The Economic Club of New York

Gold, the Dollar, and the Free World

The Honorable David Rockefeller
President, Chase Manhattan Bank

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Gentlemen: I have occasionally been seated along the wings of this table, and often with you out there in front, but this is the first time I have been privileged to stand at the rostrum. I thank you for the occasion. And I shall try to respect the virtue of brevity that I so learned to appreciate as a listener among you.

It is a special pleasure to appear on a program with Mr. Coyne. No other friendship means more to us than that with our good neighbor to the north, Canada. And I know that we have all benefitted from Mr. Coyne's remarks here tonight. In the circumstances, it seemed logical to me to make this a completely international evening. I have, therefore, elected to share with you some further thoughts on the realities and the problems of our international financial position, as I see them.

I speak of "further thoughts" since so much has already been written and said about this matter in recent months. We have had the spectra of sizable gold outflow to awaken us, and the President himself has labeled the international financial problem as one of the most pressing to confront us.

I think it is helpful, even necessary in approaching this problem to recognize that it has two rather separate, but vitally related elements.

First, we have the fact of a continuing deficit in our payments with other nations, and the various actions that must be taken if we are to eliminate the deficit. But then secondly, we must consider the whole system of international currency reserves necessary to the financing of trade between nations, which has been built up in the postwar years, and the role of the dollar in that system. For I am not sure it is widely realized that the United States Could have a sizable gold outflow even if our own international payments were in balance; or, conversely, that if foreign creditors are willing to keep on acquiring dollars, and dollar obligations in payment for goods sold and services rendered, then there can be a very sizable payment deficit with no outflow of gold. It is important, then, to face both aspects of the problem–and to take wise action on both fronts.

Clearly, the most urgent matter at present is the sizable deficit in our balance of payments. This deficit has not only led to a sharp rise in foreign holdings of dollars–it also raises grave concern about our ability to manage our own affairs. The result of a large and persistent deficit has been a tendency on the part of those holding dollars to convert them into gold or other currencies, lest the value of the dollar become impaired.

There is a certain ironic quality in the way this payments deficit continued to unfold over the past twelve months. For the truth is that our country made a great step forward in 1960 toward reducing the basic hard-core deficit. Our exports in this period have increased to a rate of near $20 billion annually, while imports have leveled out. The resulting favorable balance of trade of

close to $5 billion is far larger than that of any other nation. Yet in spite of all this, we had more real difficulty with the dollar in 1960 than at any other time in recent years.
The reason, of course, lay in a new element in the picture: a sizable outflow from the United States of short-term funds which was in no way related to trade. All told this outflow amount to $2 billion or more, much of it in the second half year. Never before in the postwar years have we experienced an outflow on a similar scale. Without it, the deficit in our foreign payments, because of our large favorable trade balance, would have been reduced to more manageable proportions–perhaps to $1-1/2 to $2 billion.

The initial spark that induced these funds to move abroad was clearly a differential in short-term interest rates which opened up between the United States and Western Europe. In late summer, you will recall, this differential amounted to as much as 3-1/2%, and the cost of hedging on forward exchange was seldom more than half that amount. It was too great a temptation for treasurers and international speculators with sharp pencils. Unfortunately, the movement in dollars set off a gold outflow. It also produced the illusion that our basic payments position was getting worse, rather than better. At any rate, certain companies that foresaw a need for funds abroad at some future date were spurred to make immediate transfers, and they were then jointed by others, including speculators, who began to bet against the future of the dollar. A stream of modest size soon threatened to become a flood. An outflow of gold caused by a spread in interest rates came close to precipitating a confidence crisis for the dollar, which might have been far more serious.

Fortunately, this danger now appears to have passed. Not only Americans, but foreigners holding dollars seem to have regained their poise and perspective. In the meantime, too, the differential in interest rates has narrowed. Today after hedging on forward exchange the differential amounts to about 1%, a far less tempting lure to foreign exchange speculation. Certain American companies with rather sizable holding of short-terms foreign assets are now considering repatriating at least part of their dollars.

A lesson might fairly be drawn from this experience, for all of us in the business community. It would seem wise and responsible–in a time such as the recent past, when the national interest clearly is involved–to exercise restraint in responding to a differential in foreign interest rates, particularly when the gains are incidental to a company's main business, and loom relatively small on the income statement. Here, as in so many areas, the business community has an opportunity, even an obligation, to lead the nation in a rational pattern of behavior consistent with our growing role in the world.

A return of short-term funds, which is bound to come sooner or later, will of course, temporarily help our balance of payments. But this will only tend to conceal the real problem, just as last year's outflow tended to exaggerate it. Assuming our favorable trade balance continues at the present level, we wills till have a hard-core deficit in our balance of payments in the neighborhood of $1-1/2 to $2 billion a year. In view of the fact that our cumulative deficit in the past ten years amount to $17 billion, this continuing had-core deficit is too large. Wes should aim to eliminate it altogether–or at least to keep it within modest proportions.

I know you all are familiar with the basic cause of this deficit–the fact that our favorable trade balance, large as it is, still is not great enough to finance the very sizable military, political and economic commitments we have abroad. One of the major outlays, of course, is the $3 billion we spend on the maintenance and support of military establishments in other countries. Another is the $2-1/2 billion or so of private foreign investment by American business, and still a third is our foreign economic aid, including government loans, which also amounts to $2-1/2 - $3 billion.

There has been much public debate on this economic aid; but I believe more often than not it has generated more heat than light. There are those who would solve the imbalance in our payments by going after such aid with a broad-edged axe. I personally would be opposed to such action, as a serious disservice to our national interest. It is a political fact of life, in this divided world we live in, that a wrecking of our foreign aid program would gravely threaten the strength–and darken the hopes–of free nations throughout the world. On the balance sheet of history, there is no economic gain that weights more than such a loss. Even in strictly economic terms, however, there is sound argument against such measures. The fact is that slashing our economic aid would cut away only a small part of our payments deficit. Most aid today–approximately 80%–is tied to exports of goods and services, rather than dollars. To cut back on aid would be merely to cut back on exports–and hence would be self-defeating. Although this linking of economic aid directly to exports runs counter to the trade policy we should like to see, I believe that, under present circumstances, the United States has no other alternative. President Eisenhower headed in that direction over the past two years, and the new Administration indicates that it plans to carry on in the same manner.

The best way, of course, to solve our payments problem is further to expand exports. No one will quarrel with that. Nor is any one likely to disagree with the obvious corollary: that to expand exports we need to cut costs, to become more competitive in world markets, and above all, to keep our economic house, here at home, in good order. These are all appealing sentiments, and it is easy to voice them. It’s a much tougher proposition to carry them out. All I can say tonight is that the responsibility falls on people in the business community like you and me, and on others like us. It’s not something that can be pushed on to the next fellow or turned over to government.

At Chase Manhattan, we have been conscious of this problem and are exploring ways to give constructive help. Our primary business as commercial bankers is, of course, to provide out customers with short-term credit. We know, however, that certain types of exports require longer term financing which is not as readily available on favorable terms for American manufacturers as it is for manufacturers in certain other countries, such as Canada, Britain, France and Germany. This the case particularly with respect to medium-term credits to finance exports of machinery, equipment and other capital goods. The provision of such credit obviously involves unusual and added risks. In point of fact, however, we are already so heavily committed with domestic terms loans, that even if the hazards of lending abroad were eliminated, it is doubtful that most commercial banks would be in a position to expand to any considerable extent credits on exports, which tie up funds for periods of from three to seven years.

I am convinced that to generate this kind of credit in sufficient volume on the order, say of a billion dollars a year, our great institutional investors–such as the insurance companies, the pension funds, and the savings banks–must be induced to cooperate. They, rather than the commercial banks, have the requisite funds available for longer term lending. But they will make such investments only if the extraordinary risks frequently encountered in export financing are covered by a reasonable guarantee, probably by our government, and if they are not required to handle the credit investigations, the servicing and the collections for which they have no facilities. What is needed as an arrangement that will result in bringing together institutional funds (under an appropriate government guarantee) with the international banking facilities and services of the major commercial banks? I believe this could best be accomplished through the establishment of specialized export finance companies which might be organized as subsidiaries of commercial banks. The whole problem is one we in Chase are currently exploring, and I'm happy to say that the government is taken an active interest in examining it with us.

I wish that we could rely completely on a further increase in exports to solve our balance of payments problem. Unfortunately, this would be unrealistic. Our trade balance already is large, and though we can and should stretch it further, there is a logical limit. To try to press beyond this, would undoubtedly call forth vigorous counter-reaction by competitors in world markets. Of course there are several additional steps that can be taken, for example the expansion of tourism in our own country and the removal of foreign restrictions on the flow of capital into the United States. And yet–in the final analysis–I doubt whether all of these together will be enough to bring our international payments into balance.

If this is so, we must examine two further areas: first, whether the movement of long-term private capital abroad should be curbed; and secondly, whether our large military expenditures abroad could be reduced. To choose between these alternatives, if indeed a choice were required, would pose a most unwelcome task. Certainly, we all would want to avoid to the end, if possible, the imposition of exchange controls on private capital. The United States has never had such controls in peacetime, and they run completely counter to the type of economic world we are striving for. Moreover, it is imperative to realize that what we have done in the past to build up our investment abroad acts today as a favorable factor in our balance of payments. Last year the inflow of earnings from these investments (not counting earning reinvested abroad) amounted to almost $3 billion–a large sum actually, than our investment of new capital abroad in the same period. And yet, in spite of all this, I don't suppose there is anyone in this room who would hesitate to place controls on private capital, if the only alternative were to weaken seriously the national security of our country.

This leads us directly to one of the toughest elements to gauge in our whole balance of payments problem. Just how essential are our military expenditures, and is it necessary for the United States to carry so great a burden as we now carry. It is almost impossible for anyone not involved in the military picture to judge whether total outlays in this field can be reduced–and indeed the military services themselves divide on the question. And yet one thing seems clear; the world is now entering another period of revolutionary technology in the art of defense and aggressive warfare. It would appear that future emphasis will be place on long-range missiles rather than on manned aircraft. In these circumstances, one might hope that over a period of time the revolutionary changes now underway would tend to reduce the size and cost of our overseas forces.

In the meantime, certain steps which would reduce our military expenditures abroad could be taken fairly quickly, if necessary. For example, a reduction in the purchase of supplies from local sources, with a possible saving of as much as $200 million annually was ordered by President Eisenhower and has been sustained by President Kennedy. With a total bill for supplies purchased overseas by the military probably exceeding $1 million in 1960, it would seem possible, if need be, to shift a still larger proportion of our buying to United States sources.

Since the common cause of all free nations is at stake, it also seems reasonable to hope that our allies might absorb a part of the present dollar cost of our common defense. This particularly should be the case with respect to Germany, which devotes only about 5% of its national product to defense, as against 10% in our own country. The reports of the recent meeting between President Kennedy and Foreign Minister Von Brentano were encouraging in their recognition of the broad principle–that the large surplus which German has been running on its balance of payments has a bearing on our deficit, and that neither their surplus nor our deficit is good for the sound health of the Free World as a whole. Germany's agreement to provide foreign aid on a continuing basis (although not yet clearly spelled out) and her recent plan for an upward revaluation of the mark, both could contribute toward an improvement in this situation.

Still more progress; however, should be possible with regard to military expenditures. These run to $650 million or more a year in Germany along. All of us can recognize strong objections to Germany financing the pay and living costs of American troops. But there are also German nationals who work in support of the American forces; and our forces use German railroads, telegraph, and other facilities. Why should not Germany offer such manpower and facilities as a contribution to our mutual defense in which she clearly has such a vital interest?

The serious settling of these of these problems requires a vision broader than any simple bilateral view between the United States and Germany. The issues at stake involve not only balance of payments considerations. They also get into the thorny question of how the burden of economic and military aid should be shared. It would be manifestly unfair to single out Germany exclusively in this regard, for the United States pays out dollars for the use of facilities in many countries of Western Europe and all must participate, in varying degrees, in the solution of our common problem.

We sometime forget that the allocation of mutual costs for defense was set, for the most part, in the early '50s, at a time when the world had a serious dollar shortage, and when Western European economies were still recovering from the ravages of war. Now the whole picture has changed, and it is time for a fresh look at the whole situation–a look that can best be carried out through organizations like NATO and the newly proposed OECD. The fact is that, in concert, the nations of the West should be able to meet all their commitments, both military and economic, without undue strain on the balance of payments of any single member, including the United States. But to do so, there must be a genuine desire to work together, based on mutual understanding and recognition of common interests. This is a job for quiet diplomacy and patient negotiation.

As I suggested earlier, however, the deficit in our foreign payments is not the sole problem that confronts us. We have in addition the question of the adequacy of the monetary system of the Free World to provide sufficient liquidity for the growing volume of trade and to protect key currencies like the dollar and the pound from extreme pressures–pressures which are induced by economic and psychological developments, often intensified by speculators.

I doubt whether many people who are not specialists in these matters realize what a dominant role the dollar has come to fill in the postwar years. To a large extent, it has come to replace the pound sterling as a store of value accumulated and held by nations in all corners of the world who do not wish to hold gold for this purposes. Today other countries through their citizens, businesses, and official institutions, hold more than $19 billion worth of liquid dollar assets here in the United States, in the form of bank deposits, Treasury bills and other short-term instruments. If we are to fulfill our role as a central reserve currency, these dollar holdings must be considered as safe as gold. Indeed, some $12 billion of them, representing central bank reserves, are immediately redeemable into gold.

Large reserves such as those we have described are essential to the smooth functioning of our international monetary system. The British still play a similar role with their sterling balances, although now on a more modest scale. But, as the British discovered a long time ago, the responsibility of being a reserve currency center has its drawbacks, as well as its compensations. A country fulfilling such a role has to be as far above reproach as Caesar’s wife. Once its fiscal virtue is doubted, rightly or wrongly, the damage could be fatal. There can be, in a word, a run on the bank, threatening the country’s international solvency.

There are those who feel that such pressure is al to the good, for it places a certain discipline on the United States to lead a sound, conservative economic life, and indeed there is much merit to this argument. But the trouble is that, during periods of economic recession at home, countercyclical measures, which are perfectly sound from a domestic point of view, may run contrary to our interests as a central reserve currency country. At such a time, events outside our own control may buffet us–and drive the creditors clamoring to our doorstep. Even our own citizens may be induced to move their belongings abroad. No better illustration of this dilemma is needed than the pattern of recent events, when we found ourselves afflicted with a moderate recession, took a dose of easier money to cure it, and soon began reaping the whirlwind.

It is a fact of life that in a modern, industrial society, every nation needs a certain freedom of maneuver for its domestic economic policy. What is required of international finance is a system that will permit this, while affording the flexibility liquidity and safety that is needed in a world currency.

The international monetary mechanism as it now stands is clearly inadequate. It places too heavy a burden on the dollar and the pound, and it restricts action on the domestic scene, often at the expense of American and British citizens.

More and more this fact is gaining recognition among economists, bankers and government officials. A number of proposals have now been put forward to rectify it. Perhaps the most far-reaching of these is the so-called Triffin Plan, developed by Professor Robert Triffin of Yale University. Many of you will recall that Professor Triffin would transform the present International Monetary Fund into what, in effect, would be a super-central bank. He would set us procedures to lead member countries eventually to transfer most of their official dollar, pound and other foreign currency balances into the Fund. In addition, they could make a further transfer of gold. For all of this, they would receive deposits in the Fund. Most nations would then hold the bulk of their official foreign exchange reserves in the form of deposits with the Monetary Fund, and the fund would hold as assets both gold and liquid claims on other nations. In the case of the dollar, for example, the Fund might eventually take over most of the $12 billion of Treasury bills, time deposits and other liquid assets now held by foreign central banks. The Fund would earn interest on such assets, but it also would pay out interest to the central banks on their deposits with it.

A unique feature of the Triffin Plan would be the ability of the Monetary Fund to “create deposits,”, if necessary, under certain strict rules and procedures. In doing this, the Fund would provide added foreign exchange to countries needing it–exchange in a form acceptable to most other nations. Thus, the fund would become in the international field a “lender of last-resort,” just as the Federal Reserve System is in the United States today.

There seems to me much far-seeing sense in Professor Triffin’s proposal, but it does involve the extreme measure of turning over to a central organization immense resources and power–indeed a share of our national sovereignty. Among other features, there is one that might make the United States in particular take pause. For the Plan would require all member nations to give an exchange rate guarantee, in terms of the relation of their own currency to gold, on all assets of their country held by the Monetary Fund. In essence, this means that the United States would guarantee the gold content of the dollar, insofar as Monetary Fund holdings were concerned. We certainly would hope and expect that the price of gold would not be raised, and there is no earthly reason for such a step in the foreseeable future. Yet one hesitates to write a blank check for future generations on a matter not completely in our own control.

Much that the Triffin Plan calls for could be accomplished, I believe, in other, more simple ways. The least complicated method, if it did not encounter serious obstacles, would merely involve an agreement among major central banks to hold each other's currencies under certain conditions, rather than demand gold. Unfortunately, such an agreement runs counter to present policies and regulations of many central banks, and it is highly doubtful that we could expect its adoption. As a practical matter, I believe we may do best to look to the Monetary Fund in its present form for more effective help–making only moderate changes in its rules and procedures. This may not provide the ultimate answer, but it would go al long way toward meeting the immediate dilemma.

In line with this proposal, the United States itself might do well to contemplate borrowing freely from the Fund at an appropriate moment. Under existing rules, we have a theoretical capacity to borrow as much as $5-1/2 billion. I use the term "theoretical," because the Fund at this stage doesn't possess the equivalent of $5-1/2 billion of the types of currencies the United States would require. And, of course, no one would really expect us to borrow as much as $5-1/2 billion. There is no reason, however, why we shouldn't go to the Fund as a routine matter for as much as $1 billion, since that is approximately the amount of gold which the United States paid into the Fund. Such a borrowing would carry only a small service charge, and it should arouse no concern. At the same time, the Fund ought to use currencies other than the dollar in making new loans to deficit countries. For example, if the British have to borrow again, they might borrow in marks rather than in dollars.

If the Fund is to buttress the dollar against extreme swings, it will need to have at its command larger supplies of other currencies. It has been proposed by E.M. Bernstein, former Director of Research of the Fund, that the Fund e given the right to borrow automatically currencies of member countries which are running a surplus. This is a very simple proposal that makes a lot of sense. It would assure a greater degree of flexibility for the Fund, and put it in a better position to deal with emergencies.

One over-riding conclusion emerges from any consideration of these twin problems of the balance of payments and the gold outflow: that is the need not only for discipline at home, but for understanding and cooperation from other peoples, particularly those of the West. The United States would find it very difficult to erase the deficit in its foreign payments by acting alone–especially where heavy commitments for mutual defense and aid are involved. By the same token, if we are to realize stability in world currency arrangements, mutual restraint and coordinated action are imperative.

For this reason, I share Douglas Dillon's belief in the great importance of OECD, the newly proposed Organization for Economic Cooperation and Development. In OECD, as well as NATO, we have forums where many of these matters can be faced, where policies can be coordinated, and where burdens can be shared. There is more here, than, than a gold outflow or payments deficit to challenge us. These matters challenge our wisdom, our patience, and the sense of common purpose binding all free peoples.

We can never respond by retreat for isolation means evasion. We can never respond by panic for no strength is born of fear. We can respond only by acting–ourselves and with our allies–in a manner both mature and imaginative, to show the world the capacity of free nations to think anew and to act together.