INTERVIEWEE: FREDERICK DEMING (Tape #2)

INTERVIEWER: DAVID G. MC COMB

January 17, 1969

M: This is the second taped interview with Mr. Frederick Deming. The date is January 17, 1969; again, the interview is in his office; the time is 4:10 in the afternoon; and my name is David McComb.

Now, to say something about the balance of payments problem. My understanding is that the balance of payments deficit--so-called deficit--has been with the United States almost since World War II, and that it is now recently, just this year, being brought to a favorable balance, so to speak.

D: That's correct. The rough history of this is this: For seventeen years, beginning in 1941 through 1957, the United States had deficits in eleven of those seventeen years. They totaled to something less than ten billion dollars; they averaged, I think it was, five hundred and sixty-three million dollars a year. But what that really reflected was not a true deficit at all, because in that period we gave, or loaned in a form of loans and grants, a lot of money. My recollection is the cumulative figure was about a hundred and twelve billion dollars.

The rest of the world didn't have any money and didn't have any goods, and it used this to buy American goods. We had a cumulative trade surplus of something in the neighborhood of ninety to ninety-five billion at that time, and a capital inflow, including the earnings, of about ten billion during that period. The overall deficit, as I say, less than ten billion--we actually gained gold. We financed the whole thing by an increase in our dollar balances with the foreigners. They wanted their reserves to be built up, they preferred it in the form of dollars rather than gold because the dollar earned money and earned interest. We weren't in any meaningful economic sense in deficit.

Beginning, in 1958, however, we got into a whole series of chronic deficits. They averaged close to four billion dollars in '58, '59, and '60. They got cut back to something in the neighborhood of two-and-a-half billion dollars in the next four years. We reduced them to about a billion-and-a-quarter in '65 and '66, and then had a very bad year in '67 when it was three-and-a-half billion. By working like beavers, we got it into surplus, which in a preliminary basis looks like it's a hundred fifty million on a liquidity basis, a billion and three-quarters on the official settlements basis in 1968.

Now, I think it's fair to say that nothing much was done in the way of a balance of payments program until President Kennedy came into office. That's not to indict the former administration because the problem was new, and it takes a little time for it to register, and there's no question but what there was concern about the balance of payments in 1959 and in 1960. All I'm saying is that there wasn't what you might call a program to deal with it until perhaps 1961.

M: Let me clear up one point. Since we had this long-running deficit, what makes it a problem then in the late '50's? Is it due to the changing reserves in Europe?

D: Yes. It's due to two factors. One, as I've said, there was no deficit of any meaningful economic sense. The rest of the world didn't figure that an American deficit in the order of five or six hundred million on the average was really much of a deficit. The world needed dollars both in the private and the public sectors. As a vehicle currency the dollar was used to finance world trade; as a reserve currency it was held in international reserves. As long as nobody is much concerned about the situation, there really isn't a worrisome situation, and the deficits weren't all that big. They were, as I say, less than s six hundred million dollars a year on the average. And the proof of how little they were concerned about it is that we actually gained gold in this period. Nobody came to us for gold, so to speak; all they did was to hold additional dollars, and they even sold us some of their gold. The dollar was better than gold.

Now the numbers got a lot bigger--a four billion dollar deficit is a lot different than a five hundred million dollar deficit, and that's what we faced in '58, '59, and '60. In the ten years from 1958 through 1967, the deficit averaged 2.8 billion. That's four-and-a-half times what it had been before. It's a little like getting drunk, if you want to put it that way, or taking some whiskey. A drink doesn't bother you very much, but you oughtn't to take about seventeen of them. And we began to pump the dollars out faster than were desired either by the private world economy or the public reserve world economy, and it made the rest of the world nervous that we didn't seem to be doing anything about the balance of payments deficit.

M: The cause of this excessive spending is what?

D: There are several causes. We had maintained a very substantial trade surplus in the war and immediate post-war years. We maintained it by giving people money to buy our goods, so that we ran the deficit on the government finance account and the surplus in the trade account. When we began to cut back on our aid programs, and I'm not talking about cutting them back in a nasty way or anything, but we reduced the volume of foreign lending and the volume of foreign grants. With that and the rebuilding of the rest of the world, we got ourselves into a position where our trade surplus shrank. It had been about seven-and-a-half billion in the war years, it dropped to about six-and-a-half billion in the late '40's; and in the period from '50 through '57 it dropped to about three billion--still a respectable trade surplus, but it had gone down from this very high figure.

It had gone down consistent with a reduction in American financial help, either grant or loan, overseas. It had gone down because we had permitted some trade disadvantages to take place against us. It didn't make that much difference at the time. We also began to pick up more of the check for the defense of the free world. You see, these countries had been occupied earlier, and we didn't have much of a foreign exchange problem. When you stop what you might call the occupation and begin to do this on a cooperative and allied basis, we still paid for it. That is, we began to pay for it--we didn't live off the economy so to speak. In addition to that we began to get a rise in tourist outflow. And after 1956 we began to get a capital outflow because the world was a better place to invest in. We suffered some competitive disadvantages. Our costs were getting out of line. We didn't have to worry about that up until about 1957 because we were the only place they could get goods anyway, and they bought it. But after they built up their own industrial plant their costs were kept more constant and ours rose. We got into a competitive disadvantaged situation, as well as being in a basic trade disadvantage by the rules of the game--the GATT rules.

The net of this was that the trade surplus in 1958, '59, and '60, while it hung at about three billion dollars, we began to lose heavily on these other accounts--tourism, military, capital outflow. If you're going to come into balance, you've got to either increase the trade account to finance these others losses on the other accounts, or you've got to do something about the other accounts.

We were also pursuing, and quite logically so for domestic purposes, a fairly easy money policy, which meant that it wasn't as attractive to put your money in the United States--it didn't earn as high a rate of return as it could elsewhere. It no longer was the only safe place to put your money. It wasn't a question of it losing its safety, but there were alternative places that were regarded as safe and where you could get a higher rate of return.

Beginning with President Kennedy, a program got underway to do essentially two things in the very early '60's: to try to cut the costs of government expenditures overseas--the foreign exchange costs, and to follow a monetary policy in this country that wouldn't lead to such low interest rates (and consequently would attract some foreign funds into this country); and to stimulate the economy through fiscal policy rather than with just easy money. It was a recommendation that came out of the European economic schools, and agreed to here. Walter Heller talked about tight money and loose budgets, and this was the prescription to both expand the economy and compensate for some of the balance of payments loss.

M: And the tax cut fits into this?

D: That's right. The tax cut that was introduced in 1962 fits in with this. We also took some steps on taxes to try to stimulate investment in this country by changing the depreciation reserve requirement, and putting in the investment tax credit. Both of these were designed to stimulate investment in the United States. In 1963 the Interest Equalization Tax went in because foreigners were borrowing--this is a great big capital market. Savings are high. It was a favorable place to borrow; you can borrow in big chunks; you don't have to queue up behind and get permission from a central bank. You had to observe the rules of the SEC and so on, but those are designed to protect the borrower and the lender and not to protect the balance of payments. So it was easy to borrow.

We put the IET into effect--it actually didn't pass until '64 but it was retroactive in its impact--in the middle of '63. That in essence raised the borrowing costs to a foreigner in a developed country in our capital markets by one point. And that choked off some of the borrowing from the American capital market without affecting the domestic interest rates. That was what it was designed to do. A year later in early '65, that was extended to long-term bank loans defined as more than one year. And it reduced the volume of bank lending overseas on long term accounts.

In 1965 when President Johnson came into office, there was a much more broad balance of payments program that went into effect. There was a voluntary program to limit direct investment overseas. There was a voluntary program to reduce bank lending overseas on top of the Interest Equalization Tax. The program for the IET continued. Essentially these were capital measures. And a strong effort was underway to further cut government expenditures overseas, basically to cut military expenditures overseas. All of these things worked, and we were using fiscal and monetary policy in the way I described--tighter monetary policy and a somewhat looser fiscal policy. These things worked reasonably well, but Viet Nam came along.

We had increased our trade balance to a level of about five billion dollars between 1961 and 1964. We were operating with the advantages of a slower economy, less pressure on prices, less pressure on costs, and so we really restored our competitive position. And the trade balance went up. Beginning in the middle of 1965, we began to see some decline in the trade balance as the economy got hotter, and we began to lose some of our competitive advantage. It became easier to sell in the United States because we needed the goods, and we were beginning to push the economy to a higher level of activity. It became less attractive to sell abroad on the part of the United States producers because they could sell everything they made in the United States. Now, that's an over simplification, but in a rough way [explains it].

So that it between, in 1965-66, and '67, we saw the trade balance come down steadily. In '67 it was three-and-a-half billion dollars, and we were back about to where we had been in the 1950's and the early 1960's as we sort of lost competitive position. We still suffered from the trade disadvantages, the border tax, export-rebate kind of thing, and we were finding it progressively more difficult to build up the trade balance.

Then we also were suffering greater foreign exchange losses direct because of Viet Nam. Our total military expenditures were going up. The capital controls programs that had gone into effect in early '65 really were a life-saver at that time. They curtailed the flow of funds from the United States abroad on direct investment and from financial institutions. In those two years consequently, '65 and '66, despite the fact that the trade balance dropped and despite the fact that the military foreign exchange costs were rising, we did better than cut our deficit in half. It was 2.8 billion in '64, and we cut it to I think it was 1.365 in '65, and approximately the same figure in 1966.

In '67 with the trade balance shrinking further, the military expenditures foreign exchange costs rising further, the capital controls continuing to work but with some leakages, and all of the international monetary system upset, particularly the British devaluation, we went backwards. Now there were some special factors in that year on the balance of payments side. The British converted something like five hundred million dollars of stocks they held in this country and took that money back to England, and that affects us adversely on the balance of payments. So we had a balance of payments deficit of 3.6 billion.

So on the 1st of January 1968, the President put in a new program that was in its design pretty completely comprehensive. In its execution to the extent that it was activated, it was comprehensive also, but not all of the segments of the program were activated. I like to look at it as being in two pieces. What I'd call a general piece and which the President called the first order of business.

He recommended prompt enactment of the surcharge, which he had recommended six months before but which the Congress hadn't acted on; the elimination of strikes in key industries that affected the balance of payments; and better wage price restraint. In other words, that's what you'd call the demand-management side to keep the economy from being too over-heated.

The other part of the program aimed at specific segments of the balance of payments. There were what you might call five figures to it. Two of them were capital. One was a continuation but with tightening of the federal reserve program to arrest financial flows; the second was a mandatory program and a consequent tightening of that to limit the flow of funds out of the United States to finance direct investment overseas. In this program there was never an attempt made to reduce the total volume of direct investment overseas by American firms, but an attempt to shift the financing abroad so that when they wanted to build plants and equipment, they would borrow more money overseas to finance this.

M: You mean an American steel company wanting to build a plant, say, in Japan--

D: Well, it wouldn't necessarily borrow Japanese money, it just had to borrow it overseas--it borrowed a lot of it from the Euro-Dollar Market. It might borrow it from Germany to finance a plant in France. It was a question of getting the money overseas.

The net of those two programs was a very substantial saving in 1968--a major reduction in capital outflow. The proof of the fact that this didn't really arrest investment overseas is that our dividends and our returns on investment continued to rise. Our estimate for 1968 is that that totalled 8.2 billion returned on our investment overseas--two-and-a-half billion dollars more than it had been in 1964 hen these programs started. So it hadn't really cut back on the volume of investment, but it had arrested the financial flows.

The other thing that happened in '68, we began to get some real benefits from some programs that had begun earlier that attempted to attract foreign capital into the United States. There's a thing called the Foreign Investors' Tax Act which would make it less onerous for foreigners to invest in the United States. It didn't really give them tax breaks against American citizens, but it removed some tax barriers that they suffered as against American citizens. We began to see late in 1967 and it continued to grow in '68 an inflow into American equities, people buying American stocks. American Mutual Funds went overseas and began to sell, as American firms can, very hard, and they bought a lot of American equities in that form--mutual funds. An Italian friend of mine talks about selling mutual funds to Calabrian peasants, who are notoriously not very wealthy.

That, plus the American company borrowing overseas, which counts as a capital inflow, accounted for about a four billion dollar inflow into the United States. Stock purchase was about two billion, purchase of American bonds by foreigners to finance this foreign investment about two billion. On top of that, we worked very hard to get foreign governments to offset our military expenditures, purchasing equipment where it was possible but where it was not possible, to purchase non-liquid securities of the United States.

And that financial neutralization program to offset military expenditures brought in a billion-and-a-half dollars in 1968.

M: Did this just start in 1968?

D: No. We had been working on this since the fall of '66. But it really got to be pretty big-scaled in 1968.

M: So that cuts down military expenditures?

D: That's right. But it's really a capital inflow, you see.

Now in addition to that, a number of governments attracted by the higher interest rate structure in the United States and looking at their own reserve positions, and partly I think some of them designed to try to compensate for some of the military expenditures that we were undergoing overseas, although not directly linking it to a military offset, lengthened their investments in American banks--certificates of deposit, in various kinds of securities they bought in the United States with the technical result that that began to be counted as capital inflow. You see, if you hold a certificate of deposit in an American bank that is over one year by definition, that is a non-liquid security. If it's under one year, by definition it's a liquid security. Now there obviously is not much difference between something that's eleven-and-a-half months and something that's twelve-and-a-half months. But that wasn't really what they did so much. They went from what you might call a CD of three months to one that in some cases was as long as three years. The interest rate return was more attractive, and I do think they wanted to make a cooperative effort at the same time. That brought in quite a lot of money.

And finally American corporations overseas repatriated some of the funds they had on deposit overseas and brought it back to the United States. The rules of the foreign investment program required them to keep within certain limits on the amount of funds that they had overseas, and they brought that money back home. Now all of these things provided a very substantial inflow of funds into the United States. Some of it I think resulted from the unrest in Europe--the riots in France and elsewhere. It had made the United States look safer again than it had been for some time, relatively safer. That coupled with the high rate of return and the prospects for the American economy brought investment into this country. So that we balanced our accounts this year with a slight surplus, despite the fact that the trade balance went to the devil. It looks as though it's only five hundred million plus, as against three-and-a-half billion last year and as against six-and-a-half billion back in 1964.

Now this is not, I think, the ideal way to balance our accounts. There's nothing immoral about it, and there's nothing unsound about it, but the United States ought to have a bigger trade balance and consequently be able to be a capital exporter rather than to do it in reverse. We oughtn't to be a net capital importer.

But I think the lesson of '68, if I can close on this note, is this, the lesson of the programs for the last four years: it is not possible, given the position of the United States in the world, to reduce our net military expenditures overseas by very much. You can cut them back when Viet Nam is over, but under the present system you can't. They're undertaken primarily in defense of the free world. Fiscal and monetary policy, general demand management policy, isn't going to do anything about those. Therefore, it is highly important that you neutralize those foreign exchange costs, first, and most preferably, by having the host countries assume the foreign exchange costs of the expenditures incurred in the common defense. There is no earthly reason why the sheer accident of geography should give, let's say, Germany a billion dollar windfall and cost the United States a billion dollars on its balance of payments because the defense of the West happens to require troops in Germany. The Germans agree to this, incidentally. We quarrel some about amounts, but the principle is quite clear and it's expressed in a NATO ministerial statement. Preferably from our point of view, it would be useful to have countries where these things occur, assume some of the expenses of this cost. Secondly, they ought to buy military goods and services as a clean offset. Thirdly, to the extent the other two didn't balance, you ought to continue with this financial neutralization program. And our goal should be to steadily reduce the foreign exchange costs of our military.

Now, I'm not a military man, and I haven't gotten any real competence to judge whether we need more troops here or less troops there, but what I do believe is that we should not be constrained by pure balance of payments aspects in determining what our military posture should be. We should adopt a military and a governmental posture that is essential to our position in the world and our politics. Then we need to seek ways to remove the foreign exchange constraint through these various forms of neutralization. Unless we do that, we face a problem which we can't cope with in any other way than a political decision--a problem of foreign exchange drain from this source.

We also suffer a massive outflow on tourist account. You can't keep Americans--high-income country residents--from travelling, and you shouldn't. But what you should do is try to get some other people over here to offset some of the costs. We never worked at this very hard. There are a hundred different ways in which you can attract tourists to this country, and a task force under former Ambassador McKinney has written a pretty detailed report on how to do this. It needs some financing. But we spend--my recollection is --something like three million dollars for the United States governmentally to attract tourists into the United States, and I think Denmark spends thirty million to attract tourists to Denmark. We need to do more and plan better to get some of them over here.

If we are able to cut the tourist deficit, or the deficit on what I call services account, or even to just hold it where it is at the present time, which is a two-and-a-half billion dollar drain; if we continue to have government capital and grant exports of capital of the order of about three-and-a-half billion, and I don't see any other way we can do except that, and if we were at best able to reduce the military deficit to a billion dollars, then a trade balance of seven billion would balance those accounts but it wouldn't leave any room for capital export. So what you really have to do is to work very hard at keeping the economy running at a good gait so that it maintains a good trade balance, [and] continue to try to get capital inflow from abroad into the United States' gross. If you can do both of those things you will be able to export more capital gross, but we won't be able to export as much capital net as we did back in the early '60's. I think this is a perfectly viable position, perfectly responsible position for the United States to get into. But you've got to run the economy well, we've got to get rid of some of these trade disadvantages, and we've got to work harder at these various programs.

M: What happened to the travel tax?

D: I stopped with my two fingers on capital, didn't I. There were three other aspects. One was the reduction of government expenditures overseas--I've already spoken about that on this military neutralization. The other two things were, one, to remove trade barriers --non-tariff barriers to our goods abroad, and I've really spoken about that too to some extent. The third was to reduce the tourist deficit. Long run, in a way of attracting tourism to this country --Ambassador McKinney's program. Short run, to reduce the tourist outflow in 1968 and 1969 to as low a figure as we could.

M: That would be a temporary--short-run.

D: That was temporary. We suggested a travel tax on expenditures of American tourists in Europe in effect. The Western Hemisphere was so that the Orient was covered too, but the big outflow was to Europe. The tax would have operated on a progressive basis so that an American tourist abroad would get an increasing rate of tax, the more money he spent abroad. It was never intended to keep anybody at home necessarily. If you went abroad and you had budgeted thirty dollars-a-day, a tax of five dollars-a-day on that thirty dollars would cut your expenditures abroad down to twenty-five dollars. And that's where the foreign exchange costs comes in what you spend abroad. That tax was designed to save us five hundred million dollars on the tourist deficit. The Congress didn't like it very well, nobody seemed to like it very well, and consequently it didn't get passed. We had finally a little fall-back position, which was to have a 5-percent tax on foreign tickets, which was the same as domestic ticket tax--foreign airplane and ship tickets--which would provide money to finance this longer range program in attracting tourism to the United States. That didn't get passed either.

So that in summary on the '68 program, you could say that the direct investment and the bank outflows, both programs that went into effect the 1st of January worked fine. The big demand management program and tax program didn't go into effect until mid-year, and our trade balance went to pieces. There were some other factors too, but that was I think a major one. We didn't get anything on tourism. We did very successfully carry out the reduction in the net cost of government expenditures overseas, and we benefitted from the program designed to suck investment into this country from abroad, to some extent I expect from the unrest abroad. So that we got a pretty fantastic net inflow of capital which more than offset the trade decline, and we really improved our balance of payments by somewhere between three-and-a-half and four billion dollars just in 1968. The developments were sound, they're not fragile, I'm not sure they can be repeated in this amount, but we need to continue to get that sort of capital inflow as well as to improve the trade balance and to continue to neutralize these foreign exchange expenditures. I think then we're in a reasonably sound position.

M: What kind of opposition did you get on this travel tax?

D: We got opposition from everywhere. I think a good many people who opposed it didn't understand it. And they kept talking about it as an exchange control, which it wasn't--it was a tax measure. They seemed to think that what it was designed to do was to keep people from travelling abroad. It wasn't designed to do that. It was designed to keep them from spending so much abroad. Now if they didn't travel abroad at all, it obviously would save money. But it's just a sales tax on expenditures, is all it is. And theoretically at any rate, if you put a sales tax on and it's high enough, it retards the level of expenditures on goods and services. That's what this was designed to do, but it was to retard expenditures on goods and services abroad. I think it was reasonably well conceived, could have been implemented and executed, but nobody liked it.

M: There would be no accounting problem in this?

D: I don't think so. Some problems, but not all that many. But that wasn't the basic reason for the opposition. The basic reason for the opposition was the philosophy that you shouldn't interfere with people travelling abroad. [It is] a proposition to which I subscribe, except we needed help in 1968, and on this one we didn't get very much.

M: Was the idea of dropping the amount of goods you could bring back tax free--

D: That's part of the program too, but there wasn't a great deal of saving in that. I've forgotten what the estimate was--forty to fifty million dollars. That's another difficult area. There's nothing that I know that's God-given that says an American should be able to buy overseas and bring in goods duty-free that he has to pay duty on in the United States. As a matter of fact, I don't know a single country that doesn't have a very low exemption on this thing--something like twenty-five to thirty dollars. We, when we were trying to stimulate foreign spending overseas to help other countries to adjust their balances of payments favorably--you could bring back five hundred dollars worth. We cut that back to a hundred dollars wholesale, which is about a hundred and fifty dollars retail, and then I guess finally it got cut back to a hundred dollars retail. It's still a pretty generous allowance, and if it had been cut back to where we wanted it to be cut back, we would probably have picked up--maybe it's more than fifty million, I don't recall precisely--it was not a major item of saving in the balance of payments, but it was one that we thought would have been useful.

M: Let me ask you about this pound devaluation late in '67, which was followed by a gold crisis in late '67, and then another one in the spring. How do you go about containing that devaluation of the pound without a round of devaluation currency elsewhere in retaliation?

D: You understand that the pound has been under pressure for a long, long time.

M: Right.

D: And there were a whole series of what you might loosely call rescue efforts mounted to keep the British from devaluing the pound. In a pure sense of economics, most people didn't think that the pound needed to be devalued. But you've got a major confidence crisis with sterling about every fall on the fall, so to speak, and there was in '64, '65, '66, and then it culminated in '67 with the devaluation. Given the fact that the sterling had been talked about in the international financial councils and so on for so long, there had been--the best way I can put it--a sort of a tacit understanding among the big countries that if sterling did have to go and it didn't go by more than so much, nobody else would move. Now, there wasn't any signed contract on this, but it was pretty well understood that none of the members of the Group of Ten were going to move their currencies because the British did.

Maybe the 2.80 rate was sustainable; it obviously as of mid-November of '67 proved to be unsustainable on a confidence sense. When you change the value of the currency you have to take care of not only the economic problem, but what you might call the credibility problem because if you devalue by a little amount, everybody thinks you're going to do some more later on. So it has to be big enough to be credible, and it has to be big enough to take care of not merely the economics at the time, but some of the leakages that you get in the form of price increases in your own country that flow from it. And it was generally agreed that if the British didn't do more than 15-percent, that was a modest and logical change in the parity of the pound--they did 14.3 by reducing it from 2.80 to 2.40, and that no big country was going to follow. With that general sort of agreement, tacit as I say, and the other countries with the United States would furnish additional credit to the U.K. in order for them to support this new rate, this was put together very quickly. And over the weekend of the British devaluation, there was a command post operation out of the operation room at the state department which got in touch with most of the other countries of the world that are important to be sure that nobody was going to move his currency.

M: Everybody hold the line.

D: Everybody holds the line. And I've forgotten how many countries actually devalued--it was a very small number. I shouldn't really say that some countries are important and some aren't, but the only important country that changed its parity was Denmark, and it did it by about 9-percent. The countries that went along with Britain were mostly the ones that were in the sterling area and had to do it sort of laterally to follow the British thing. There were only one or two outside--Spain was another important country that devalued. It devalued by the full amount. But on the whole nobody else changed very much. It was probably--because the sterling is still an important currency--the best contained devaluation in history. And even so, the consequences for the gold market were horrendous.

M: Before you get into that, did this devaluation solve the British problems?

D: It didn't solve the British problem because the British have had problems ever since that time. It provided a basis for a solution of the British problem. I think that in retrospect the U.K., knowing it had to have an austere program to make the devaluation itself stick, waited longer than they should to put that austere program fully into effect. Part of this is no more than tradition. But the British budget goes in in the spring of the year, usually in April. They advanced it by about a month. What they really should have done was put their tax measures in in November. Now there are lots of political problems with this, and we ought to be the last people in the world to tell somebody else to act fast on taxes. But nevertheless, they should have done this. In retrospect all the measures they're presently doing now would have been better done had they done them more quickly. I think had that been done, you would have found the British economy and the British balance of payments responding more rapidly than it did, because you had a period of about a year where you didn't really see much response.

It now looks as though the British are making some net gains. I'm sure that our program to bring ourselves into balance made it harder for the British to bring their payments into balance too. But they've had a lot of credits--the countries of the world have been pretty responsible in this respect. There was a set of credits set up at Basel just this last summer--the so-called sterling balance credits. The U.K. is reasonably well buttressed with international financial cooperation now, so if they can make the basic economy program go, they ought to get along all right. But it's still a sensitive area in terms of confidence--not in terms of economics so much, but again still in terms of confidence.

But as a result of the British devaluation, while it was better contained than anything else, it scared a lot of people and destroyed some faith in currencies as a whole. And so you had a run into gold, because this is where people go when they get scared.

M: Is there any sense in that?

D: No, not a bit.

M: It's all a matter of confidence in other words?

D: If you look at it this way, people that are holding gold because they think there's going to be an increase in the price don't have any sense at all in my judgment. It's a sterile investment, it earns nothing; and if you hold it long enough without any income, you incur not only storage costs and interest costs, but also you incur a loss of income. And anybody who holds an investment that doesn't appreciate and doesn't yield any rate of return has really got a basically bad investment. But if you're frightened of your currency and you think it's going to go down in value, any sort of an investment that isn't going to go down in value may be an escape for you. And gold by tradition holds its value pretty well.

M: And it might be another currency.

D: That's right. It might be another currency, but on the whole people tend to glom onto gold because they think it's more safe. So that a lot of people that were buying gold weren't necessarily looking for the price to increase--they were just a little scared that the currencies they held might decrease or depreciate in price. The very facts of preceding devaluations which had caused a chain reaction caused them to want to get out. And if you can buy something that will hold its value and keep you from suffering a 15-percent loss on what currency you've got, from that standpoint it's a good investment. It may not yield you anything, but it isn't going to yield you a loss probably.

M: Who are these people involved?

D: They range all over the place. They weren't--at least to any extent that we know of--they weren't Americans; they weren't really English; they weren't Dutch, because there were rules against nationals of those countries holding gold. They ranged from French peasants to Canadians, to Swiss, to all sorts of people who sort of instinctively go into gold. Certain banks sold relatively small gold bars to people who just hold them for hoarding purposes, to protect themselves.

Again, I don't think they're buying much of this for appreciation but just for safety's sake. Then there was a whole bloc of people who thought that the price might go up. This had been one thing that developed in the '30's when you wanted to do something with the international monetary system. And they were gambling on this, and the gold interests were pushing this line.

M: Those are the speculators?

D: Those are the speculators. Then there were people who used gold in their industrial work, and I wouldn't say so much for speculating but were hedging. They were buying as much as they could to keep an upward price. The net of it was we had run since 1961 a gold pool in London. I shouldn't say we, because I think the Bank of England actually ran it, but we were the principal shareholder in it. There was a gold rush in late 1960 and early '61 because with the change in administration, the rest of the world began to wonder whether or not the United States was going to increase the price of gold. We were the only ones who could do that. And until, and even after, President Kennedy made an absolutely dogmatic statement that he wasn't going to do this--when he was President-Elect, I guess before the election, after the election, and then again in February 1965--there was a demand for gold in the private market and directly by central banks from the United States.

That quieted down but it was decided by eight big countries, all of the Ten except Japan and Canada and Sweden plus Switzerland, that they'd operate a gold pool to smooth out fluctuations in the London market. They would buy gold when the supply was too great, and they would sell gold when the demand was too great. There wasn't much of a kitty put up on this thing. I think it was two hundred and seventy million dollars for the group of which the United States put up half and the others their proportionate shares roughly related to their overall reserves. In 1961 we were in rough balance on that account. That is, we bought about as much as we sold. In 1962 we were in rough balance. In 1963 and '64 we picked up about a billion and a quarter in gold. Obviously there was too much supply. And if we hadn't taken it off the market, the price would have dropped. In 1965 and in 1966 up to devaluation, we'd lost about five hundred million. On net, given the whole period up until sterling devaluation, the pool was ahead by something like a billion dollars. We'd taken that much off the market to maintain the price.

But when people began to run into gold, the big central banks --the gold-pool countries--had only two options. One was to continue to supply gold in the hopes that the speculative trend would break. This is the classic method of meeting any speculative run. If somebody comes into a bank and wants to draw out his money, you pay him. And if you do this enough, you may lose some deposits, but you stop the run. This method looked as though it were working. The gold-pool countries were resolved--they weren't going to raise the price--to meet this issue by supplying gold in the quantities necessary to hold the price at thirty-five. And there were periodic rushes. We lost a lot in the week following sterling devaluation. The pool met at Frankfurt Thanksgiving weekend, issued a statement that it was going to meet any demand in the market, and the demand fell off. We lost five hundred million in the week before the meeting, it went down to something like a hundred million in the next week. Then it built up again. And we lost some more. And there were various statements made, but it wavered back and forth.

Even though it had been very quiet in January-February, by March the demand intensified, and it became evident that the speculative fever had really taken over, and that it was no longer a practical possibility to break that run by continuing to supply the gold. Actually, the supplying of gold seemed to be adding to the speculative fever at that time. We lost eight hundred million dollars in gold in four days just before we closed the market in London.

Now the other alternative was to stop supplying gold to the market which we hadn't done before 1961 anyway, and just to reserve the monetary gold for central bank reserves and let the private market price do whatever it did in terms of basic demand and supply. That was the decision that was taken on the 17th of March here in Washington at the meeting of the gold pool countries in the so-called Washington Communique. At that point the central banks said they had enough gold, and they weren't going to buy any more, which took one factor of the demand out of the market. They also said they weren't going to sell any more in the private market. That took that supply factor out. The normal industrial demand for gold, plus what you might call nominal hoarding, not for gold price depreciation but just for safety's sake--Indian peasants, French peasants, etc.--probably is less than a billion dollars a year. Gold supply is about a billion-four. There ought to be a balance between supply and demand and no upward pressure on the price if the central banks got out of the market. Plus that you had three billion dollars of overhang because that's what the private people had taken out of the private market in London during these gold rush periods. So that there was a two-tier system established.

Now there was one other potential source of leakage. Since the whole base of the international monetary system rests on a dollar that is convertible into gold at thirty-five dollars an ounce, a fixed price, and other currencies which are convertible into dollars at the proper parities, it was always possible for a country to come to the United States and buy gold at thirty-five dollars an ounce and have us on our commitment, and then to turn around and sell it in the private market at a profit. This the gold pool countries said wasn't good practice. Therefore, so said the so-called Washington Communique, any country that was going to try to arbitrate was sort of outside the lodge, and the United States was not compelled to sell it gold.

Now this raised a nice delicate question as to how convertible the United States would be under the system, because technically we respond to any proper request for gold. But the powers that issued this communique asked for cooperation, and almost all of the countries in the world said they wouldn't do this. And as far as I know, nobody has done it. So we sort of licked the arbitrage problem without ever refusing anybody gold. If anybody came in for it, we gave it to them. We did say to them when they came in, "You understand the rules of the Washington Communique, and we understand that you're not buying this gold to sell it in the private market." They didn't really have to answer that question, they understood it, and were all pretty cooperative.

The second big exposure was if they got nervous about the price of gold and were holding dollar balances, if the free market price went too high and there was any possibility of the official price being changed, a country that held dollars (it's finance minister and its central banker) might be in a very difficult political situation if they just sat back and said, "Well, we won't buy gold at thirty-five even though the price may rise." Now that, we've had very little of. I'm sure there were some purchases of gold by some small countries that did fear this, but they weren't all that big. And on the whole the two-tier system has worked very well.

M: Is it a key point here that we keep assuring people that the thirty-five dollars per ounce price will be maintained?

D: Yes, it is. It's an absolutely crucial fact. As long as the other countries of the world are assured that the United States won't let the price of gold officially change--and we've got a veto on this so that it can't be changed unless we concur in it, and the American Congress is convinced that it and it alone has the power to do this --then people will hold the dollar balances and won't come in and convert them. If they have any feeling that we might waver on this, their course of prudence would be to convert the dollar balances as long as the Americans continue to convert gold into the dollar. Our only alternative in that case would be to suspend gold convertibility, which would be a shock to the system. They don't want that to happen because the system works better as it is. Therefore, acting responsibly, they won't come in and convert dollars into gold except in rare cases. But if they really thought that we were going to change the price of gold, it would be terribly difficult for the Germans who sit there with something like four billion dollars and the Italians who sit there with two, and other countries who sit there with big dollar holdings to have their fellow central bankers and finance ministers and the people in their country point their fingers at them later on and say, "You people were just stupid; the price of gold has gone up, and you knew it was going to go up, and you sat there and didn't get the thirty-five dollar price." So it's a delicate balance, and that's why it's important to have that assurance in the markets.

But the market itself has performed I think quite well. Its high point which just occurred recently went up to $42.75. For the most part, it has floated between about $38 and $41, which is not enough to stimulate the kind of conversions. Almost all of the countries of the world have acted responsibly in this respect, and I would say that with some notable exceptions, no central banker or no finance minister wants the price of gold to be increased. South Africa quite obviously would like the price of gold to be increased. It's its major product for exports. It consequently has been eager to have the price go up. There are people throughout the world who think that this would be a good thing to do too. Some of them because they hold gold on speculation, some of them because they just believe it's good economics. But the overwhelming bulk of central bankers and finance ministers would be opposed to this, in my judgment. If you want a number on this, out of 111 members of the fund, I expect --and I won't try to even identify any more than South Africa because I don't know who they are--but I guess that maybe 108 would be in favor of not changing the price of gold. Maybe there are three that would be in favor of changing it. And I don't know who they are except for the South Africans.

M: Was there anybody in particular who was responsible for the development of the two-tier idea?

D: Carli of the Bank of Italy has been given I think most of the credit for this, and he deserves most of the credit. He didn't like the gold pool that was started back in '61. He has felt that we should depend recently on the presence of the new special drawing right to meet the need for reserves. And he's the one who basically advanced the idea of the separation; he advanced it back in November at the Frankfurt meeting. I'm not sure it would have worked as well at that time as it did when it actually went into force, because by the time it went into force you could see the SDR on the horizon. You could see that the need for reserves could be met through the new SDR. That enabled the gold pool countries to say with confidence they didn't need any more gold--they'd meet their reserve needs with this new international reserve asset. They no longer wanted to be enslaved to the vagaries of a monetary system that went up and down depending on the supply of gold and the speculative demands and so on; so that if you could insulate the gold in the monetary system they were perfectly happy.

M: How does Carli spell his name?

D: C-a-r-l-i. Guido Carli. He's one of the real great central bankers of the world.

Now, the two-tier system is vulnerable, as I say, only if central banks try to arbitrage, and that I don't think they'll do; or if they lose confidence in the United States' determination to hold the official gold price. So it has gone along very nicely for I guess eleven months now--ten months now, and I see no reason why it can't continue to go along nicely as long as they have confidence in the

American gold commitment.

It is also important to recognize that with the United States' balance of payments in equilibrium on the liquidity basis, and in surplus on the official settlements basis, that dollars aren't being pumped out. So the exposure so to speak is not as great as it would be if we continue to have a deficit. The fact that the United States seemed to be getting its economy into better balance through the tax measure, the fact that we have come into this balance of payments position, strengthens confidence in the American gold commitment and its ability to carry it out. I think it probably is more than coincidental that when the figures on the American payments position became known--yesterday, really, or the day before--I guess the President's State of the Union message--that the gold price fell in the free market. It had gone up before that time. It had jumped up to this very peak, this 42.75; I think it's back down to something like 41.90. And it's interesting also that the press attributes some quotations to the Swiss bankers who say they're perfectly willing to sell the gold at 42.50 because they're sure they can buy it back cheaper. So that that would indicate that there's some strength in the two-tier system also.

M: Where does the gold cover limitation fit in?

D: The gold cover limitation was more of a symbol than a fact, but when the American gold stock began to drop it became a difficult fact to face. 'Way back the United States Federal Reserve legislation said that you were to keep 40-percent in gold against notes and 35-percent against deposits. In World War II that was reduced to 25-percent. In the spring of 1965 the cover was taken off deposits and left only on Federal Reserve notes. But it did lock up close to $10,000,000,000 in gold reserve. Now when we had $25,000,000,000, that lock-up didn't mean very much. When you got close to the marginal point, it could have stimulated gold conversions also on the simple ground that maybe you ought to get in line first if there was a cut-off point.

Now it was always perfectly clear to the sophisticated central banker that the Federal Reserve could suspend the provision, but in suspending the provision it had to, after a time, increase the discount rate, and it might not have been pertinent at the time to do that for economic policy reasons but it would have been forced to. It was also perfectly apparent to the sophisticated central banker that the domestic currency supply was going to rise, and that in time without anything else happening, the increase in currency was going to absorb all of the free gold that the United States had and more than that, because you just have a natural rise as the economy gets bigger. And it was perfectly obvious also that as long as the American Treasury kept supplying industry with its needs for gold, over and above its production in this country, that that was going to be a drain on the gold stock. So that at any given point in time you could sort of compute when you were going to run up against the ceiling, and it was going to be difficult to handle.

It became quite important after the gold rush had taken so much of the gold from us to make perfectly evident to the world that this reserve constraint was not going to keep us from paying out gold for legitimate monetary purposes. And the removal of the gold cover

I think was a major step that way. It wasn't until that gold cover was removed that we thought it would be possible to close that London market and establish the two-tier system, so the two went hand-in-hand. We would probably have closed the market a day or two earlier had the gold cover legislation gone through earlier. What could have happened in that case was that it wouldn't have gone through in the excitement and all the rest of this that was going on, and we would have been in a less credible position to honor our convertibility commitments. So that's how that ties into that story.

I don't know whether it could have been done or not. But in retrospect, we should have gone down in 1965 for removal of both the note cover and the deposit cover. But at the time it didn't seem practically possible to get both off.

M: Did you have a hard fight in Congress over that?

D: Yes. It passed by very slim majorities in both House and Senate partly because I guess there was just the mystique in gold, partly because some people didn't want us to be in a position to pay out any more gold. I don't think anybody wanted to have the price of gold raised. I don't think that was an issue, but it's a technical matter and you get all sorts of people saying that you may destroy the value of the currency unless it's backed by gold, which is absolute nonsense but nevertheless is believed.

M: And since you can't get gold--

D: That's right. But it wasn't an easy job; it was a difficult job to get done. But now it is done, and we're in far better position. Our entire gold stock is at our disposal to meet our convertibility commitment, and we gained gold incidentally, partly because of the

French problem. We've gained gold net from the time the two-tier system closed in spite of the fact that there were some conversions, as I say, out of nervousness, because of the sterling devaluation where they were trying to diversify their reserves. We're almost two hundred million dollars ahead now than where we were at the time that the markets were closed.

M: Did the opposition in Congress to this, split along party lines or conservative-liberal lines?

D: I'm not even sure it's proper to say they split. They didn't split along party lines, and I don't think it's possible to say they split along conservative-liberal lines. Wallace Bennett of Utah was one of the stalwarts in helping the legislation in the Senate, and he comes from a mining state and certainly is a conservative--a great Senator in my opinion also. But it was split between, I would say, really between those who understood what the problem was and those who didn't understand what the problem was. I don't mean to be invidious in my commentary, but I think that was basically the point. It's awfully hard to explain. As I say, this comes almost into a mystical area and it isn't resolved solely by logic. The ones who were logical were both conservative and liberal, both Republican and Democratic. The ones who were more emotional on it were both conservative and liberal and both Republican and Democratic. I don't think there was any real party division in this at all.

M: Did you have to do some work on the Hill on this?

D: Only in talking to individual senators and congressmen. I didn't carry the testimony on it. I think I was in Europe most of the time that the testimony was going on on this thing. Joe Barr did most of it.

M: You were helping sell the idea to individual congressmen?

D: Yes, the same way we try to sell any Treasury legislation. There's an old Treasury habit that the Treasury doesn't have a major congressional relations staff. It has an excellent one, but it isn't very big. And the Treasury secretary and the undersecretaries and the assistant secretaries have a lot of individual contacts with congressmen on any piece of Treasury legislation. You couldn't possibly cover the Congress with [it]. I think our Congressional relations staff consists of three people; that is, three people who would be in contact with the Congress. It's no major group of troops that you can put down there so that we all do it. Some do more than others, and it depends on the question, but we all talk to key congressmen and senators on any piece of Treasury legislation.

M: Where do the SDR's fit into this picture?

D: The SDR's fit into the picture in this way. Go back to the American deficit which was basically supplying reserves to the rest of the world.

M: There had been talk about SDR's for quite awhile.

D: Oh, yes. I'll get to that in just a second. But the fundamental problem was how were you going to add enough reserves to the world's supply on a more or less regular basis without depending on gold which wasn't going to supply enough, or on an American deficit which made both us and the rest of the world nervous. And the answer to that was that you had to work out some kind of an agreed-upon international reserve asset that every country would treat as being as good as dollars or as good as gold. It would supplement the existing supply of reserves, and they would use it cheerfully and use it willingly.

M: Is it fair to say this is a new medium of exchange?

D: I wouldn't call it that. I'd say it's a new type of international reserve asset which is agreed upon, and that is the way I'd pose the problem.

M: Can you say it's a replacement for gold?

D: No. I don't think it's a replacement for gold or a replacement for dollars or a replacement for sterling. It's a supplement to those. But the existing supply of reserves was a little over seventy billion dollars--gold about forty billion and the rest of the stuff about thirty. If you say that reserves ought to grow--there's nothing magic in this number, but it's a fashionable number--by about three percent a year, that means you need about two billion dollars a year in international reserves overall. If you need two billion a year, and you can only depend on gold at best for about four or five hundred million, you've got to find a billion-and-a-half somewhere. Now you don't want the Americans to be in deficit so that you can't get the billion-and-a-half anywhere.

It's easy to pose the problem. The real problem was to design an instrument that everybody would agree was a good one. Now what you design might look perfect to you, but I would find some difficulties. So the long problem--the long negotiations that we underwent in creating the SDR--were an attempt to hammer out an instrument that everybody agreed would be properly controlled, would not be created in too big or too small an amount, and would be acceptable. And that's basically all the SDR is. You're never going to see one, it's not going to be anything except entries on a book, but countries have agreed in a covenant and a contract that they've signed to take it and to use it.

There are rules for its use. You're not allowed to use it to change the composition of your reserve. That's shorthand for saying this. You don't take SDR's which you get for free, come into the United States and sell them to the United States for dollars, and then use the dollars to buy gold. That's against the general rules of the game. It doesn't mean you can't use dollars to get gold, but it means you're not supposed to use the SDR's for this purpose. You use them to meet your balance of payments needs when you need them. You can do a little reserve composition changing, but you don't do it in a disstabilizing way to hurt the system. Countries agreed to receive and hold SDR's within certain limits. You're going to get these allocated proportionate to IMF quotas. In a numerical sense that means that if you created a billion dollars in SDR's in a year, the U.S. would get about two hundred and fifty million, the common market would get about, as I recall it, something like a hundred and fifty million.

The United States agrees, and the common market countries agree, and so does everybody else in the scheme, that they will receive SDR's equivalent to twice as much as they get through the allocation. So that if you've created a billion dollars, the United States agrees to receive and hold as much as seven hundred and fifty million; the common market would agree to receive and hold as much as three hundred million more than it receives in the allocation. Now it would use them as it needed to. There are provisions called reconstitution provisions--sort of a spend thrift clause, if you want to put it that way which say that no country will keep outstanding more than 70-percent of its allocation in a five-year period. So that if the United States gets a billion-and-a-quarter in a five-year period, it will be able to use whatever 70-percent of that billion-and-a-quarter is and that's its limitation on use. Now it can use all of it in any given year. It can use all of it for as many years as it wants to as long as its average is 70-percent during the period.

There is no basic economic reason for either the holding limit or the use limit. But to get a new instrument started which is untested and untried, it was deemed desirable to put these limitations on so that the system would have confidence in it. I'm sure that over time as this gets greater respectability and greater confidence in it that those limitations will just sort of melt away. You'll find people using SDR's just as they use dollars, just as they use gold--both in the holding and in the use. But initially you need these provisions, and this is part of the problem of putting together a system. So that it's a new instrument, and, as I say, it's universally acceptable. The scheme I suppose ought to be characterized in this way.

No country sitting around the table, whether it was the Group of Ten or all 111 members of the International Monetary Fund, has a scheme that each one thinks is perfect. I'm sure that every finance minister of the Ten is convinced that left to his own devices he could have fixed a better scheme. But the problem here was to get agreement. And it is not a weak scheme. It wasn't watered down to the lowest common denominator. But a provision that the Italians would like was given up to get rid of one that the Germans would like or to get rid of one that the United States would like or to add one in each case. I think it is agreed that it's a pretty good scheme, and is really the way that reserves will increase over the future.

M: Are you in concurrence with the thought that this is a major accomplishment?

D: Oh yes. I have no disagreement with the President's own characterization of this as the greatest step forward in the international monetary system since Bretton Woods. It's the first time that the countries of the world have really agreed on a cooperative and multilateral basis to deliberately increase the international money supply for reserve purposes, if you want to put it that way. You see, fund credits have always been temporary. They have to be repaid. Swap lines are even more temporary. They have to be restored. Gold provided the solid basis as long as it was flowing in in adequate amounts. Dollar balances substituted for the inadequacies of the gold that went out. But the bigger the dollar balance is out, the more our liability position is vulnerable. Now this is underwritten by the world--this SDR--and the liability is the world's liability, not any particular country's.

M: When did the world financial community begin to talk about these things?

D: I can't really tell you that. In one sense you can say that they began to talk about it back in 1945 and '46 when the IMF was invented, because it isn't vastly different from a scheme that Lord Keynes put forth at that time. I shouldn't oversimplify it--it is vastly different, but the germ of the idea was in the Keynes approach.

M: When did this germ start to grow.

D: Along about 1960, '61, a man named Eddie Bernstein began to write about it here, and various other people did. And the initial idea was that only the big countries needed this kind of an asset. They knew each other and you could have one circulate and it would be a sandwich with gold. For every SDR, a piece of gold; and maybe two SDR's and one piece of gold in the middle. And this would make it acceptable. It would be easy for countries to accept it.

As the discussion went on, it became evident that it was a world need and not a need purely of the Group of Ten countries. Then it became evident that you couldn't make this work with a gold sandwich, because a lot of countries didn't have much gold and some countries had a lot, and so you made it no gold in it at all. It's a gold value guarant ed asset, but it doesn't pass with gold. It passes on its own weight.

M: Is there any significance that there was discussion of this, that there was discussion of balance of payments problems, there was a great deal of apparently more work with the Group of Ten all about the same time?

D: Oh yes. Let me put it in these terms. If the United States had not had a balance of payments deficit, you'd have had to do something about this a lot earlier because there wouldn't have been any source of world reserve growth. Having the United States [with] a whopping big balance of payments deficit, which made us and the world nervous, meant that you had to find a substitute for the dollars coming into the system. So that it was perfectly consistent to say, "We need to get something for when the United States comes into balance of payments equilibrium because it no longer has any excuse. It has to pump the dollars out." You needed the forum. You needed the Group of Ten and the Working Party. It was basically a Group of Ten discussion, but as I said the other day, the same people. You needed a forum, and you needed to get to know each other better, and you needed to have constant work being done on this or you couldn't have had it done.

Like a lot of other ideas it originated in what I'd call basic theoretical circles. Gradually as it begins to be looked at by the people that have to operate it, it takes on practical possibilities. It then becomes a question of governments coming to positions on this which leads to a long negotiation and a hammering out of an agreed upon plan. But all of these are critical elements in the process.

M: This would seem to be a major historical milestone in international--

D: It is. And people's views shifted over time. It goes back to discussions that began, as I say, sort of academically in the very early '60's and maybe before that--this newest manifestation. It was discussed in the early '60's. To a certain extent it's true, in which some people asserted including the Americans, that what you needed was more adequate credit facilities--bigger quotas in the fund, that sort of thing. You didn't necessarily need new owned reserve assets.

But it gradually became realized, to put it in terms of an individual person, that it's one thing for me to have an assured line of credit at the Riggs where I bank, and it's quite another thing for me to have $200 in my checking account. And I'm more happy if the checking account goes up to $250 from my earnings than I am in having Lew Jennings say, "I'll lend you $50 if you need it." And so owned reserves were recognized as being more important. Then it was recognized that the rest of the world needed them as well as the big countries. Then it was recognized that you had a management problem on your hands, and how were you going to resolve this thing, and how were you going to create this. What we've worked out in the system is that the managing director of the IMF will make a proposal after judicious counselling and study and so on, and that the countries of the world will come to an agreement on creating X amount of these new international reserve assets in which they'll take into consideration the state of the monetary system, the working of the adjustment process, and all the things one would think about. It isn't going to be very scientific, but the first activation is also going to be a multilateral agreement that you need about so-much.

Now some people will say, "You need four billion a year." Some people will say, "You need two billion a year." Some people will say, "You may need one billion a year." And as you discuss this, you will come gradually to a consensus and a figure; and I don't have any idea what that figure is. But since there have been losses of reserves due to the gold rush and due to the Americans coming into surplus, I suspect that the feeling will be that there ought to be more than we were talking about a year-and-a-half ago when we were talking about the same subject.

M: What's the significance of the Rio conference in this?

D: That just happened to be the IMF meeting where the fund as a whole put its blessing on an outline plan. The procedure on this sounds complicated, it really wasn't. The Ten were discussing this in their meetings; the Fund was discussing it independently in its meetings. They put the two together for a discussion that lasted for a year, and they agreed upon an outline plan. Now it wasn't a legal contract. It was an outline plan. It was presented to the governors of the International Monetary Fund at Rio. They said, "We like the plan fine. Now go ahead and draw up some amendments to the article in legal language that we can vote on."

That took approximately six months, I guess. And in the process of drawing up the articles of agreement, there were other negotiations. Because you had an outline but when you came down to the specific language and the specific provision, you also had some disagreements and some quarrels that had to be resolved. So on the 30th or 31st of March the Ten met in Stockholm and resolved all their differences. Then the IMF board met and resolved all the remaining differences.

M: All this in Stockholm?

D: No. Met by itself, here in Washington. Then the agreed-upon articles went forward. They went out to the governments, and the governments approved the articles, and said, "Now, you can put it to a vote." It's a legislative process. It then goes to the parliaments, and we passed ours last June. Other countries are in the process of passing it, and as of today, as far as I know, there are twenty-nine countries with 47½ percent of the weighted vote that have approved. I expect the Germans to be in any day now. That ought to lift it above the 50-percent mark in terms of weighted vote and make it thirty countries.

Sometime early this year, there ought to be enough countries--you require sixty-six countries or sixty-seven countries with 80-percent of the weighted vote to get it ratified. 75-percent of the weighted vote countries have to deposit what they call, I guess, certificates of participation with the fund before you can formally activate it. Then the managing director, after taking his samplings, makes a proposal. And the International Monetary Fund will accept that proposal. And I think that the proposal that he makes will have been worked out with enough different countries so that it has a reasonable chance of acceptance as a proposal when it's actually made.

That doesn't mean there won't be lots of negotiation, but there will be negotiation before he makes the proposal because he isn't just going to step up and slap down a particular figure. He's going to have consulted, he's going to have analyzed, the staff is going to have done the analysis of course. And in the process of discussions in the Ten, in the Fund, and elsewhere, there will emerge a consensus, as I say, that this is about the right number. Now nobody's going to prove it's the right number, but it's about the right number and everybody thinks it's about the right number. At that point the managing director will make his proposal, and it will then be accepted and at a particular point in time. It'll be for a five-year period, you see. At a particular point in time it will be activated, and then they will credit to the accounts of the various countries of the Fund their pro rata share of the special drawing right, and you'll be in under an international reserve asset business.

M: Do you feel that our Congress understands all of this?

D: We made an especial point of keeping the members of the Congress who are particularly conversant with this area fully informed as we went along with the discussions. We had this advisory committee that I mentioned that Doug Dillon chaired which met with us monthly for a full day, practically every month as we went through this. Particularly Henry Reuss and Bob Ellsworth in the House--Ellsworth then left the Congress, he ran for the Senate, but was pretty conversant with this--he and Reuss made a couple of trips to Europe to look in on this. As a matter of fact the general procedure that we followed in carrying out the final negotiations I think Bob Ellsworth can claim a lot of credit for. In a speech he made on the House floor, he outlined a procedure which wasn't very different from the one we actually fell into finally.

In the Senate we had the leadership in on these matters. A group of people, Paul Douglas when he was in the Senate; Wallace Bennett was made familiar with this; various people on the Foreign Relations Committee technically went into it.

Joe Fowler made a presentation, I guess at the time we went down with the legislation, in which he cited most of the members of the Congress who had made pretty explicit contributions to this. Now obviously it would be absurd for me to say that every member of the Senate and every member of the House fully comprehended all of this. But it went through the Senate with unanimous consent, and it passed the House with a fantastically high vote. I think there were only fourteen votes against it. And I think it fair to say that the guts of the plan most of the congressmen and the senators understood, and the pretty intricate technicalities of the plan, Henry Reuss and Bill Widnall understood pretty well. Bill Moorhead and various others in the House Banking Committee who would be very modest and would certainly disclaim any attribute of technical competence in this field, but they understand it I think pretty thoroughly. And the same thing is true in the Senate.

M: What about with the White House and the President?

D: Well, the President understands this thoroughly. Again, he's not a technician and doesn't pretend to be. But his savvy in terms of this kind of thing is at a pretty high level. He also, I'm sure if you asked him would say, "No, I don't really understand this at all." He understands all the important aspects of this. And he and the White House staff were kept fully informed.

We had this little group I've mentioned in here. Francis Bator of the White House staff worked with it. The President was informed, it's fair to say, every step of the way. Now we obviously didn't run over to him with a change in a word, but all of the important things he pretty thoroughly understood. And I think the proof of that would be found in listening to him talk to anybody about this approach. He could conduct, and you know his ability in this field, he could conduct a real campaign for this. I've heard him lecturing foreign ambassadors on this, and he sounded as though he were a real pro. And I'd say that he's absolutely first-rate in his understanding of this.

M: You've been talking about an hour-and-a-half. I probably should talk to you about taxation. Would you like to go on, or would you like to have another session?

D: I've got to go.

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By Frederick L. Deming

to the

Lyndon Baines Johnson Library

In accordance with Sec. 507 of the Federal Property and Administrative Services Act of 1949, as amended (44 U.S.C. 397) and regulations issued thereunder (41 CFR 101-10), I, Frederick L. Deming, hereinafter referred to as the donor, hereby give, donate, and convey to the United States of America for eventual deposit in the proposed Lyndon Baines Johnson Library, and for administration therein by the authorities thereof, a tape and transcript of a personal statement approved by me and prepared for the purpose of deposit in the Lyndon Baines Johnson Library. The gift of this material is made subject to the following terms and conditions:

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Signed Frederick L. Deming

Date Nov. 8, 1972

Accepted Harry J. Middleton - for
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