Chapter V

THE BALANCE OF PAYMENTS ISSUE
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Following the Second World War the United States initiated and continued, through the Marshall Plan and other programmes, an unprecedented series of measures calculated to help rebuild the war-devastated nations of Western Europe. During the years of rebuilding, the United States, through various means, placed dollars in the hands of these nations so that they might be able, in the process of their rebuilding, to buy the services and goods which only the US could provide in the period immediately after the war. Besides economic aid, the United States bolstered the military security of European nations by providing military aid and also by stationing US troops. All these programmes resulted in a flow of US dollars abroad.

The effect of these policies on the United States balance of payments (BOP) began to be felt ever since about 1950 and resulted in moderate BOP deficit in every year except 1957 because of the Suez crisis. American exports were artificially high in the first quarter of 1957, when they were swollen by the shipment of oil to Europe. However, from 1958 onwards, once again adverse BOP continued. The foreign exchange cost of US troops stationed in Europe was one of the main factors responsible for the US balance of payments deficit as can be seen from Table 7:

1 "Directive by the President Concerning Steps to be Taken with Respect to the United States Balance of Payments," 16 November 1960, Text.
TABLE 7
US FOREIGN EXCHANGE EXPENDITURE ASSOCIATED WITH
THE US TROOPS STATIONED IN EUROPE
(IN MILLION DOLLARS)

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross BOP Expended</th>
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</thead>
<tbody>
<tr>
<td>1950</td>
<td>168</td>
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<td>1960</td>
<td>1,638</td>
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</table>

The consistently growing BOP deficit associated with the US troops stationed in Europe did not significantly alarm the Administration or the Congress in the early 'fifties. When the BOP problem persisted along with the domestic recession of 1954, the Administration and Congress focused their attention on early

domestic economic recovery rather than simultaneously taking steps to solve the BOP problem also. Democratic members of Congress suggested federal expenditures on public works for promoting economic recovery. Some Republican members proposed a tax cut. The Administration did not "panic", and President Eisenhower warned of the dangers of "premature federal action." Eventually, without significant federal intervention, the 1954 recession passed off with the "economy's gradual emergence from difficulty," wrote Eisenhower in his memoirs.

Recovering from the recession of 1954, the American economy surged forward. "Between the third quarter of 1956 and the third quarter of 1957, business investment in new plant and equipment went up 27 per cent; manufacturing investment went up 37 per cent." During the same period, however, adverse BOP continued, as Table 7 would indicate. By and large this development did not disturb seriously either the Administration or the Congress. It is noteworthy that neither branch gave serious consideration to solving the adverse BOP through a reduction of US military presence in Europe.

The year 1958 brought domestic economic recession again. Excess of productive capacity, high cost of equipment and wages, high interest rates, a tightening of bank credit, brought on a decline in business investment and the economy started on a downward course. The unemployment rate increased by more than

4 Ibid.
a million, reaching about 7 per cent of the labour force in April. Democratic members of Congress once again proposed federal expenditures on public works to counter recession. Many members of Congress, mainly Democrats and a few "conservative" Midwestern Republicans, proposed a "freeze" on farm price supports for one year. A few other Republicans urged Congress to cut taxes as a cure to recession.

The President once again did not favour federal expenditure, and refused to advocate a tax cut without more "evidence that it would help rather than hurt." Secretary of the Treasury Robert B. Anderson, supported Eisenhower's action by pointing out to other Cabinet members that "built-in stabilizers were helping the economy and warned of the dangers of premature federal action." Federal non-intervention paid dividends. "The clouds of pessimism gradually began to roll back. Between the middle of April and the middle of May unemployment had dropped by thirty thousand.... By June or July...the storm was over," Eisenhower wrote in his memoirs.

During and after the recession, while the BOP problem persisted, the executive and legislative branches did not seek to tackle it by any effort to re-examine the expenditure on maintaining US troops in Europe. Partly because of the Soviet launching of the "Sputnik" and other developments like the Quemoy and Matsu crisis, the Lebanon crisis, and the second Berlin crisis, the year 1958 passed without any significant

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5 Ibid., p. 310.
attention to solve the BOP problem either by the Administration or by Congress. However, in the following year, discussions within the Executive branch commenced on tackling the BOP problem, and the question was raised whether US military expenditures abroad could be pruned.

The Treasury Department and the Bureau of Budget Suggest Troop Withdrawal

In October 1959, during the fiscal year 1960 budget-making process, differences of opinion emerged within the Administration over the prospects of stemming US dollar drain abroad through withdrawal of some troops from Europe. Secretary of the Treasury Anderson and the Director of the Bureau of the Budget, Maurice H. Stans, suggested that the US troops in Europe should be gradually reduced to three divisions. In the Pentagon, the Air Force Department supported the reduction of ground forces not simply for financial reasons but because of its belief in basing European defence increasingly on nuclear-armed planes and missiles. That these important elements in the Administration, including a part of the military establishment, took such a position indicates that the maintenance of six divisions in Europe was not regarded by them as vitally necessary for safeguarding US interests. But the Army and the Navy Departments opposed the troop reductions in Europe.

The Army and the Navy positions were that the United

States and the Soviet Union had reached something equivalent to nuclear parity—meaning that a state of mutual deterrence existed—and that a general war would be impossible. They argued that in such a state of affairs the danger of limited wars had become greater, requiring avoidance of reduction in the conventional forces and enhancing the capabilities for handling limited war situation.

The Secretary of Defence, Neil H. McElroy, initially objected to a reduction of troop levels in Europe according to the Washington Post. But Budget Director Stans overcame the objections by his arguments. Stans told McElroy that one of the ways to make a substantial reduction in the Pentagon budget would be to reduce overseas troop levels, specially US troop levels in Europe. Stans requested McElroy to review the Nato "shield" defence theory under which the six divisions formed part of a ground shield for Western Europe while the Strategic Air Command formed the "sword" pointed at the Soviet Union. Stans suggested that a single American division in Europe would be enough if the United States acted on a realistic acceptance of the "trip-wire" defence theory. The Soviet Army could overrun all six divisions if it wanted to. If American military presence was to serve as a deterrent, would it not suffice if the US kept only one division in Europe? Stans pointed out that a single division in Europe would be enough to exhibit the

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American commitment to Western Europe, and that a Soviet attack on that single division would set off a trip-wire alarm for the entire American military establishment. Why then six divisions, with the heavy outflow of dollars that they entailed?

Stans succeeded in influencing McElroy. Treasury Secretary Anderson also continued to support the reduction of overseas US troop levels, the Washington Star reported. About this time word about what was happening reached the State Department, where it alarmed Secretary of State Christian A. Herter. He strongly objected to any reduction of troop levels in Europe, and did not favour connecting the BOP problem with US troop levels in Europe. He argued that any serious military cuts would create a major psychological problem in NATO, outbalancing the savings in dollars. This was the basic issue, as the State Department saw it.

As a deadlock ensued, the matter was referred to the White House. President Eisenhower rejected the Stans-McElroy proposal for a reduction of overseas forces, and sided completely with Herter. That decision, the New York Times reported, was perhaps influenced by the recommendation of a committee set by the President to study the United States assistance programme abroad, headed by William H. Draper, former Under Secretary of

8 Washington Post, 4 April 1960.
9 Washington Star, 10 November 1959.
10 Washington Post, 4 April 1960.
the Army. It might be inferred that the committee had recommended against any troop reductions overseas. The President's decision was made public by McElroy after a meeting with Eisenhower and Stans on 16 November 1959. He announced that no "immediate" withdrawal of troops abroad was planned. He denied reports that the Army was being asked to bring two of its divisions from Europe or that, in order to effect savings, the Army's role would be altered merely to the fighting of "brush fires." "Certainly we must do nothing to weaken the NATO alliance," McElroy declared.

With a sigh of relief, the State Department informed anxious NATO ambassadors that no change would be made in the US commitment to NATO. On 17 November 1959, Secretary Herter reiterated the commitment in an address to the NATO Parliamentarians conference in Washington. He said:

"Recently, there have been speculations in the press that United States concern with its balance of payments is an indication that it might fail to give adequate support to NATO. In answer to this speculation, let me say clearly that the United States will continue to throw its support to NATO, as the record shows we have always done, since its inception. We shall continue to carry our fair share."  

NATO commander Lauris Norstad conferred with Herter, and declared publicly that no cuts were contemplated.

12 *Baltimore Sun*, 16 November 1959.
The Department of the Treasury and the Bureau of the Budget raised the issue of troop levels again in 1960 when the foreign exchange deficit continued. This time they came up with a new ploy. The New York Times reported that once again in October 1960 an intensive review of US BOP problem commenced during the fiscal year 1961 budget-making process. The Treasury Department and the Bureau of the Budget wanted a policy commitment for a troop reduction over the next three years if the United States continued to incur a heavy payment deficit, and if the European Allies did not help to cut the deficit by assuming some of the cost of stationing US troops in Europe.

That policy suggestion had two significant features. Firstly, the two departments did not propose a specific cut as they did in 1959. Secondly, they indicated that a troop reduction would not be necessary if the European Allies helped to reduce the BOP deficit by assuming some of the cost of stationing US troops in Europe.

The new policy suggestion of the Treasury Department and the Bureau of the Budget put the ball in the State Department's court. Under Secretary of State Douglas Dillon, who was adamantly opposed to a reduction in 1959, was not disposed to fight so hard in 1960. Nevertheless, the State Department persuaded the Treasury Department and the Bureau of the Budget to agree simply that consideration should be given to such a possible reduction in the future if the situation warranted.

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Options and Actions
Discussed In A White House Meeting

As the balance of payments "weakness" continued, Treasury Secretary Anderson approached the President to take urgent steps to stem the drain of American gold reserves. On 9 November, a meeting was held in the White House with the President in the chair to discuss the BOP problem. The participants included Anderson, Secretary of Defence Thomas S. Gates, Under Secretary of Defence James H. Douglas, Under Secretary of State Douglas Dillon, Under Secretary of the Treasury Julian Baird, Chairman of the JCS General Lyman L. Lemnitzer, and Chairman of the Federal Reserve Board William C. Martin. Various options were discussed to solve the BOP problem. Raising the American tariffs and tightening the "custom barriers" were first considered. Anderson and other participants felt that such a course would be contrary to the trade policies followed by the United States for the past eight years, and perhaps would encourage other countries to retaliate in similar manner. So these options were dropped. Imposing an embargo on the export of gold and prohibiting Americans from holding gold abroad were then considered. Such actions, the participants felt, would destroy the monetary system and create a fear of possible devaluation of the dollar, leading to a demand on gold stocks. These options were also rejected.

Finally, another set of solutions relating to military expenditure was discussed--a cutdown in the number of dependents of overseas personnel; reduction of American overseas troop

15 Eisenhower, n. 3, pp. 604-5.
strength wherever possible and practicable; and stoppage of the procurement of foreign-made items for US defence and civilian personnel. As Eisenhower described it in his memoirs, the participants "concluded that this kind of program would be preferable," and the President asked Anderson "to serve as Chairman of a group to prepare a plan of action."

By 15 November, the Anderson group prepared a draft of a Presidential directive. Though a reduction of overseas forces was discussed in the 9 November meeting at the White House, it was not included in the draft directive. From this the inference is possible that the President did not favour the option of reductions. Eisenhower discussed the draft with Gates, Anderson and others. Though Gates did not object to the directive concerning the reduction of overseas military dependents, he was not enthusiastic about it. He told the President that the military services would be unhappy, particularly since it would create morale problems. The Services Chiefs were of the view that retaining dependents was essential to keep career men in uniform. But the President was determined to go ahead with the directives prepared by the Anderson group.

On 16 November, the President issued the directive "concerning the steps to be taken with respect to the United States balance of payments." He said:

A definite improvement in our balance of payments situation is mandatory not only to insure our economic well-being and military security here at home but also to insure that the
United States can continue as a strong partner in the future economic growth and military strength of the free world. (17)

The directive envisaged a reduction in the number of military dependents stationed in foreign soil by more than half—from 484,000 to 200,000—at a ratio of at least 16,000 per month, commencing from 1 January 1961. In addition, the President directed the Secretary of Defense to discontinue the procurement of foreign-made items for American post exchanges and commissaries. The directive also contained instructions to the Secretary of State to induce the European Allies to share the burden of assistance to underdeveloped areas of the world.

Anderson and Dillon's Mission to Germany

The Presidential directive was issued on the eve of an official visit to West Germany by Anderson and Dillon. The primary aims of the Anderson-Dillon mission were to induce the Germans to share the cost of US troops stationed in West Germany and to seek German cooperation and participation in sharing the burden of assistance to underdeveloped areas of the world. The mission was keen that West Germany should take over in a somewhat indirect fashion, an annual expenditure of about $600,000,000 which represented the outflow of dollars from the United States caused by the stationing of US troops in West Germany.

17 "Directives by the President Concerning Steps to be Taken With Respect to the United States Balance of Payments," 16 November 1960, Text.

During the negotiations with German officials, Anderson and Dillon put forward a proposal that the Federal Republic might set up a special fund to finance costs of equipment and services such as telephone, electricity, communication, and labour, which would reduce the dollar outflow from the United States. The American proposal appeared to the Germans as not only adding $600,000,000 to the West German Government's budget—to be raised from taxes or capital borrowing—but also in effect, as a resumption of the payment of occupation costs, which had been ended several years ago. The Federal Government rejected the US proposal. Reports from Bonn indicated that Anderson warned Chancellor Konrad Adenauer of the possibility of some troop reduction by the US if its BOP deficit continued. The German response was negative partly due to the fact that elections were approaching.

The German Government made a counter proposal to help the United States to meet its BOP problem. It said that West Germany would make immediate settlement of an $800 million debt, being repaid on a long-term basis, arising from American aid after the Second World War. As part of the proposed settlement, the Germans asked the United States to deduct $200 million in German claims for assets held in the United States since the Second World War. Anderson rejected the German proposal by pointing out that though it represented a net payment of $600 million to the United States, it would be only a one-shot affair, and would not subsequently mitigate the BOP situation.

On 28 November, Anderson reported to the President:
We met with Chancellor Andenauer. We described our gold problem, emphasized the necessity for defending the dollar and reminded him that our troop support costs in Germany run to $600 million a year. Again and again, however, Chancellor Andenauer kept repeating that only one thing worried him; the possibility that we might redeploy some of our troops. (19)

Anderson informed the President that the Germans had agreed to implement a $1 billion foreign aid programme in the following year, and that 20 per cent of the amount would be in the form of goods bought in the United States. The Germans, Anderson added, promised to explore the possibility of buying about $250 million worth of military equipment in the United States.

The Eisenhower Administration had placed high hopes on the Anderson-Dillon mission to solve the BOP problem. When the outcome was no regarded as satisfactory, the Administration thought it fit to raise the issue in public. There were reports that the United States would not shrink from withdrawing some of its troops from Germany if that proved necessary to protect the "integrity of the dollar." The New York Times reported that the President had instructed Horder to issue a warning to the NATO Council of a possible troop withdrawal though no mention of such withdrawal had found a place in the position papers prepared for the forthcoming Council meeting. In his speech before the Council meeting in Paris on 16 December, Horder warned that the adverse balance of payments of the United States

19 Eisenhower, n. 3, p. 607.
might force a reshaping of the United States overseas military commitments. He declared that the United States wished "to continue to make a maximum contribution to NATO, but a redeployment in some degree might be advisable as a study of the overall U.S. military program progresses and unless our balance of payments is brought into equilibrium."  

The Administration's moves indicating the possibility of reducing troops to solve the BOP problem constituted a clear manoeuvre for preparing the ground for further efforts to make the Allies, especially FRG, more amenable. In actual fact, it did not take any decision to reduce troops. Indeed, after the return of the Anderson-Dillon mission from Germany there was considerable relaxation in the withdrawal of dependents from overseas. A study was ordered by Defence Secretary Gates in December on actions which could be taken to reduce US military manpower overseas without impairing combat effectiveness. The report submitted on 9 January 1961 did not recommend any reduction in the number of troops.

It may be asked why of all the European countries, FRG was singled out for pressure by the United States to neutralize the foreign exchange cost of US troops stationed in that country. The fact that more than 75 per cent of the total US troops deployed in Europe was stationed in that country was the primary cause. The foreign exchange expenditure for the

United States in Germany was, therefore, much greater than in any other European country. Simultaneously, the US had with FRG an adverse balance of payments greater than with any other European country.

Till 1955, the foreign exchange expenditure associated with the US troops stationed in Germany was neutralized to a great extent by German payment to the United States for "occupation cost." Table 8 indicates that the payment which began in 1945 gradually increased and reached the highest in 1952—$310 million. When the Allied occupation of Germany was terminated and the FRG was made a member of the NATO alliance, the occupation cost paid amounted to $327 million. After that too payments of "occupation cost" continued; it was drastically reduced and became practically non-existence by 1960. Perhaps to compensate that, the US pressure on FRG mounted from 1960 onwards when the BOP problem intensified. The US sought economic adjustment measures to neutralize the BOP deficit.

Kennedy's Advisers Differ In Tackling the BOP Problem

The Kennedy Administration inherited the BOP problem from its predecessor. In the Senate some concern about the growing BOP deficit was voiced by the Majority Leader, Mike Mansfield of Montana on 2 January 1961. He told the Associated Press that the US commitment to Europe could be reduced to two or three divisions, and that that would permit US to save a substantial amount of foreign exchange. Such troop reductions
### Table 8

**US Occupation Cost Paid by FRG**

*(In Million Dollars)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Payment for Forces Stationed in FRG</th>
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<tbody>
<tr>
<td>1945</td>
<td>65</td>
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<tr>
<td>1946</td>
<td>160</td>
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<td>1947</td>
<td>196</td>
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<td>1948</td>
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<td>1</td>
</tr>
<tr>
<td>1960</td>
<td>1</td>
</tr>
</tbody>
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with all its dependents "might make it possible to ease upon
the financial pressure." "If the Europeans felt their security
may be weakened by a withdrawal of the American forces,
they are in a financial position now to strengthen their own
military forces, and could do so," Mansfield declared.

Arthur M. Schlesinger writes: "The balance of payments
remained a constant worry of Kennedy. Of all the problems he
faced as President, one had the impression that he felt least
at home with this one." Kennedy chose investment banker
Douglas Dillon as Secretary of the Treasury; economic professor
Walter Heller as Chairman of the Council of Economic Advisers;
and professional economist David Bell as Director of the Bureau
of the Budget. The President also consulted with economists

The Treasury Department and the Council developed dif-
ferences on tackling the BOP problem. Dillon and Under Secre-
tary of the Treasury Robert Roosa held the view that the prob-
lem could be controlled by a wide range of piecemeal measures:
"tying the bulk of foreign aid to purchases within the United
States, reducing overseas military expenditures, offering cre-
dit guarantees to promote export and the like." But Heller
and James Tobin of the Council of Economic Advisers, Under

25 Cited in Congressional Record, vol. 114, Part 17,
p. 22527.
26 Arthur M. Schlesinger, A Thousand Days: John F. Kennedy
27 Ibid., p. 566.
Secretary of State George Ball, and Carl Kaysen "took a different view." They favoured reconstruction of the international payments mechanism rather than improvisation.

Ball and Tobin pointed out that the American gold crisis was primarily the result of American expenditure on European economic recovery and defence. Yet the European bankers converted the dollar reserves in gold and tremendously affected U3 gold reserves. Ball suggested that there should be multilateral agreements among governments designed to "insulate excessive" gold losses. Tobin declared that it was technically and politically possible "to reform the international monetary system by putting the world banking functions," performed by the United States and Britain, "into an international institution."

Dillon strongly opposed these doctrines. Kennedy was intellectually sympathetic to the reformers but was not ready to go along with them. He mostly approved Dillon's recommendations. Thus, the piecemeal measures including the reductions of overseas expenditure, especially military expenditure, became the accepted course of the Administration. Some of these measures included: restriction on the policy of grant aid in arms to Allies; more vigorous implementation of the "Buy American" policy even when it entailed increased costs; increase in sale of U3 arms to Allies; and withdrawal of some non-combat

28 Ibid., p. 568.
29 Ibid., p. 569.
US troops from Europe through various streamlining programmes of the Pentagon, already mentioned in Chapter 2.

All agencies spending overseas, from the publicity-pushing United States Information Agency to the Central Intelligence Agency were subjected to root-and-branch examination, the New York Times reported. The military, a big spender abroad, was counted upon to make big cutbacks. It was reported that the Pentagon was actively considering such programmes as faster rotation of troops overseas, closing of some foreign bases, and urging servicemen to pare private spending abroad. On 16 July 1962, the Secretary of Defence announced his drive to slash the overall dollar drain by one million a year without "reducing US combat effectiveness abroad or creating hardship for the individual serviceman or his dependents." More than half of the saving was estimated to accrue from Europe.

Without opting for troop reductions, one of the programmes announced by the Pentagon for saving foreign exchange was the Army's "cost efficiency" plan of shorter rotation periods for troops on foreign assignment. Dubbed as "Rotaplan", it provided for airlift of some 1,500-man "battle groups" overseas.


particularly to Europe, for periods as short as six months instead of two or three years. Under the plan, the Government did not pay for dependents' travel, although "tourist" visits by dependents were permitted. According to the Pentagon officials, this would discourage dependents accompanying servicemen to Germany, since they would be compelled to pay for their own travel. Moreover, as the families of the quick-tour men would in all probability stay in the United States, it would diminish a major category of overseas spenders.

Against the backdrop of the Cuban missile crisis, the US Army introduced its "Rotaplan" with an additional objective of exhibiting its airlift capability to foes. The operation began with the transportation of a 1,500-man battle group stationed at Fort Benning, Georgia, to Germany. Jet transport flying US troops to Germany returned with a battle group of the 8th Infantry Division stationed in West Germany. Subsequently, one more 1,500-man battle group and three 600-man battalions were sent overseas while units of equivalent sized were brought back. But it developed that the anticipated "savings" on 4,000 dependents did not materialize. So the Pentagon abandoned the "Rotaplan" within a year of its introduction.

US-FRG Offaet Agraement

While "Rotaplan" proved abortive, another move of

considerable significance for the future, had been set in motion by the Kennedy Administration. The Department of Defence, backed by the State and the Treasury Departments, undertook in 1961 a series of exploratory discussions with the West German Minister of Defence to determine whether the two Governments could not work out a cooperative arrangement leading to approximate equality in the flow of expenditures on the military account between the two countries. In September 1961 these discussions culminated in an agreement by which the German military purchases in the United States were to offset the level of US military spending in Germany. It was an important breakthrough, representing the successful culmination of the Administration's effort to persuade the most developed of the European Allies to take concrete action to provide some relief to America's BOP problem. The fact that Congressional opinion would welcome such a gesture, and that the action would mitigate the demand for reduction of US force levels in Europe were probably used to good advantage by the Administration in its effort to win the acquiescence of the Federal Government. The same factors were to be cited again in the years that followed during the Kennedy and Johnson administration. The United States concluded two-year and one-year agreements known as the offset agreements with West Germany.


The offset agreements had a significant effect on the United States BOP deficit. Table 9 shows that the net foreign exchange loss or net foreign exchange cost associated with US troops stationed in Germany in FY 1961 was more than what it was in the succeeding fiscal years after the conclusion of offset agreement in FY 1962.

In addition to the German offset, during the period FY 1961-67 major military sales were negotiated with NATO countries, where the United States had sizable military expenditures, particularly in the U.K. and Italy. Table 10 indicates the steadily rising US military cash receipts from NATO countries other than West Germany. Such defence cash receipts reduced the intensity or magnitude of the US BOP problem.

The fact that the offset agreements and military sales agreements were only a partial solution to the BOP problem meant that Congressional criticism would not go away but would spurt again from time to time. This situation had both positive and negative implications for the Executive branch. The negative aspect was represented by Congressional criticism of the Administration for lack of vigour in ensuring compliance by the Allies, and demands for troop reductions. While cautiously meeting these problems, the Administration sought to use the existence of such criticism, to induce West Germany to renew offset agreements, and that country as well as others to continue to make military purchases in the United States. The European governments
TABLE 9

FOREIGN EXCHANGE OUTLAYS ASSOCIATED WITH US TROOPS IN WEST GERMANY

(IN MILLION DOLLARS)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Gross Deficit</th>
<th>Covered by Offset Agreement</th>
<th>Net Deficit</th>
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<tbody>
<tr>
<td>1961</td>
<td>636</td>
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<td>636</td>
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<td>837</td>
<td>675</td>
<td>162</td>
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</tbody>
</table>

(a) The US-German Offset Agreements provided total military procurement in dollars for two fiscal years. The amount mentioned in the table is a rough calculation by equally dividing for each fiscal year.

(b) In FY 1961 there was no US-German Offset Agreement but military sale to Germany existed. Individual figure for Germany is not available. However, total military sale to NATO countries was only $165 million.

### TABLE 10

**FOREIGN EXCHANGE OUTLAYS ASSOCIATED WITH US TROOPS IN NATO COUNTRIES EXCLUDING WEST GERMANY**

*(IN MILLION DOLLARS)*

<table>
<thead>
<tr>
<th>Fiscal Year</th>
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<th>Defence Cash (b) Receipts</th>
<th>Net Deficit</th>
</tr>
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<tr>
<td>1961</td>
<td>893</td>
<td>165 (c)</td>
<td>728</td>
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<tr>
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<td>720</td>
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<tr>
<td>1967</td>
<td>636</td>
<td>497</td>
<td>139</td>
</tr>
</tbody>
</table>

(a) US gross deficit in NATO countries other than FRG is roughly calculated after deducting the gross deficit in FRG from the total gross deficit in NATO countries.

(b) Defence cash receipts figures for NATO countries excluding FRG are calculated roughly after deducting the US-German offset amount from the total defence cash receipt figures of NATO countries.

(c) As individual defence cash receipts figures for NATO countries are not available, the FY 1961 figure includes cash receipts from FRG.

35 Ibid.
had also to reckon with public opinion in their respective countries. They had to demonstrate to their people that reluctance to make the agreements urged by the Administration might lead to undesirable consequences. The Administration, for its part, needed to convince Congress and the American public that it was pushing Allied governments hard, and that if the latter were not sufficiently responsive to the BOP problem, the United States might well have to consider other options including a possible reduction of troops. Press reports from time to time served this purpose, and the Executive branch appears to have used the media with a certain skill.

The Big Lift

It was clear that the Kennedy Administration, striking a posture of determination to keep NATO strong, was not in favour of reducing the American troop levels in Europe to solve the BOP deficit. But the Administration utilized the press to indicate that it was not averse to withdraw some troops from Europe to solve the BOP problem. The New York World-Telegram & Sun reported that McNamara had sent a memorandum to the JCS in March 1963 seeking suggestions for possible reductions in overseas forces with a view to reduce foreign exchange cost. In July, the Washington News reported that the JCS was considering a programme of pruning, consolidation, and curtailment in support forces. The Department of Army suggested that it

could bring home as many as 7,700 men.

Meanwhile, the Washington Star reported that top Pentagon planners were also considering a division-size airlift exercise aimed to demonstrate US airlift capability to Allies as well as to potential foes. It was believed that such a demonstration might enable NATO Allies to accept, in time, a partial pull-back of combat troops from abroad, and thus lead to a reduction in overseas expenditures. So on 23 September 1963 McNamara announced that an entire armoured division would be airlifted to Germany from Texas in the following month. The operation, given the code name "Big Lift," has been discussed in Chapter II.

A few days after, the Department of Defence also announced that 5,400 supply troops from Europe would be withdrawn under reorganization of the lines of communication programme. This programme was part of the effort to reduce gold outflow.

On 19 October 1963, on the eve of the "Big Lift" exercise, Deputy Secretary of Defence Roswell Gilpatric delivered a speech. That speech, to be described presently, contained a reference to a possible troop withdrawal. When Secretary of State Rusk


39 Baltimore Sun, 28 September 1963; and Department of Defence, Annual Report for Fiscal Year 1966 (Washington, D.C., 1967), p. 120.
saw an advance copy of Gilpatric's speech, he almost "lost his composure," columnist Drew Pearson reported. Rusk warned that American withdrawal would disintegrate the NATO Alliance. If the American commitments were to appear to weaken, Rusk argued, the European Allies might become inclined to desert NATO. Pearson reported that the matter was eventually referred to the President who overruled Rusk's objections. Finally the speech was delivered by Gilpatric with few changes in Chicago. The President probably wanted to launch operation Big Lift and the Gilpatric speech as balloons to elicit Allied reaction to a possible US troop withdrawal, and to induce the Allies to come up with constructive alternatives to ease America's difficulties if they wanted US troop levels to be maintained unchanged.

In his speech Gilpatric indicated that national defence was entering a "new phase" when shifts could be made in overseas deployments without impairing military strength or support for global Allies. The capability developed through Big Lift would give the United States the ability to "make useful reductions in its heavy overseas military expenditures without diminishing its effective military strength or its capacity to apply that strength swiftly in support of its worldwide policy commitments." Gilpatric set no deadline for effecting such reductions. But he implied that the time for planning and

negotiating such a reduction with the NATO Allies might not be far distant. At the same time, Gilpatric assured the Allies that the central aim of American policy would be to continue "to sustain a major American presence in the defense of Western Europe at all levels of force."

It was probably not wholly by chance that Gilpatric's speech coincided with the publication of an article by former President Dwight D. Eisenhower in the Saturday Evening Post. The old warrior stated that the time had come for the United States to withdraw some of its troops from Europe. "One American division in Europe can 'show the flag' as definitely as can several," wrote Eisenhower. He stated that while he was in the White House he privately took the position that American forces should be cut "as soon as European economies were restored," but that "the matter was then considered too delicate a political question to raise." In making some troop withdrawal suggestion, Eisenhower acknowledged that such a "move would have many repercussions." But he said that it was necessary to withdraw US troops because of the balance-of-payments problem.

Gilpatric's speech and Eisenhower's comments aroused
some misgivings in Western Europe concerning US intentions. Most seriously alarmed were the West Germans, who urgently demanded a clarification of the Gilpatric speech. The West German press charged that the Administration was playing directly into the hands of French President de Gaulle by confirming his contention that the United States was an undependable ally. "What is alarming about those announcements," wrote the Frankfurter Allgemeine Zeitung, "is that they are grist for the mill of those in Europe who recommend getting used to the withdrawal of the Americans, and claim that there would still be a passable road to European security."

After the warning represented by the trial balloon came a sweetener from the American side. On 27 October Secretary Rusk categorically pledged during his visit to West Germany that there would be no troop withdrawals. "We have six divisions in Germany, we intend to maintain these divisions as long as there is need for them—and under present circumstances there is no doubt that they will continue to be needed," Rusk declared. The Secretary also asserted that operation "Big Lift" signalled "not an intention to withdraw but a major source of added strength to the alliance." Later, at a news conference on 31 October 1963, Kennedy himself sought to allay the anxiety of the West Germans by stating that the policy of the United States was to maintain six divisions in Germany as long as they

were required. The assurance also applied to six smaller units sent to West Germany at the time of the 1961 Berlin crisis. Nonetheless, the very fact that "Big Lift" was organized and implemented meant that its implications could not be overlooked by the Allies.

**Congressional Committees Mollified**

Pledges to maintain American troop levels in Europe continued to be given by Kennedy's successor, Lyndon B. Johnson. The BOP problem also persisted despite the offset agreement and arms purchases. Rising European prices for goods and services aggravated McNamara's difficulties in reducing the BOP deficit resulting from expenditure on US troops in Europe. There was concern among US officials that the dollar outlay would go up instead of down, making the BOP problem even more acute. Concern was voiced in Congress too about the adverse consequences of the situation for the nation's economy.

On 2 February 1965 Secretary of the Treasury Dillon told the Senate Banking and Currency Committee that the deficit had to be erased "in a very brief time...in a very brief period of years." Federal Reserve Board Chairman William McChesney Martin

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45 Washington Star, 1 November 1963.

spoke on an even graver note when he told the Committee that the BOP was the most important problem that President Johnson was facing in the beginning of 1966. The continuing chronic deficit, Martin said, put the United States "behind the eight ball." "I think we're going to fritter away here the political bargaining power of the United States," Martin asserted.

On 2 February the President himself presided over a special meeting of some of Cabinet members and advisors. Those who were present included Dillon, Assistant Secretary of Commerce for Economic Affairs Andrew Brimmer, Federal Reserve Board Chairman Martin, Under Secretary of the Treasury Frederick Dominy, and Assistant Budget Director William Caflon. The deliberations of the group centered on hammering out a new and tougher programme for the President to present to Congress in a special message. Eventually on 10 February Johnson presented to Congress his blueprint for attacking the payments deficit through appeals to banks and corporations for voluntary cutback in their foreign investment. Other BOP measures included a directive to the Secretary of Defence to conduct fresh efforts to reduce overseas spending by the Pentagon. It is noteworthy that no reference was made to any troop cutbacks.


The Joint House-Senate Economic Committee, in its annual report released on 17 March, welcomed the President's move. But it also urged the Government to undertake at once a reassessment of US military commitments and expenditures overseas, to help reduce the BOP deficit. The Committee's 10-man Democratic majority and six-man Republican minority agreed on the advisability of reducing US military expenditure in Europe. The Democrats urged new studies on the subject and cited the 1963 airlift of soldiers to Europe from the United States as demonstrating a possible alternative to stationing of troops overseas.

The Administration needed to make it appear that it was alive to the situation. In March, the New York Post reported that Pentagon policy planners were considering proposals to ship some American troops back home to ease the pressure on the US dollar. On 10 March, Assistant Secretary of Defence Charles J. Hitch told a Senate Subcommittee that a separate review of defence logistic and other support activities in France, Spain and Italy were being conducted to recommend to the Secretary of Defence the reduction that might be possible in personnel, facilities and material required by these activities.

49 Baltimore Sun, 18 March 1965.

50 New York Post, 5 March 1965; and Statement of Charles J. Hitch, Assistant Secretary of Defence, before the Senate Subcommittee on International Finance of the Committee on Banking and Currency, Defense Department Digest, Vol. 2, No. 8, 15 April 1965, pp. 5-7.
The New York Herald Tribune stated that McNamara favoured some combat troop reductions in Germany. Secretary of State Rusk was reported to have opposed McNamara's suggestion and to have had, on this occasion, the support of Secretary of the Treasury Henry H. Fowler. Fowler reportedly pointed out that the reduction would not improve the BOP problem because the cost of keeping US troops in West Germany was being neutralized by German purchases of American military arms. While the public and Congress followed these reports and awaited the outcome, no decision was taken in 1965 to reduce the six divisions stationed in Europe. This leads to the inference that while the Johnson Administration wanted to appear to be discussing and debating various options, its intention was to deflect any Congressional demand for reduction in troop levels in Europe. Although the BOP problem continued to be regarded as serious, political and diplomatic considerations led to the maintenance of the status quo in troop levels. It was not ruled out, however, that the issue would not be raised again by the Administration if needed to mollify Congress or to apply pressure on the Allies.

Tough Bargaining Image Projected

The US-German offset agreement worked out smoothly till the end of 1965. But by the first quarter of 1966, a new dimension to the United States BOP problem developed as a result of the FRG's failure to fulfill its commitments. Under the Offset

agreement concluded in 1965 the FRG was required to buy $675 million worth of military equipment in the United States in FY 1966. In May 1966, however, Bonn was around $600 million behind on its American purchases. Bonn's basic explanation for the failure to buy as much as it had promised was that that with the expansion of its armed forces completed, it could buy much less from the United States than before.

The US, however, was not prepared to accept the German explanation. On 13 May 1966, a direct discussion of the issue took place between Secretary McNamara and West German Defence Minister Kai-Uwe Von Hassel in Washington. It was reported that Hassel reiterated that Bonn already had just about all the arms it needed, and had reached a limit on defence spending. He even pointed out that Bonn would not be able to continue the offset agreement in future because of its own severe budget problems. Von Hassel also put forward Bonn's solution to the BOP problem. For some time Bonn had been suggesting that it could offset the dollar drain associated with American troops in Germany in a better way than by purchasing military hardware it did not need—especially after 56 crashes and 30 pilot deaths in its 700-planes fleet of modified American F-104-G Star-fighter Jets. Bonn proposed that part of its committed purchase funds could be shifted to buy civilian industrial equipment for its aid programmes in the developing countries, including Vietnam.

52 Washington Star, 14 May 1966; and Baltimore Sun, 17 May 1966.
McNamara, the New York Times reported, did not approve of Von Hassel's explanations and suggestion. He told Von Hassel during the meeting that he did not consider the twelve West German divisions to be adequately equipped and armed. He indicated that he wanted to upgrade the German forces with more support units and bigger war reserves. He informed Von Hassel that the US could not do without the German offset agreement. The United States would henceforth reserve the right to reduce its forces in Germany "proportionally" should Bonn's lagging purchases of American arms fail to offset US troop costs, McNamara declared. This was the kind of "tough" bargaining image that McNamara thought it fit to convey through press reports to Congress and the public.

On 15 May, on his return to FRG, Von Hassel made comments at the Bonn-Cologne airport, indicating that he had sensed an indirect threat to reduce US forces if FRG did not carry out the agreement. On the next day, the German Press Secretary, Karl Guenther Von Hase told a news conference that no American official presented the issue to Von Hassel as an either or proposition. Such alleged squeeze play, following the Pentagon's transfer to Vietnam of 15,000 US troops allegedly without consulting the Federal Government, was reported to have produced consternation in Bonn. The West German Ambassador in Washington, Heinrich Knappstein, was reported to have protested to Secretary Rusk and asked for an explanation of McNamara's

action. Several West German newspapers described the American action as being in the nature of an ultimatum.

American newspapers again had a field day, commenting on the differences that had supposedly developed between Rusk and McNamara. The Department of State, according to some reports, took a sympathetic view of Bonn's position. It partly shared Bonn's view that that it was dangerous to treat the defence of a vital frontier as a German rather than a common Western interest. To equate it with the American interest in selling military hardware was absurd, according to the State Department. The Department, in fact, did not oppose the FRG's proposal for shifting the offset funds from the purchase of military hardware to industrial equipment, the report alleged. The Department of the Treasury, it was reported, was also favourable to German suggestion. But the Pentagon strongly opposed the shifting of so-called offset agreement funds. It was interested in maintaining a high level of arms sales partly to help amortize research and development costs, and partly as a politically palatable way of checking the overseas gold drain.

These newspaper reports might well be true, though hard evidence is lacking. It appears to the present writer that a different kind of scenario would also have to be given some consideration. Could this not have been a double play in which State and Defence appeared to take two opposing positions while


the objective was common, namely, to secure an ultimate resolution which would assure continued German expenditure at the desired level, and mitigate the ruffling of feathers that might be caused? Especially in the situation that existed at the time, West Germany needed reassurance from the State Department. Thus while the Defence Department took a seemingly "tough" stance, the State Department adopted a "conciliatory" posture, with both looking towards an eventual "compromise" that would appear to the FRG as a reasonable "bargain", and to Congress as the best that the Administration was willing to get out of West Germany under the circumstances. French withdrawal from the NATO integrated command and the French eviction notice to US forces had created a ticklish situation. That was not time to have any complications in US relations with the FRG. Rusk was particularly keen to secure an unity demonstration of the 14 NATO members against French action in the ministerial conference of NATO members in Brussels on 7 and 8 June. Soon after the Brussels meeting Rusk went to Bonn, ostensibly to assure Chancellor Erhard that the US would not link US troop levels and military sales. On 10 June Chancellor Erhard said in a news conference that Rusk had told him that there was "no link" between the strength of the American forces in West Germany, and the amount of military equipment that West Germany bought in the United States.

After returning to Washington, Rusk along with McNamara

57 Ibid., 11 June 1966.
mot the President on 11 June. From the subsequent news conference of Rusk and McNamara it could be inferred that troops issue and the offset agreement were discussed. If one were to give credence to the earlier newspaper reports of sharp differences between the State and Defence Departments, one would have to conclude on the basis of the outcome that the President had decided to lean closer to the State Department position than to DoD's. If on the other hand, the alternate scenario that had been suggested were to be considered, it has to be concluded that the Administration had decided that the time was opportune to announce the reasonable-sounding solution. That also meant that the Secretary of Defense would moderate his demand as put forth earlier. Sitting beside Rusk at the White House after both had conferred with the President, McNamara told newsmen that the US planned no specific troop withdrawal from Germany. He doubted that even a single battalion would be transferred from there because of the war in Vietnam. The Secretary of Defense made no threat whatsoever concerning troop withdrawal if the offset purchases were not made. He pointed out, however, that the promised purchases were connected by agreement with the dollar drain, and said that the US was expected to keep its part of the bargain--i.e., its defence outlays in Europe--in return for West Germany keeping its part. That, of course, had all along been the crux of the matter.

The exercise was over for the time being. And the FRG's

response to the United States appeal to fulfill the offset agreement obligation was encouraging. The New York Times reported that "a high government source" said that West Germany intended to fulfill its commitments to buy enough military equipment in the United States to offset the cost of maintaining US troops in Germany until mid-1967. Subsequently, on 26 June, Chancellor Erhard told an Associated Press reporter that the FRG would do every thing possible to offset the dollar drain. However, he deplored the linking of US troop levels and military sales, and called for the offset purchase agreement to be modified to allow purchase of space equipment for peaceful purposes as well as military weapons.

US Truce to Stop
Troop Cut Moves in NATO

On 5 July 1966, Chancellor Erhard sent a letter to President Johnson outlining his views on the offset issue. The Chancellor insisted that the offset agreement should be modified and consideration "should be given to payments and services other than purchases of military equipment." He pointed out that such a change was necessary because of budgetary problem of his government, and also because of lack of political support for the offset agreement. But Johnson was not prepared to go along with Erhard's suggestion. He states in his memoirs that the budgetary problem of the German Government was self-imposed. Moreover, he was critical of the Erhard Government for

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60 Chicago Tribune, 27 June 1966.
failure to mobilize public opinion in favour of the offset agreement or at least to remove wrong notions about the agreement. He wrote:

...in 1966 West German Chancellor Ludwig Erhard found himself in budget trouble. His government had increased spending for numerous welfare programs, and as a result of heavy political pressure military spending had leveled off. There was no money for increased purchases of U.S. military equipment. The problem was further complicated because the German authorities had done an unsatisfactory job of explaining to their people that this foreign exchange windfall resulted from our common commitment to NATO, and that they had an obvious obligation to help offset it. Many Germans believed that they were actually paying for the presence of foreign troops, rather than simply offsetting abnormal foreign exchange earnings, by buying goods and services from the United States and the United Kingdom. (61)

It is interesting to note that at the time when Erhard wrote his letter to Johnson, legislative pressure was mounting in the United States and in Britain for a withdrawal of some troops assigned to NATO—especially in Germany. The US Congressional pressure has been already discussed in detail in Chapter IV. In Britain when the economic situation developed "crisis" proportions, Parliament demanded cuts in military forces assigned overseas, especially to NATO. The Labour Government tried to placate its Parliament any critics. On 20 July, in a speech in the House of Commons, British Prime Minister Harold Wilson declared that the government would cut £280 million in overseas spending, mostly in defence. On the following day, Chancellor of the Exchequer James Callaghan gave


some details of cuts in overseas spending in a speech in Bonn. He said that British forces would be soon reduced in West Germany. He pointed out that the reduction had become necessary because the Germans were unwilling or unable to offset with military purchases or direct budgetary assistance the $263 million a year cost of British forces stationed in FRG.

A few days later, Harold Wilson met Johnson in Washington. It was reported that Wilson told Johnson that for economy reasons the British had to reduce their military commitments abroad. The reduction would affect either their 50,000 troops east of Suez or their 50,000 troops in West Germany. The Christian Science Monitor reported, McNamara expressed himself as opposed to a pull back of British forces east of Suez. The Monitor stated that McNamara preferred a British force reduction in Europe to a cut in forces east of Suez. The New York Times reported that the President shared the views of McNamara, and both wanted the Britain to maintain its troops east of Suez as a symbol of collective security in the Indian and the Pacific Ocean areas. By 29 July, a consensus apparently emerged on the issue; Wilson pledged that Britain would keep military power "east of Suez" despite its economic problem. On the question of reduction of British troops in Western Europe no consensus was apparently reached on the date or size of any reduction.


(Contd. on next page)
The British apparently were of the view that the FRG should be responsive to its BOP problem too. Like the United States, Britain had concluded a 3-year offset agreement with Germany which was to expire in April 1967. Under the agreement, the German government agreed to make extraordinary purchases of British goods—both civilian and military equipment—to a value of £150 million a year. On 19 August 1966, the British Government announced its determination to have a quick renegotiation of the offset agreement involving an increased West German commitment. Far from agreeing, the Germans reportedly insisted upon cutting their foreign exchange contribution to £88.2 million. But the British Cabinet decided that the British troops be brought home if no prompt and satisfactory offset arrangement was made with the Germans.

President Johnson did not relish the British action. He believed it would spur critics in the US Senate to demand withdrawal of some US troops from Germany, triggering a chain reaction in other countries. "I was determined to resist the unraveling of North Atlantic defenses and the collapse of our

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postwar efforts to build a healthy Atlantic political community," wrote Johnson in his memoirs.

The President and his Cabinet members considered "three basic questions." First, should the US and Britain deal separately with the FRG, as Bonn and some of President's advisers had proposed, or should they work together on the problem? Secondly, should the financial issue or the security of the NATO region be given top priority? Finally, how could the gap that existed between the German position and the British and the US positions be closed? Johnson writes in his memoirs that he discussed the questions in detail with his advisors, and he claimed that in August he took a decision in favour of multilateral talks. The main consideration that led Johnson to take such a decision was that "working together would strengthen the alliance" and "working separately would be divisive."

In early September 1966, a significant US-UK dialogue on the issue of troop withdrawals took place. This exchange occurred when British Home Secretary Roy Jenkins visited Washington. It was reported that he had "touch and bitter" private huddles with Under Secretary of State George Ball and White House foreign policy adviser Walt Rostow. There was a clash of views, and the American side strove hard to convince Jenkins that the Labour government should delay any cuts in troops in Germany. Jenkins pointed out to Rostow, according to a New York Daily News report, that the British could not

67 Johnson, n. 61, pp. 307-8.
68 Ibid.
negotiate on such a basis, and that since their economic situation was grave, a troop reduction could not be long delayed. 69

A few days before Jenkins' visit, Senator Mansfield on behalf of the Senate Democratic Policy Committee introduced the Senate Resolution 300, calling for a substantial reduction in US troops in Western Europe. Soon the Senate pressure for troop withdrawals had mounted, and had coincided with the British refusal to postpone its own troop withdrawals. It was at this point on 8 September that the President chose publicly to counter the British and Congressional pressure for troop withdrawal with a suggestion that the troop levels issue should be discussed in a NATO forum. This was not a surprise to Britain because, in late August, Johnson had proposed in a personal message to Wilson the holding of special American-British-German talks to head off any hasty troop withdrawals.

Trilateral Talks

President Johnson's call for a special American-British-German talks, it was reported, had initially received a cool reception from the British Prime Minister. In answering Johnson, however, Wilson indicated British willingness to participate in such talks. But Germany resisted Johnson's suggestion, preferring to negotiate bilaterally with Washington and London. Chancellor Erhard indicated that he wanted to talk with the


President personally before going into any trilateral talks.

On 26 September, in a White House conference, Johnson proposed to Erhard for setting up of formal three-nation talks to take a hard look at the strategic requirements of American and British troops in the FRG over the next few years, to define minimum force levels, irrespective of costs, and higher desirable levels if ways could be found to pay for them. In order to prevent precipitate British action, Johnson sought a quick approval of his suggestion. But Erhard, according to reports in the Washington Post and the New York Times, hesitated to spend the FRG's limited resources on what he considered as less reliable British forces, and gave higher priority for American troops. Erhard insisted that the trilateral talks should not exclude continuation of American-German bilateral discussions.

After the initial Johnson-Erhard meeting, Cabinet aides on both sides joined the White House conference. The discussions centered on the German financial problems in meeting the cost of maintaining American troops. Erhard told Johnson that he felt a moral obligation to meet the cost for 1965-66 but did not see how he could do so by the deadline 30 June 1967. Earlier, German sources had hinted that Erhard would seek a moratorium on part of offset funds as well as a reduction in what Germany would pay in subsequent years. In fact, Erhard pleaded for a new agreement under which German purchases would

71 Ibid.

be half of the existing amount. But Johnson, it was reported, was not prepared to accept Erhard's request. However, there was no detailed discussion, since it was then agreed that the issue would be referred to the three-power talks.

Erhard also reiterated at the conference that Germany should not be forced to buy military hardware that it did not need or desire. He insisted that, in a new offset agreement, Germany's military as well as civilian purchases should be counted against American troop costs or included in the agreed offset fund. The Johnson Administration, it was reported, was unwilling to allow civilian items like civilian planes and space equipment to be included in the offset agreement. Its argument was that Germany in any case would have to buy those items in the United States and as such their purchase would not really offset the foreign exchange cost of US troops. To break the deadlock, Johnson proposed that Germany should buy interest-bearing US Government securities with terms of redemption to be decided later. He stipulated that the Bonn government should retain or hold the non-transferable securities till the time when its own balance of international payments might become unfavourable. The interest-bearing certificate, the Administration contended, would bring the stipulated amount of cash to the United States without forcing the Germans to take goods they did not want. Johnson's proposal was a major concession by the Administration to the FRG.


The Joint communique issued at the end of White House conference indicated agreement between Johnson and Erhard on trilateral talks for a "searching reappraisal" of Western strategy, including the number of troops necessary, and how to pay for them. No date for the talks was mentioned in the joint communique. However, there was indication that they would begin promptly and would last about three months, ending by mid-January 1967 with recommendation to be submitted to the full membership of the Atlantic Alliance.

In the following month, the three nations had announced their respective chief negotiators for the trilateral talks that were to commence on 20 October. They included Special envoy of President Johnson on NATO affairs John J. McCloy; British Minister of State in the Foreign Office for European and NATO affairs George Thomson; and German State Secretary in the Foreign Office Karl Carsten. The three nations also took a step to allay possible misgivings among other member of the Alliance by inviting the NATO Secretary General, Manlio Brosio, to participate in the negotiations. Brosio nominated Arthur Hockaday, one of his special Assistants, as the NATO representative.

The first session of the trilateral discussions centered on "questions of defense policy, the defense burden and the foreign exchange problems resulting from the stationing of troops in Germany." The negotiators set up three working

groups, one to assess the Soviet military threat; another to examine the Allied military and strategic position in NATO's central front; and the third to report on inter-allied financial arrangements.

The first round of discussions ended on 21 October. The deliberations indicated that Britain was impatient for action, and was determined to reduce the British Army of the Rhine if West Germany did not offset the foreign exchange cost of the Rhine Army. The United States was reportedly more cautious, holding that every step should be taken in concert, after careful planning. At the same time, the *Baltimore Sun* reported, US officials made it clear that a substantial part of the Seventh Army would be withdrawn unless Germany made full offset purchases in the United States after the expiry of the existing agreement. The West German position, however, did not substantially change. It was neither prepared to make full offset purchases nor was willing to see a reduction in the American or British military presence.

On 9 November, the negotiators met again for a second round in Washington. It was reported that McCloy, Thomson, Carsten and Hockaday spent most of the time in reviewing reports prepared by the working groups that had been meeting in Bonn. There was general agreement on the reported manpower and weapon strength of Warsaw Pact countries. But negotiations

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77 *Baltimore Sun*, 27 October 1966.
on the future financing of US and UK troops in West Germany were reported to have been inconclusive. Chancellor Erhard's government faced internal problems, particularly after his party lost its majority in the Bundestag in the elections held in October 1966. With the designation of Kurt Kleiber as the Christian Democrat candidate for the Chancellorship on 10 November, Erhard's position became still more delicate. The political uncertainty led US negotiators to restrain their pressure on Germany for an early decision on the financial issue. But the British negotiators insisted on assurances that by the mid-December NATO Council meeting the entire foreign exchange cost of their troops in Germany should be met by either the FRG alone or by the FRG in combination with the US.

The British insistence that the United States agree to act together with Germany to offset the foreign exchange cost of its troops stationed in Germany was a new development. It was part of the bargain which Britain sought for postponing its troops withdrawal in the wake of pending financial arrangement with West Germany. From later developments it could be inferred that the United States had acquiesced to British pressure, and obtained in return a postponement of British troop withdrawals. That development perhaps was responsible for the North Atlantic Secretariat sources to declare on 10 November that Britain would postpone indefinitely its suggested troop cuts in Europe. However, at the end of the session, the question of the exact way

in which the US was to perform its part in offsetting Britain's foreign exchange loss remained unresolved.

The third session of the trilateral talks began on 28 November in Bonn. The New York Times reported that the three sides agreed on military potentials and capabilities of the Warsaw Pact countries as well as on the resources available to NATO to meet a military threat from the East. The continuing political crisis in Bonn led the US and UK to postpone any effort to push for a solution to the issue of the financing of their troops stationed in Germany. The possibility that the Social Democrats would join a "grand coalition" with the Christian Democrats was probably one of the British considerations. The British Labour Party had fraternal relations with the German Socialists. The Labour government was probably reluctant to present a gratuitous affront to a new government in Bonn with an ultimatum on troops. Prime Minister Wilson had a convincing argument for his public that it was "no time to threaten" a withdrawal of British troops from Germany. At the same time, the British side kept up the pressure on the United States. By the time the session concluded it had reached agreement with the United States for an additional US military purchase in Britain to offset part of the British foreign exchange loss.

On 12 December, George Thomson announced in the House of

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Commons that Britain had postponed its deadline for withdrawal of some troops to 30 June 1967. In exchange for agreeing to the postponement, Thomson said, Britain was promised £35 million in additional American arms purchases in Britain. Thus, the third session ended with a concession by the United States to Britain rather than by the FRG to the US or UK. Implicit in the arrangement was a US agreement to make no substantial change in its NATO-based forces until June 1967. Ironically, the US which had initiated the trilateral talks to solve primarily its own BOP problem had to deviate from its own objective, and assume responsibility for helping Britain temporarily to overcome its BOP problem. Apparently the Johnson Administration was convinced that such a course was the most responsible course that the United States could take as the leading member of an Alliance when confronted with a situation where two important fellow members faced genuine difficulties.

Before the President and his associates could lay the problem of how Congress would react to the development, Senator Mansfield declared on 16 December that the interim tripartite arrangement had "just postponed the situation for six months." He complained that by aiding Britain to meet the cost of its army of the Rhine, the United States was "ignoring the essential question." This was whether the US should maintain its existing troop levels in Europe in the light of its own BOP problem, changes in the European political situation, and the poor response of NATO partners to fulfill their troop commitments.

Mansfield who had agreed in October to wait for three months while tripartite negotiations continued, said that he would not accept another delay. He announced that he would reintroduce the troop reduction resolution in the following session.

US Offers FRG New Plan To Ease Troop Cost Load

Mansfield introduced his resolution in the Senate in January 1967, as described in Chapter IV. The following month, the FRG government presented a budget for the new fiscal year containing no funds for further offset payments to the United States. On 24 February, a White House meeting discussed various options. There was the West German proposal to include civilian purchases in the US-FRG offset agreement which the Treasury and the State Departments inclined to favour. Though the Pentagon had favoured only military sales to be the basis of any offset agreement, it had grown receptive to some change. In between, the President, most probably on the suggestion of the Treasury Department, had proposed to Chancellor Erhard the purchase of US security bonds by FRG to offset the BOP deficit. The deliberations at the White House meeting centered on how to incorporate the already suggested courses in a proposal to the FRG. Eventually by the end of February, a decision was taken on the nature of a future offset agreement.

Johnson writes in his memoirs that he gave McCloy "a

82 Baltimore Sun, 17 December 1966.

letter of instruction" on 1 March. It set guidelines for re-
newed negotiations with the British and the Germans. The
general approach provided was that, first, Germany should deter-
mine how much military equipment it wished to buy in the United
States. Secondly, the remaining balance of payments should be
dealt with by cooperation among Allies "in the management of
monetary reserves or by other agreed means." This principle,
Johnson claimed was "a departure from traditional policy."

Some details of the new policy were publicly announced
by the State Department on 3 March. It stated that the United
States would abandon the concept that the Bonn government's
arms purchases in the United States should match the dollar cost
of US troops stationed in West Germany. Instead, the FRG should
decide arms purchases on the basis of its requirement "to bring
its military forces up to appropriate strength levels." The
statement acknowledged that there was every likelihood that
German purchase would not completely offset the foreign exchange
costs of US troops. For dealing with the remaining BCP conse-
quencies of US troops stationed in Germany, the State Department
proposed that the FRG should continue its policy of refraining
from demanding US gold in exchange for its huge dollar reserves.
It should also use some of its large dollar reserves to purchase
medium-term US securities. Under US accounting procedures, such
purchases were considered an inflow of dollars, and the Adminis-
tration felt that that would alleviate pressure on the American

84 Johnson, n. 61, p. 310.
BOP.

Bonn Agrees To Monetary Cooperation Idea

The State Department statement was timed to coincide with the arrival in Bonn of McCloy for initial discussions with the German officials. The New York Times reported that initially the response of German monetary authorities was not favourable. In their view further cooperation in support of the dollar would commit Germany to an automatic underwriting of American foreign and economic policy, including private corporate investment abroad, without assurance that the United States' deficit would be controlled.

McCloy reportedly told Chancellor Kurt Kiesinger that Washington recognized that military security considerations should have priority over financial pressures. Even though the US was in a difficult BOP position, it did not want any troop reduction to be made if it could be avoided by some other means. German consent to monetary cooperation would be essential for that purpose. Bonn, in return, could be sure of the Johnson Administration's effort to fight off Congressional groups that had been demanding substantial troop withdrawals. Kiesinger, it was reported, gave a non-committal reply; German sources stated that he raised no serious objection. He told McCloy that Bonn welcomed Washington's willingness to accept non-military

payments as part of a new offset agreement. McCloy also got a favourable hint that the Deutsche Bundesbank was inclined to buy about a billion dollars in United States Treasury notes. Thus, the two governments appeared to be well on the way to reducing the issue to manageable proportions.

On 15 March, the German Cabinet decision to make concessions to the United States to avoid US troop withdrawals was announced. The compromise included the purchase of $500 million US Treasury notes during the fiscal year 1968. Karl Guenther Von Hase, the government spokesman, told a press conference that the board of Deutsche Bundesbank would meet the following day to ratify the dollar bond purchase. Earlier, the US Federal Reserve Board and the Deutsche Bundesbank Board had discussed the transaction. It was reported that it would consist of four equal instalments of quarterly treasury note acquisitions. The term was to range between 4 and 4½ years. "The purchase would cover about four-fifths of the US foreign currency losses caused by stationing US troops in Germany during the twelve months beginning 1 July," Von Hase said.

American officials were reluctant to state whether the Johnson Administration would be satisfied with the $500 million offer. However, the Washington Post, quoting authoritative sources, reported that the US would accept both the amount and the method of payment, firstly to close the period of haggling.

88 Baltimore Sun, 16 March 1967.
with an ally; secondly because the US recognized that the FRG had its own BOP problem; and thirdly because the US accepted--with some reservations--the German argument that they did not need more weapons to be purchased from the US.

The fourth session of the trilateral talks commenced on 20 March. After the first day's deliberations, McCloy told newsmen that he felt that there was "real progress" as a result of the West German offer to buy $500 million US Treasury securities and to purchase $112.5 million of British goods, both military and non-military. However, no agreement was concluded because an expected statement of Deutsche Bundesbank assuring investment in American securities did not materialize before the talks commenced. Moreover, the New York Times subsequently reported that the Germans were holding up final approval of the financial arrangements until the question of US-UK troop levels in Germany was settled.

Soon after the conclusion of fourth session, a joint US-FRG group began intensive study of the troop levels issue. By the third week of April full agreement was reached on all aspects except the number of US planes to be removed. Even that issue was solved on 27 April, during the fifth and final session of the trilateral talks, when the President approved McCloy's compromise proposal. These developments have been

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discussed in Chapter III. Thus, with the troop levels issue settled, final approval of the financial arrangement, tentatively agreed earlier, was also tendered.

A Modified US-FRG Offset Agreement Concluded

On 2 May, the State Department issued a statement containing details of the agreement concluded. On the BOP issue it said: "In particular the financial arrangements that have been concluded between the British and German Governments, between the American and British Governments, and the German Bundesbank will help deal with foreign exchange costs of American and British forces in Germany." Under the agreement the FRG agreed to continue procurement of military goods and services in the United States. However, the FRG was relieved of its responsibility of completely offsetting the foreign exchange costs through military or civilian purchases. Instead it was decided that the FRG would decide for itself what level of procurement it wished to undertake.

The Administration now faced the task of convincing Congressional critics that it had dealt to the best of its ability with two important Allies on a very complex issue involving the BOP problem as well as unity in NATO. The Majority Leader in the Senate, Mansfield, was also one of the principle critics of the Administration and a proponent of the view that

substantial troop reductions were necessary, among other things to tackle the BOP problem. He and his associates needed to be convinced, at least in part, that the arrangements that had emerged out of the trilateral discussions involved definite advantages to the United States in respect of the BOP issue.

In a letter to Mansfield, Secretary of the Treasury Fowler, tried to explain the significance of the new arrangement. He wrote:

...these bilateral financial arrangements...we believe... is unavoidable...in managing monetary reserves...related to... stationing U.S. and British troops in Germany. Decision on appropriate troop levels should be based primarily on security needs, but the financial consequences of such decisions should be dealt with at the same time. Our security interest could be adversely affected if we undertook commitments without simultaneously taking the necessary steps to maintain our domestic and international economic strength which is required to carry out our security actions.

The current Trilateral Talks have demonstrated a recognition by our German and U.K. allies of these relationships and a spirit of cooperation...for dealing with...mutual security and financial needs simultaneously.... (92)

While going over the main features of the financial arrangement Secretary Fowler pointed out to Mansfield that the Deutsche Bundesbank had agreed to invest during the period between July 1967 and June 1968, £500 million in non-transferable, non-convertible, medium-term US Government securities bearing interest at the rate of 4½ per cent and a maturity period of 4½ years. "This investment is a long-term capital inflow and consequently has the same effect on our payments balance as any

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92 Correspondence between Senator Mansfield and Secretary of the Treasury Fowler, US Senate, Congress 90, session 1, Combined Subcommittee of Foreign Relations and Armed Services Committee, Hearings, United States Troops in Europe (Washington, D.C., 1967), p. 124.
other long-term capital inflow," Fowler declared.

In addition, the Bundesbank, in agreement with the German government, assured the US government in a letter that the Bundesbank intended to continue its policy of refraining from dollar conversion into gold from the US Treasury. The agreement also provided for $100 million military hardware procurement in the United States. The total offset amount agreed thus amounted to $600 million.

The US-UK-FRG accord did not encounter rough weather in the Senate. Mansfield and his associates were principally interested in the troop withdrawal issue, and as some troop withdrawal was a feature of the accord, the comments were focused on it. The modified offset agreement was neither criticized nor praised or commented on by Senators. But the Administration, with growing Congressional discontent over the seemingly unending war in Vietnam and distrust over the Executive's "commitments" in other parts of the world, was aware that troubles lay ahead.

The offset agreement was to expire on 30 June 1968. Negotiations for a new offset agreement had commenced as early as February. The background to such an early negotiation was further worsening of the US BOP position. In his New Year's Day message, the President pointed out that the BOP position was deteriorating, and that the deficit would be around $4

93 Ibid., p. 123.
billion in 1967, the largest deficit since 1960. "He cannot tolerate a deficit that could threaten the stability of the international money system...," Johnson declared. He announced that he would take steps to curb investment abroad and foreign travel by Americans. He would also seek to have a half-billion of US military expenditure in NATO countries paid for by NATO. All these steps, Johnson suggested, would save $4 billion in foreign expenditures, and bring US deficit in foreign payments into balance.

Following Johnson's announcement, Under Secretary of State Nicholas deB. Katzenbach and Assistant Secretary of State for Political Affairs Eugene V. Rostow visited some European and Asian countries. They met German leaders on 2 January. It was reported that they insisted that West Germany should resume offsetting the full foreign exchange loss of US troops in fiscal year 1969 as part of the drive to cut the BOP deficit. German leaders reportedly made no commitments, but promised to give "sympathetic consideration" to Johnson's request for additional aid to defend the dollar. At the same time, the German government was reported to have expressed many reservations. Some German politicians were openly hostile. "A clear no" to the American request was demanded by the opposition Free Democrat legislator Hans İnde. The weekly Rheinischer Merkur, which often reflected the views of the conservative wing of the government, stressed that the US was defending its own security.

95 Washington Post, 2 January 1968.
in Europe as well as Europe's, and thus should not expect Europe
to shoulder the burden alone.

In spite of some opposition within the government and
legislature, the German government agreed to commence negotia-
tions on offsetting the cost of US troops stationed in Germany
for the period beyond June 1968. Under Secretary of State
Eugene Rostow and Under Secretary of the Treasury Frederick
Deming, discussed the troop-cost problem with Chancellor Kiesin-
ger and key German officials on 12 and 13 February. Although
US officials declined to comment on the offset amount sought,
German sources indicated that the US was seeking around $700 to
$800 million as against the $600 million for the previous year.

The Christian Science Monitor reported that German offi-
cials affirmed that until 1971 no new budgetary funds would be
available to purchase American weapons for the West German armed
forces. Any arms bought would have to come from money already
deposited in the United States under the former offset agreement.
They reiterated that West Germany would not offset the BOP defi-
cit with weapon purchases in the United States. Nevertheless,
two sides agreed to negotiate on the basis of the 1967 offset
formula.

96 Baltimore Sun, 4 January 1968; New York Times, 9 January
1968; Washington Post, 4 January 1968; and Chicago
97 Christian Science Monitor, 16 February 1968.
98 Ibid.
When the negotiations began in May in Washington, the United States reportedly insisted on "complete" coverage of the dollar drain in West Germany. The State, Defence and the Treasury Departments estimated the drain at more than $800 million. The West German officials contended that the figure was too high. The only agreement reached was that the parties should meet again after three weeks to resume the negotiations.

Meanwhile, the US Congressional demand for transferring some troops from Europe to Vietnam was gaining momentum. The developments in Czechoslovakia, the Warsaw Pact manoeuvres in Czechoslovakia, and the Soviet hint of possible military intervention there, aroused official concern and anxiety in the United States and West Germany. It was against this background that the US-FRG offset negotiations commenced in June. Both sides made compromises on the total amount, ostensibly to avoid any semblance of disunity in NATO, and to stem Congressional pressure for additional troop withdrawals. The American team fighting to shore up the US dollar, won an offset amount that was larger than the earlier ones.

The FY 1969 offset agreement concluded on 10 June 1968 had two significant features. First, in addition to Bundesbank purchase of $500 million worth of medium-term Treasury bonds, a substantial purchase of $125 million was to be made by a West German private banking consortium. Secondly, the West German State-owned Lufthansa Airlines agreed to pay $60 million in cash.

100 Washington Post, 11 June 1968.
for aircraft purchased in the US. Besides, West Germany also agreed to continue purchase of at least $100 million worth of military hardware in America. The total offset amount agreed thus amounted to $786 million.

The new agreement, unlike the earlier one, came under strong criticism. Mansfield contended in a Senate speech on 19 June that the agreement did not neutralize the foreign exchange cost of US troops in Germany. It was a "strange" agreement that increased the foreign indebtedness of the United States. "For...not only do these Treasury bonds carry interest at the market rate prevailing at the time of their purchase... but they must also be redeemed or renegotiated in the not too distant future," Mansfield noted. The US would be paying in 1968 $27 million in interest on the first $500 million worth of bonds purchased by the Bundesbank in FY 1968. In addition, it would have to pay an estimated $18 million in interest on the second $500 million worth of bonds that would be purchased in FY 1969. An estimated $3 million in interest would be payable on the $125 million worth of bonds which would be sold by the West German banking consortium. On the whole interest payment would amount to $53 million. "If we keep going at this rate, our interest payments will soon equal the foreign exchange we will be saving as a result of this year's limited redeployment of 35,000 troops to the United States from West Germany," Mansfield asserted.

102 Ibid., vol. 114, Part 14, pp. 17730-1.
The Senator resumed his attack after his return from a tour of East European countries in August. He told newsmen that the West German effort to retain American forces by buying American bonds was the "phoniest deal I have ever seen." "That's not sharing cost, but making a profitable investment," Mansfield added.

The Senator had used strong words but neither he nor his associates had come up with constructive suggestions on better ways of dealing with the BOP problem. Their attention was focused on demanding a reduction of troops—a course concerning which the Executive branch had all along harboured serious reservations. Given these constraints as well as the domestic compulsions faced by the two major Allies, the Johnson Administration had to work for accords that would not disturb Allied unity, and that would also ease America's own burden on the balance of payments issue. Since the intricate negotiations on the BOP issue took place among the governments concerned, and since the discussions were of a secret nature, they did not evoke any heated controversy in Congress till virtually very end of the period under review. Even then it was only Senator Mansfield who condemned the FY 1969 offset agreement as the "phoniest deal I have ever seen." In earlier years he as well as other Congressional critics had tended to add the BOP problem to the list of arguments that were put forth in support of a reduction of US troop levels in Western Europe. The Executive

103 Chicago Tribune, 19 August 1968.
branch, anxious to forestall the demand for troop reductions, exerted itself to induce the Allies, particularly the FRG to be responsive. Given the complexities of the situation, its efforts could be regarded as reasonably successful.