absolutely brand new would have to come forward for it, and you negotiated with the Europeans and the others successfully, very ably. Do you believe that it is desirable, and maybe timely, for the United States to exert similar leadership, for example, in making IMF a world banker of last resort, so to speak, as a very helpful tool in preventing these fluctuations that are so damaging, or are we doing that?

Dr. BURNS. This is a question that is now being studied very carefully by my own staff and by the Treasury staff and is being discussed

by high officials of our Government. No decisions have been reached and, therefore, I cannot say anything at this time except to endorse the broad concept that you have suggested. I think the time has come to consider the possibility not only of strengthening the International Monetary Fund—something we must do if the rule of international law is to exist in the monetary area—but also to convert it into an international central bank.

Mr. GONZALEZ. Well, thank you very much. I am very happy to hear that because I feel that this is one place where American leadership is indispensable, and I just feel that the rest of the world really more or less looks to America for leadership in that direction. The atmosphere has been so pessimistic that I thought, well, perhaps this is just a pipedream, but when you came back and announced the gold agreement, it proved you were able to get some up-to-then intractable Frenchmen and others, which I think is an achievement which really deserved our thanks and it should not be minimized.

Mr. JOHNSON?

Mr. JOHNSON. Thank you.

Dr. BURNS, this certainly is a tremendous statement you have made and you have covered so many topics, both of which are so current that you certainly are to be congratulated on your statement.

I was really shocked last evening. I read that article in Business Week on the effect of our military by the Mideast shutdown, in not allowing us to purchase oil. It is really a shocking thing that it has happened. Our Mediterranean Fleet is practically devoid of any source of supplies for gasoline and other fuels and it has even extended to the Philippines where Saudi Arabia has ordered the Philippine Government not to dare sell us any of their oil products at the Clark Airbase and Spain has to do the same thing. I suppose history will say that what is taking place, is probably the greatest piece of international blackmail against the United States and the world in all history, and it certainly should be resolved as rapidly as possible, because the more we read about it, hear about, and the way it effects this great Nation of ours is certainly something that staggers the imagination. So, I am glad that you have touched on it here today because it is a real grave situation that is facing the United States of America. It does have a lot to do naturally, of course, with the fact that our dollar is strengthened abroad. I think perhaps the greatest reason is that the Europeans figure that we are not going to be spending our money for oil and, therefore, our balance of payments will improve.

Now, I think another important thing that you have said in this statement is the fact that, in due course, the United States and other countries will make decisions about the possible sale in the gold market of gold. Can you conceive of a situation where the United States would feel that they would be, let us say, obliged to sell some of our gold in the open market?

Dr. BURNS. Well, I can easily conceive of a situation in which we would find it desirable to do so.

Mr. JOHNSON. You can?

Dr. BURNS. Yes.

Mr. JOHNSON. As I say, that is an interesting statement that you have made because, as I stated several weeks ago, I believe you were

before us, it is very comforting to me to know that we have some \$12 billion worth of gold at the old price and now if you value it at the present market price of \$100 an ounce it is worth way up into some \$23 or \$24 billion. I think a country that has gold is a pretty strong nation, and a country that has no gold is in a deplorable situation. Is that not generally true?

Dr. BURNS. Yes, but I would prefer oil to gold right now.

Mr. JOHNSON. I think you are right. Last year or this year it is true, is it not, that the German banks and Belgium banks when the dollar was under such frightful pressure stepped in and bought up dollars to save the dollar. Now with the dollar strengthening are they not in a position to start gradually selling these dollars back into the market and recouping what appeared to be a tremendous loss to them at the time they bought the dollars?

Dr. BURNS. I think so. The Japanese have been doing it on a very large scale this year, and if the dollar remains strong, which I expect will happen, I would anticipate that other central banks will be selling dollars from their large portfolios.

Mr. JOHNSON. You do not anticipate any large sales of dollars?

Dr. BURNS. I do, yes. I anticipate sales of dollars by other central banks.

Mr. JOHNSON. But as our balance of payments and our balance-of-trade position keeps on improving, the dollar will remain relatively strong and, therefore, this pressure on central banks to not dump dollars, but gradually get rid of them, will not have an appreciable effect on the dollar abroad? That is your opinion?

Dr. BURNS. Well, my opinion is that with the dollar strengthening in foreign exchange markets, foreign central banks will begin on an increasing scale to sell off the dollars they have accumulated, just as the Japanese have been doing.

Mr. JOHNSON. I might just make an observation. I was in Sweden in September and I was at a luncheon table with the finance minister of Sweden. At that time our balance-of-trade position, and our balance-of-payments position had improved materially, and he attributed that almost alone as the reason that the dollar was much stronger with respect to Swedish currency and he seemed to place almost all of his observations on our increased balance of payments and balance-of-trade position. That probably is one of the great reasons, is it not, for the strength of the dollar all over the world?

Dr. BURNS. I think that is the basic reason, yes.

Mr. JOHNSON. My time is up.

Mr. GONZALEZ. Mr. Reuss?

Mr. REUSS. Thank you, Mr. Chairman.

Dr. Burns, some nations apparently do not regard the abolition of the two-tier gold agreement as a step away from gold as a monetary reserve, but instead regard it as a prerequisite to an increase in the official price of gold. What is the U.S. policy on the official price of gold, and how would we respond if foreign central banks did buy gold at prices higher than the official price?

Dr. BURNS. We would regard it as a violation of article IV, section 2, though I must say I do not anticipate that foreign central

banks will be buying gold in the foreseeable future. I have indicated that in my statement. I think this is an informed judgment.

Mr. REUSS. In your statement you say, and I am quoting:

It would be desirable for other countries with excess reserves also to sell dollars gradually when market forces are serving to appreciate the dollar substantially against their currencies.

I would certainly agree with that statement.

Tell me, has the United States either at the conference on the Loire a few days ago, or at any other time, indicated to our monetary partners or in any way given them the impression that they could sell their dollars in order to maintain a given exchange rate; namely, the parity agreed to last February?

Dr. BURNS. We have discussed this problem frequently. We discussed this problem again at the recent meeting in France. But, at no time have we suggested to foreign governments or foreign central banks that this or that exchange rate or parity be preserved. In other words, we have not sought to peg exchange rates.

Mr. REUSS. I know we have not sought to peg, but have we indicated to them by thought, word, or deed, that we would not do much about it if they sought to float dirty, to peg, or whatever you want to call it, at the February levels?

Dr. BURNS. No, we did not. In the conversations that I have been a party to, we have been cautious. We have not imputed any such motive to foreign governments and, therefore, have not had to indicate what countermeasures we would take.

Mr. REUSS. But, so far as you know neither you nor any representative of the U.S. Government has indicated to the foreign finance ministers and central bankers that we would acquiesce, however tacitly, in an effort by them to so intervene so as to preserve the February 1973 agreed rates?

Dr. BURNS. That is true. But, I do not want to overstate the matter. At various times, in the course of these conversations, one or another of the participants indicated that at the time of the second devaluation it was widely believed that international exchange rates were brought into equilibrium. But no one has insisted that that condition has persisted and that it characterizes the present condition. I think there is a general willingness, particularly now, in view of the new uncertainties introduced by the oil problem, to test markets rather than to try to characterize this or that situation as a set of equilibrium relationships, and try to maintain them as such.

Mr. REUSS. I was glad to hear your view that international monetary reform is an evolutionary process, and that it does not seem imperative to you that on a date certain, like next July 30, there be struck off a complete new constitution which tries to handle every problem. I think that is what you were saying?

Dr. BURNS. That is correct. I have come to believe increasingly that it is a rather unrealistic concept.

Mr. REUSS. Now, in the light of that and I, obviously, agree with your view there, in the light of that, why isn't there a technical working party of the Committee of Twenty now drawing up guidelines for central bank intervention under a continued float, if we are going to float for awhile, as I surely hope we do? It would seem to me sensible

to put in place some guidelines. You have mentioned two, yourself, today which sound pretty good to me. One, you could intervene to maintain orderly markets; two, you can intervene to get rid of excess currency. Here we talk mainly about selling dollars gradually, but not in support of any fixed exchange rate. Well, those would do as a start, but who is working on this vital work, if anybody?

Dr. BURNS. One of the technical groups is working on a more general problem which subsumes the question that you have just raised.

Mr. REUSS. The adjustment group?

Dr. BURNS. That is to say, there are to be rules for the adjustment process. Technical groups are working on these rules in connection with a system of stable parities and in connection with floating exchange rates as well. When you examine, as I am sure you have, the U.S. position with some care, you will find that the position that we have advanced on reserve indicators covers stable exchange rates and a floating system equally well.

Mr. REUSS. I was also glad to hear you say, or give your view, that we should relax our controls on foreign lending and investing by this country abroad, step by step, with the improvement in our balance of payments. I think that is exactly what we should do and I am glad to hear it. Why not also make the goldbug happy and get them off our backs by letting the Americans own gold? As you know, we put into the law that the administration should decide when that can be done without causing the sky to fall in, and I suggest that time has come. Why not make them happy for Christmas?

Dr. BURNS. Well, I rather doubt that the gold enthusiasts will be made that happy by Christmas. However, in time I am sure they will. It is entirely a question of judgment and entirely a question of priorities.

I would think that it is more important to reduce our controls on American investment abroad, and controls on our purchases of foreign securities. It is important to make progress in that area first, and then relax or remove our current restrictions on the ownership, purchase, or sale of gold by American citizens.

Mr. REUSS. Thank you. My time is up, Mr. Chairman.

Mr. GONZALEZ. Mr. Stanton?

Mr. STANTON. Doctor, I wish to add my congratulations to those already expressed by our chairman and Mr. Johnson. I thoroughly agree that this is the number one success story economically of 1973, the increased confidence of the dollar abroad and the strengthening of our balance of payments.

In that regard, I just have one question and, mainly out of curiosity I guess. I fully realize this is out of your realm of responsibility. But we are going under the assumption that the trade bill will come up before the Congress next week and it has been on again, off again, as you well know. I wondered if you would give us some of your thoughts in regard to this bill, and do you look to it as a useful tool, or what effect will it have on strengthening our balance of payments or maybe increasing the confidence in the dollar abroad? I wonder if you would care to comment on that?

Dr. BURNS. I cannot honestly say that I expect that the bill will serve to improve our balance of payments. I do expect that it will

serve to augment mutually beneficial international trade and investment, and that is a positive gain for this country and for the international economy. It may also have beneficial effects on our balance of trade, but I find it difficult to be very confident that that will happen. Therefore, I look for benefits in other directions which seem definitely promising—that is, the augmentation of international trade and investment.

Mr. STANTON. Then you, yourself, are a supporter of the bill?

Dr. BURNS. I am a supporter of the bill. There are some protective measures in that bill for American industry that I think can be useful if other countries do not play the game of international trade fairly.

Mr. STANTON. Thank you very much.

Mr. Chairman, that is all.

Mr. GONZALEZ. Well, thank you, Mr. Stanton.

Mr. Young?

Mr. YOUNG. Yes, Mr. Chairman.

It is always good to hear from you but, I still have a feeling that the progress you have made, while significant, is progress made among friends, people who have demonstrated long term common interest. Your statement, for instance, about hoping that people will sell their surplus dollars frightens me. If you would apply that to the Arab Government who might try to use their large surplus of dollars as politically as they have used their oil. I wonder, do we have any protection against that?

Dr. BURNS. The protection that we have against large movements of short-term capital, whether by Arab nations or by others, is very small indeed at the present time.

On the other hand, I would not exaggerate the danger of Arab countries selling dollars. Other countries may be eager to buy them and to use these dollars to the advantage of the United States. I am not sure that the Arab countries are going to sell dollars unless they see a clear advantage in doing so. In determining advantage, Arab countries will look out for their economic interests just as others tend to do.

Mr. YOUNG. Also, using the political use of oil, you are saying that oil is perhaps more valuable than gold right now, and speaking in terms of how we involve the third world more in our common community of interests, are you in a position to say whether some consideration of a link in the monetary fund toward development might be in the U.S. interest, especially since we find ourselves now in a situation where the Arab nations are making a strong initiative toward Africa, and given a drying up of Arab oil supplies, we might become more and more dependent on Nigerian oil or oil to be found, in other countries of Africa? Are the recent events doing any more to make us rethink our position on the link?

Dr. BURNS. Well, I think recent events are disturbing because raw materials are distributed very unevenly on our globe. What has happened in oil so recently may happen in the case of phosphates tomorrow, copper in a day or year after, and bauxite at a later time. This is a disturbing thought, because our political institutions and our political relations are not adapted to these newly emerging economic

realities. These are matters that many of us will have to think hard about in the days ahead. I would heartily endorse the general thought that you have expressed; namely, we should seek to achieve a larger degree of harmony with these less-developed parts of the world. On the other hand, I have opposed the link in the past and my opposition has not diminished with the passage of time.

What the link means essentially is that currency would be printed up and distributed to the less-developed countries. I think this is a poor way of aiding the less-developed countries. I think that if we really are interested in their welfare—as we should be for their sake and also our own—the Congress should extend aid directly by appropriating funds for that purpose, rather than by sitting by passively and letting an international organization print up money for the purpose. I am opposed to the link for that reason.

I am opposed to it also because it has, inevitably, domestic implications. Very soon people in our own country would say, "Here you have printed up currency to distribute to the poorer nations of the world; why don't you print up a little more and distribute it to our own poor people?" I do not know what the future of our economy or the future of the dollar would be if we ever travel this road. I must say that while I endorsed the SDR at the time it was established, and while I continue to think that it is a useful device in carrying through international monetary reform, I, myself, would become very skeptical about the future of the SDR if, at the very time when a new SDR is established in the interest of strengthening the world monetary system, we proceeded to weaken confidence in the SDR by giving it this extraneous function as far as monetary reform is concerned; namely, using it as a device to assist the poorer countries of the world.

Mr. YOUNG. Do I have time for one more, Mr. Chairman?

Mr. GONZALEZ. One more.

Mr. YOUNG. In view of the present situation, we have a possibility of high unemployment looming and, normally, that would mean a relaxation of tight money. I am wondering whether it means that, in view of unemployment being brought on by a scarcity of resources, there is some possibility that money might be relaxed for an area like homebuilding, as a means of dealing with the unemployment problem, but still maintaining controls in other areas?

Dr. BURNS. Well, there can be little doubt that the economic outlook has worsened. It certainly has become clouded as a result of developments affecting petroleum supplies. But it is important to recognize that the shortage that we have is a shortage of oil and not a shortage of money. Therefore, monetary devices for dealing with this problem can have very limited usefulness.

The Federal Reserve has no very effective way of dealing with the housing problem as such. Fortunately, the inflow of funds to savings and loan institutions, in particular, has resumed on a large scale. In the month of October, the inflow of funds to savings and loan associations expressed as an annual rate amounted to 9 percent. For the month of November, we do not yet have a firm figure, but our current staff estimate is that the S. & L.'s will probably gain something like 7½ percent, expressed as an annual rate. The S. & L.'s are no longer

borrowing at present from the home loan banks; credit is now more readily available for more mortgages; and interest rates on new mortgage commitments have declined noticeably since mid-October. So, there is a corrective process at work in the homebuilding industry at present.

Unfortunately, the oil situation does not make the prospect for homebuilding any brighter, because if a real estate developer has acquired a large tract—30, 40, or 50 miles away from a large urban center—he is going to think twice about developing that tract in view of the gasoline shortage that is now pending.

Mr. YOUNG. You mean maybe the Arabs may really force us to redevelop the central city?

Dr. BURNS. Well, I think they are stimulating us to think in many ways, and this may be one of the unseen benefits. Another may be that we will become independent in the energy field, as we should be.

Mr. YOUNG. Yes.

Dr. BURNS. Still another may be—and here I am going way outside of my area—that we will rethink our defense problem and be a little more willing than we have been of late to see defense budgets of a sufficient size to assure this Nation's military and political strength.

Mr. YOUNG. Thank you very much.

Mr. GONZALEZ. Mr. Conlan?

Mr. CONLAN. Mr. Chairman, I do not have any questions for Dr. Burns. I just sit here and marvel at the way he very definitively fields the questions. Without being in any way evasive, he nevertheless does not use any more words than he has to. This is a learning experience for me and I compliment him very much because I think some of the questions we are asking, some of those I would like to ask, really are more in the nature of what should be done to educate some of us on the subcommittee a little bit further. I do not think those are the types of things that we can ask in a full, open meeting like this, because Dr. Burns cannot go, perhaps, into some depth on these, because words could be misconstrued by the international community and others. So, I would just withhold my questions and perhaps at some time in the future I might be able to ask them, or perhaps at some time in the future we might have some meetings with him and with other leaders in our Government that are in the nature of an informal thing, bringing us up to date in some areas where we can let our hair down a little bit. Then Dr. Burns will not have to be as masterfully guarded, and appropriately so, as you are today.

Mr. GONZALEZ. Well, Mr. Conlan, thank you very much.

Let me say that Dr. Burns in many ways is an angel but he does not ever rush in. He is not only cautious, he is very succinct and to the point. I think he has answered questions that many witnesses perhaps would fear to try to answer because of the possibility of misinterpretation.

Mr. CONLAN. My comments, Mr. Chairman, were not critical of him.

Mr. GONZALEZ. I understand.

Mr. CONLAN. They were complimentary of him doing very well in a very difficult field, and one that is prone to misinterpretation. I am just saying this is one of the problems that we get into, and I am just complimenting you for it, Dr. Burns.

Dr. BURNS. Thank you very much.

Mr. GONZALEZ. Mr. Stark?

Mr. STARK. Thank you, Mr. Chairman.

I want to take this chance to ask Dr. Burns some questions that might stray a little bit afield, but I am sure that he can make some comments. It is my understanding, Dr. Burns, that you are on record as opposing the provision that would allow savings and loans to take unlimited public deposits, and without collateralizing them, or guaranteeing them. If that is a correct assumption, would you also comment on your feelings on the net result of increasing the insurance limit to \$50,000 from the present \$20,000, and perhaps allowing savings and loans to take public deposits up to their insurance limit? Would you be equally opposed to that?

Dr. BURNS. I think I would, yes. The present insurance limit is \$20,000, and I think there is ample justification for raising that limit, certainly to \$25,000, and possibly to \$30,000. But to go much beyond that, I would hesitate for this reason—and it applies to banks as well as to savings and loan associations. If you approach complete insurance, then as far as the public and corporations are concerned, one bank, one financial institution, would become indistinguishable from another. The degree of discipline and care that we have, the degree of prudence that is exercised both by banks themselves, and by their depositors would diminish. I think this incentive for prudent management is well worth preserving, so I would be cautious in raising the ceiling from \$20,000 to \$50,000.

Mr. STARK. Then just to explore that one step further, if I may, Dr. Burns, the savings and loan now are pressuring to get more sources of funds. I would agree that there is some real danger in unlimited insured funds mostly liquidity dangers, in unlimited public deposits that are not fully collateralized or fully insured. I do wonder whether it might not be of some help, particularly to the smaller savings and loans to say they could, indeed, take deposits up to their account insurance without collateralization. Whether the various municipalities would approve that or not is a question that they would have to resolve. But, I wonder in the aggregate whether this would be so insignificant that you might not have any objection to that?

Dr. BURNS. Offhand, I would have no objection to that, but I would not want to give you a definitive reply until that question is explored by me and by my staff. But, offhand, I see no difficulty with your suggestion.

Mr. STARK. One other area is that the question that comes up—and we have discussed it in various hearings in this room is the question of adequate funds, domestic funds for homebuilding or industry. Very little has ever been said about the question, in inflationary times, of the retired person, the small saver, the consumer. There is very little pressure from industry to pay higher interest rates to these people, many of whom depend on their interest as a source of income.

I, in the past, as you are aware, have been somewhat critical of the series E bonds of the savings bond program, in that it has been a voluntary additional income tax, and the sales campaigns have been thrust toward the wage earner who can least afford it. Would we be able, in your opinion, to develop a program to get some kind of parity

in the interest rates of savings bonds with the higher instruments that banks or savings and loans offer if it were done with enough leadtime so as not to disrupt the whole Treasury financing system? Do you see that as a possibility?

Dr. BURNS. It is a possibility but we have to watch it because any large increase in the interest paid on savings bonds could drain funds from the savings and loan associations and thereby multiply their difficulties.

Mr. STARK. Yes. I concur. As I say, it may have to be a quarter of a percent, or some differentiation to prevent that sort of thing. But, on the other hand, would you concur that we could get the interest rates as close as possible to help particularly the person who lives on a fixed retirement income?

Dr. BURNS. Yes, I think that there is an inequity there that in crying for correction. But we are limited in what we can do, because if we try to correct this inequity, then our thrift institutions could be in difficulty.

Mr. STARK. Please let us know if you see a way to correct it. Hopefully, there is some way that we can get rid of these inequities. It has not occurred to me yet, and I would welcome any suggestion that you could offer.

Dr. BURNS. Well, some suggestions were made, of course, in the Hunt Commission report and also in the board's housing study that we released in March 1972. These are steps in the direction that you seek.

Mr. STARK. Thank you very much.

Mr. GONZALEZ. Mr. Burgener?

Mr. BURGNER. Thank you, Mr. Chairman.

Chairman Burns, we appreciate your excellent testimony and wise counsel.

In my district over the weekend I met with a constituent who asked urgently that I should do something about foreign investment immediately. I asked what I should do, and the constituent said "you must stop it." Well, I allowed as how I would look into that just as soon as I solve the energy crisis. But, in any event, in a more serious vein, on page 16, you talk about capital outflows and you said our Government has administered a system of restraints on capital outflows. I would like to talk about capital inflows. I do not want to talk about it. I want to hear you talk about it. But, in our State and in California, there is heavy investment, particularly, from the Japanese.

Question No. 1, is there any effective measuring device, nationally, that we have to measure foreign investment here. What is our policy? Should it be encouraged, discouraged, and what effect does it have on us, the taking of profits out after investment and this sort of thing? Would you be kind enough to comment on inflow of capital?

Dr. BURNS. Yes. First of all, we follow very closely the foreign investments, both direct investments and portfolio investments, in this country. Those figures are compiled on a quarterly basis. I am not sure at the moment how complete these figures are, but statistics on these investments are published regularly.

We have no general controls that I am aware of on foreign investments in this country at the present time. Our policy has been one

of encouraging foreign investment in this country, and I think that is a sound policy. After all, Americans have invested very heavily abroad, and now that citizens of other countries are beginning to invest more heavily in this country, I think that we ought to welcome it. It improves our balance of payments, and it adds energy to our industry, and may strengthen competitive forces within our economy as well.

There is only one concern that I have in this area and that is foreign investment in certain of our more sensitive enterprises, particularly enterprises that are connected with the Nation's defense effort. I do not think that I would be at all happy—in fact, I would be gravely concerned—if enterprises of this sort came under foreign control. I think this is an area that does deserve exploration. But as for the rest, I would welcome it heartily for the present. The more the better would be my position.

Mr. BURGNER. Do you, therefore, suggest that we at least ought to study the possibilities of rules, regulations, or statute as related to sensitive industries?

Dr. BURNS. I would study that; yes.

Mr. BURGNER. If Japan, for example, invested \$100 million in something in the United States and that earned a 10-percent return or \$10 million, what is the law generally on their profits earned in this country?

Dr. BURNS. I am sorry?

Mr. BURGNER. The profits they earn on their investments here?

Dr. BURNS. Yes. I did not get the question. Yes; they earn these profits, and what about it?

Mr. BURGNER. What about the taxation on that? Is it identical to ours, does it escape us, or does it vary on the kind of income?

Dr. BURNS. I do not know the details of our tax laws sufficiently to answer your question with full confidence. But, I believe that foreign corporations are taxed in exactly the same way as domestic corporations are. As for the outflow to foreign countries of income earned in this country, that outflow will become larger as foreign investment here increases. But let us bear in mind that we have a very considerable inflow as a result of the income that American corporations are earning from their foreign investments. This, as a matter of fact, has been a mainstay of our balance of payments during the difficult years when the balance of payments was in trouble.

Mr. BURGNER. On the balance scale, is it true that our investment abroad is much greater, much greater than all of the foreign investment here?

Dr. BURNS. Oh, yes; very much greater. I cannot give you the exact figures, but it might be useful to insert the figures in the record.

Mr. BURGNER. I would think that would be helpful, Dr. Burns, if we could have that.

Mr. GONZALEZ. I would certainly think so. May I interject a thought here, though. The staff, in its study that I referred to a while ago, goes into this fairly extensively. We have the staff report that is being printed up, but I believe we have sent copies to each member. It also points out that the increment of foreign investment compared to our total is still infinitesimally small and has not developed to any dan-

gerous point. In fact, they even suggest strongly that perhaps the withholding tax on interest and dividends that these investors have to pay might be eliminated in order to stimulate further investment.

But, in pursuance of your request, if you wish to place it in the form of a motion, we will suggest that these facts and figures be incorporated into the record.

Mr. BURGNER. Yes; I would so move, Mr. Chairman.

Mr. GONZALEZ. Without objection, so ordered.

[In response to the request of Mr. Burgener, the following information was submitted for the record by Dr. Burns:]

INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES—YEAR END 1972

(In billions of U.S. dollars)

	U.S. investments abroad	Foreign investments in United States	Net investment position
Private, long-term.....	128.4	59.8	68.6
Of which: Direct investments.....	94.0	14.4	79.6
Private, liquid.....	5.2	21.4	-16.2
Total.....	199.3	148.7	50.6

Source: Survey of Current Business, August 1973, p. 21.

Mr. BURGNER. One final point and thank you for your indulgence. On page 12 of your submitted statement, you remain skeptical about that long-range viability of the float. Do you mean that perhaps we might work toward fixed exchange rates sometime, or do you see constant change indefinitely in international finance, a more constantly changing thing as opposed to a rigid system?

Dr. BURNS. Well, I would look forward to a return to a par value system for most countries of the world. But I would leave a floating option, subject to rules, and I would want to see wider margins around parities than exist under the Bretton Woods agreement. I think that a system of stable parities with wider margins would serve the international economy in the long run better than a system of floating exchange rates. The system of floating exchange rates has served the international economy quite well during these recent months, but the test has been inadequate. The test has occurred under conditions of sharply rising world demand. Once there is some decline in world economic activity, or even some marked retardation in the growth of world economic activity, I would anticipate that floating would cause some difficulties. These difficulties may be in the political area as well as in the commercial area.

Mr. BURGNER. Thank you, Dr. Burns, and Mr. Chairman.

Mr. GONZALEZ. Thank you, Mr. Burgener, for your very valuable contribution.

Well, we are about to start on round 2. It is about 11:32 and I should ask you, first, Doctor, how you are suited for time? Are you in a hurry or do you have any pressing business?

Dr. BURNS. There is no business that is more pressing to me than to be of service to your subcommittee, Mr. Chairman.

Mr. GONZALEZ. Well, we deeply appreciate that, Dr. Burns, in all sincerity.

I have a couple. During your answer to one of the questions and in your exchange with Representative Young, you mentioned that at this time we had very little defense against quick, substantial, short-term movements of capital. I would like to know, from the congressional standpoint, is there anything that can be suggested that could be done from our initiative either legislatively or administratively that could help to set up some safeguards? This is the reason I was interested about American leadership in trying to refortify IMF to make it exactly that, a banker of last resort, to try to use that instrumentality as a means of controlling these precipitous, and what I consider to be exploitive movements. Is the thrust of your discussion to the effect that really at this point no one nation, or any other or bloc has the clout to bring about what it will take to control this?

Dr. BURNS. My judgment is that very large movements are extremely difficult to control and we do not know how to do it. Some countries of the world, such as Germany, France, and Japan, have instituted controls on the inflow of funds, and these countries at times have felt that the controls were very exacting and thorough, only to discover that they worked like a sieve when market forces or speculative forces—call them what you will—were causing large movements of funds.

Now, we do have a swap arrangement, and a swap network which is large at the present time. It amounts to something like \$18 billion. We have intervened in exchange markets, and so for that matter have some other central banks, particularly the Bundesbank, which has worked very cooperatively with us. I think these arrangements are helpful in dealing with movements of short-term funds, as well as with other shortrun disturbances in international transactions. But they cannot cope with an avalanche, and we have had more than one in the last few years.

This subject has been studied extensively. Perhaps one day we will be ingenious enough to know how to control these movements. At the present time, we do not have the instruments for doing so in this country, certainly. There are better instruments abroad, but they are not nearly good enough.

Mr. GONZALEZ. In that connection, it has been reported that a very little noticed flow of American capital into what is called Latin dollars—everybody has been talking about Eurodollars and has overlooked the fact that a tremendous depository has been created in Latin America to the tune of somewhere between \$15 to \$20 billion. Is that an exaggerated figure?

Dr. BURNS. Well, I did not realize it was that large. But there certainly have been large inflows to Brazil and Venezuela, and other Latin American countries have improved their foreign exchange reserves very considerably. What the total may be I do not have in mind at the moment.

Mr. GONZALEZ. I was so intrigued and somewhat disturbed because I recall that about 1½, 2 years ago, it took less than a movement of \$8 or \$9 billion to create the crisis in Europe and it seems to me that given that potential I can understand why such men as the chairman of the board of the Chemical Bank and a couple of economists have had

these dire predictions about the danger of a depression due to a collapse, and so forth. Now, whenever men of that stature make these utterances, I have to take them seriously. This seems to be the only area that this possibility could occur and I am disturbed to think that we would be so exposed.

Dr. BURNS. Well, if I may say so, there is one prediction that I can safely make, Mr. Chairman. If we have a strong economy so there is confidence in our economy and in the dollar, we will not need to fear any outflow of dollars on any significant scale. As for the inflow, if it occurred, the Federal Reserve System has sufficient technical weapons to neutralize it.

Mr. GONZALEZ. I see. Well, that is comforting.

Mr. JOHNSON?

Mr. JOHNSON. Dr. Burns, you seem to have devoted several pages of your statement to the oil crisis. I was reading in the news media recently criticisms of the so-called shortsighted policy of the United States in limiting importation of oil down through the years. I happen to be one person who down through the years had approved of a limitation on imports, and I would say, by way of observation, that if we had not limited imports which, in turn, encouraged the development of oil in the United States by wildcatting and discoveries, we would now be in a much worse situation. Do you agree with my observation on that point?

Dr. BURNS. By and large, I do. I must say that members of my profession who have opposed the restriction on oil imports so consistently over the years have turned out to be rather shortsighted, not because they were poor economists, but because they thought of economic forces in the abstract and have not paid enough attention to considerations of national security and national defense.

Mr. JOHNSON. Just as a way of maybe encouraging extensive wildcat drilling in this Nation, I just yesterday put in a bill wherein the Federal Government would say to a wildcatter, you go ahead and give us a plan of a wildcat well and, if, in our opinion, the acreage is wildcat acreage, and if you drill a dry hole, we will reimburse you up to \$25,000, or not to exceed one-half of the intangible development costs. I know that sounds radical but it just seems to me when we are so desperately facing this oil situation, that we have got to do some innovative things. I do not know whether anything will happen to the bill or not, but, if it were passed, it might bring about the greatest wildcat drilling operation in the history of the country. I am not asking you to comment on that, but it is just one of the innovations that I think might be worth trying.

Now, the last question: Since your announcement in the last 5 or 6 weeks in the restriction of our buying or selling gold, has there been any appreciable change in the world situation with respect to gold? Has it had any telling effect, in any appreciable way?

Dr. BURNS. On the gold price?

Mr. JOHNSON. Well, or in gold markets or in the movement of gold or anything?

Dr. BURNS. Well, soon after that announcement was made, the price of gold dropped from \$97 or \$98 an ounce to \$90, and in the last few

Mr. BURGNER. That, too, in terms of world economic health would be enhanced if there is equality in that, too? I mean, if it were not all going in one direction?

Dr. BURNS. That is right, the simple way of summing it all up would be to say that if the international reserves of individual countries changed very little, if you did not have huge persistent additions to the reserves of some countries and large persistent declines in the reserves of other countries, the international monetary system would be roughly in equilibrium. Actually, the plan that the United States presented on international monetary reform is designed to work toward precisely this objective.

Mr. BURGNER. Thank you very much.

Mr. GONZALEZ. Thank you, sir.

Mr. Stark?

Mr. STARK. I have no further questions.

Mr. GONZALEZ. I believe we are honored with the presence of our distinguished minority ranking member of the full committee, Mr. Widnall. We want to thank him for taking time and joining us. I would like to recognize him at this point.

Mr. WIDNALL. Thank you, Mr. Chairman.

I have no questions and I just want to join in welcoming our old friend, Dr. Arthur Burns, who I know has made an excellent witness today.

Dr. BURNS. Thank you.

Mr. GONZALEZ. Thank you, Mr. Widnall.

Well, I may ask Dr. Burns if he wishes to sum up or has any additional statement he wishes to make and we will recognize him for that purpose.

Dr. BURNS. Thank you for the opportunity. I have no additional statement to make except this: I have testified before your subcommittee, Mr. Chairman, several times and I have always been deeply impressed by the way in which you and your colleagues conduct these hearings. These are exploratory, educational, friendly, intellectual exchanges, and I appreciate them very much, indeed.

Mr. GONZALEZ. Well, thank you, Dr. Burns.

This subcommittee stands adjourned.

[Whereupon, at 11:50 a.m., the hearing was adjourned, subject to the call of the Chair.]

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days the price of gold has risen sharply. This morning it was fixed in London at \$104.25.

Mr. JOHNSON. Does that price of \$104 an ounce have a reasonable relationship to the cost of mining it, or is it an unconscionable profit to those who are selling the gold? Do you have any idea as to the relationship between the cost of production and that particular selling price?

Dr. BURNS. I do not know enough about that to express anything more than a casual opinion. My opinion is that profit in gold mining has gone up rather sharply. But, there has also been a recent change in the technique of gold mining. The South Africans are changing their techniques, and that is having some influence on costs. But, there is no doubt in my mind that gold mining has become a much more profitable activity.

Mr. JOHNSON. Thank you. My time is up.

Mr. GONZALEZ. Thank you.

Mr. Young?

Mr. YOUNG. I really do not have any questions, but you have mentioned a couple of things just sort of off the cuff that I really like to hear. One was your almost—well, the implication being that economic policy, military policy, and State Department policy can no longer be conducted as separate and independent entities, and I just wonder, is there very much coordination along these lines in the administration presently?

Dr. BURNS. I think the correct answer is, "Yes, that there is a good deal of consultation on these matters. Whether the coordination is effective enough is a matter of judgment, and I am not really qualified to appraise that."

Mr. YOUNG. Well, thank you very much.

Mr. GONZALEZ. Thank you, Mr. Young.

Mr. Burgener?

Mr. BURGNER. Thank you, Mr. Chairman.

A brief question about the balance of payments. Am I correct in my assumption that the world economy is best served if there is exact equality in import and export or balance of payments? Is that a correct assumption?

Dr. BURNS. Overtime, for total payments, I would say so, yes. Then you would have markets functioning smoothly.

Mr. BURGNER. To take a simple example: If we were to sell another country \$1 billion worth of jet aircraft and computers and they were to sell us an equal amount of automobiles and cameras, that would be parity. Now, what about that? That is trade, that is purchase, the sale of goods. Is investment capital also a factor in the balance of payments?

Dr. BURNS. Very much so.

Mr. BURGNER. So balance of payments is not simply just a purchase of goods necessarily? Is that what you are saying?

Dr. BURNS. That is right. It involves purchase or sale of goods, purchase or sale of services, and purchase or sale of securities.

Mr. BURGNER. Money flow?

Dr. BURNS. Yes; money flow. Money flows involve also purchase of some kind of securities.