

startling figures that has come out has been in the balance of international payments. On the liquidity basis for the first quarter of 1967 the deficit was minus \$2.1 billion dollars but on the official reserve transaction basis it was \$7.3 billion. This is a most amazing figure, although one which in some respects many of us had been predicting, because the surplus shown for the year 1966 came from a lot of short-term money coming into the United States that could go out just as fast.

I am interested in your analysis of this figure as it relates to the problems that you have presented to us in your original paper concerning the availability of funds in the short-term market, the likely future interest rate levels, and so forth.

Mr. GAINES. Your analysis of the reason for the very large first quarter figure is correct. It is an offset to the \$2½ billion or so that U.S. banks purchased in the Euro dollar market in the last half of 1966. With lower rates and availability of domestic funds commercial banks were able to repay a good part of the foreign borrowing and rely upon the domestic market to take care of their needs.

I would not expect that figure of \$7 billion to hold through 1967. Much lower figures are likely.

Secondly, on the effect of our domestic financial problems on the balance-of-payment figures, the credit pressures that I see ahead will at least superficially tend to improve the reported balance-of-payments statistics. To the extent that our short-term interest rates rise significantly, and assuming that the Bank of England is not prepared, given its economic difficulties, to raise the bank rate, we could either slow down flows of short-term funds out of this country or attract funds from abroad.

Representative CURTIS. If our interest rates go up?

Mr. GAINES. Yes. There is another aspect to this, however, that I think is really quite significant. I have indicated that I doubt that Mr. Wilson would wish to raise the bank rate in England to counter a loss of funds because of high interest rates in our own markets here. However, failure to do so could create most serious problems for the pound so that we might find ourselves confronting a situation where because of rising rates in our markets we might force a domestic policy upon the United Kingdom, that is, higher rates in their market, or find ourselves putting the current value of the pound in jeopardy.

So that whereas I think that the credit squeeze domestically will tend to improve our balance of payments I think it could have effects upon our friends in the United Kingdom that we do not wish to see happen.

Representative CURTIS. Do you feel that this is in any sense creating a crisis in the international finance picture considering the position of the dollar as the basic medium of exchange?

Mr. GAINES. I don't really see any crisis problem unless the worst should happen in our relationship with the United Kingdom.

Representative CURTIS. Doesn't the dollar go with the pound if the pound goes?

Mr. GAINES. Yes, I think realistically we have to assume that the United Kingdom presently is on a dollar exchange basis in any case. I believe that what would happen if we were to create the problems that I have suggested would be that the United Kingdom would begin to reuse some of the lines with our Federal Reserve System that they