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GOLD AND THE UNITED STATES BALANCE OF PAYMENTS DEFICIT

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FOREWORD

This report on "Gold and the U.S. Balance of Payments Deficit" has been prepared by the Legislative Reference Service of the Library of Congress at the request of the Committee on Foreign Affairs. It is my hope that this review of the current situation and analysis of basic issues will be of value to members of the committee and the Congress in their consideration of the vital foreign policy legislation with which they will be confronted during the present session.

It appears to me that Dr. Howard S. Piquet and his associates have done a creditable piece of work which merits careful study.

The report is presented as prepared by the staff of the Legislative Reference Service, and the Committee on Foreign Affairs assumes no responsibility for its content or conclusions.

THOMAS E. MORGAN,
Chairman, Committee on Foreign Affairs.

LETTER OF TRANSMITTAL

THE LIBRARY OF CONGRESS,
LEGISLATIVE REFERENCE SERVICE,
Washington, D.C., January 30, 1961.

Hon .THOMAS E. MORGAN,
Chairman, Committee on Foreign Affairs,
House of Representatives, Washington, D.C.

DEAR DR. MORGAN: I take pleasure in sending you, in response to your recent request, a report on "Gold and the U.S. Balance of Payments Deficit." Although it brings up to date our previous report, "Exports, Imports, and the U.S. Balance of International Payments" which was published in April 1960 as Senate Document No. 105, the present report has involved more than the updating of statistics. Important changes in the composition of the international payments and receipts of the United States in 1960 made necessary a complete revision of the earlier document with certain major changes in emphasis, particularly with respect to gold.

The present report, as was the earlier one, was prepared by Dr. Howard S. Piquet, senior specialist in international economics of the Legislative Reference Service. In the preparation of this report he had the services of Mr. Harold T. Lamar, formerly with the Legislative Reference Service, and now economist in the Office of the Chief of Engineers, U.S. Army, who kindly loaned him back to us to assist in preparing the chapter on merchandise trade. On the other chapters the author had the services of members of the Economics Division of the Legislative Reference Service.

Sincerely yours,

HUGH L. ELSBREE, *Director.*

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GOLD AND THE U.S. BALANCE OF PAYMENTS DEFICIT

Introduction and Summary

Rather suddenly, in 1958, the American public became conscious of the "deficit" in the Nation's balance of international payments. They seemed little aware that there had been an adverse balance in the international accounts every year, except one, since 1950. They probably still would not be greatly concerned over the recurring deficits of $3.4 billion, $3.7 billion, and $3.5 billion in 1958, 1959, and 1960, respectively, if it were not for substantial exports of gold. They certainly would not be concerned to the extent that they are.

Net outward shipments of gold totaled $2.3 billion in 1958. In 1959 they dropped to $700 million, but during the first 11 months of 1960 they amounted to the annual equivalent of $1.7 billion. The situation has been aggravated by widespread speculation in gold starting during the second half of 1960, in all probability a result of hoarding in anticipation that the dollar will be officially devalued.

To conserve dollars, the Secretary of the Treasury in 1959 announced that, henceforth, the proceeds of all dollar loans disbursed by the Development Loan Fund for economic development must be spent in the United States and the Secretary of State subsequently announced that some of the development loans of the International Cooperation Administration are to be transferred to the Development Loan Fund so as to make them expendable only in dollars. For the same reason the Secretary of the Treasury and the Under Secretary of State sought unsuccessfully to persuade the Government of West Germany to assume some of the cost of maintaining the U.S. Military Establishment abroad. At the same time the President announced that the families of some American troops stationed abroad would be brought back to the United States.

To stem speculation in gold the President issued an order early in 1961 forbidding Americans to hold gold abroad as they have been forbidden to do within the United States since 1934.

Because of the economic recovery of Western Europe and Japan, and because certain countries, particularly in Europe, are now in a strong enough position to replenish their gold reserves the United States has been losing some of its monetary gold. In consequence, there has been talk of raising the dollar price of gold, of curtailing foreign aid programs, and of cutting back the U.S. Military Establishment abroad to "preserve the integrity of the dollar."

Also, there continues to be some anxiety over the extent to which the United States is being "priced out of world markets," as evidenced by the failure of merchandise exports in 1959 to increase as rapidly as merchandise imports. Some of this fear has been allayed, however, by the large increase in exports in 1960 which widened the export surplus from $1.1 billion to $4.5 billion.

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The problem of the deficit is blurred by confusion as to the meaning and significance of the "balance of international payments." Before one can understand the present situation it is necessary to distinguish between three quite different concepts: (1) the balance of international payments, (2) the balance of trade, and (3) a theoretical balance sheet of the U.S. economy.

The balance of international payments is a statement of the number of dollars entering and leaving the country for any reason whatsoever over a stated period of time. International payments and receipts arise from merchandise imports and exports, from payments made and received for services of many kinds (such as shipping and insurance), from international movements of capital, from payments of interest and dividends on investments, from tourist travel, and from one-sided (unilateral) transfers in the form of support of the Military Establishment abroad, foreign aid and private gifts. The figures shown in the balance of international payments are not the summation of transactions that have been recorded on some sort of giant cash register. Rather, they are estimates compiled by the U.S. Department of Commerce on the basis of questionnaires and other information.

The balance of trade is that part of the balance of international payments which compares merchandise exports and merchandise imports. It is frequently confused with the balance of international payments itself.

A balance sheet of the U.S. economy would list changes in the assets and liabilities of the country in terms of real wealth as distinguished from monetary payments.

The fact that its international payments and receipts are in balance signifies neither that a country is strong or weak, economically. The international accounts of poor and rich countries alike are in balance when payments for imports, together with all other money outflows, are roughly in balance with total money inflows. Attainment of international balance does not signify that a poor country has become rich, nor does an adverse balance indicate that a rich country has become poor. A country can be in financial balance with other countries whether it is rich or whether it is poor; it is primarily a matter of adjustment of international money flows to levels of economic activity.

The adverse balances in the international payments of the Western European countries in 1947–48, when the Marshall plan was inaugurated, were accompanied by economic weakness. Europe had been devastated by war and was not able to generate sufficient exports to pay for the imports that were so urgently needed for its economic recovery.

The present balance of international payments position of the United States is quite different. The United States is economically strong. However, for some time it has had an adverse balance in its payments resulting from the steady unilateral transfer of between $4 billion and $5 billion for the support of its military establishment abroad and for economic aid to underdeveloped countries together with new foreign investment in industrialized countries. In recent months there has been a drain on gold for speculative purposes. Meanwhile, the economies of Western Europe and Japan have become important competitors in world markets. The excess of U.S. dollar payments over dollar receipts, far from evidencing economic weakness in the United States, evidences the growing economic strength of the free world.

The balance-of-payments problem facing the United States may be stated as follows: How serious is the current adverse balance in international payments to economic foreign policy? To what extent does it call for policy changes with respect to foreign aid, the size of the U.S. Military Establishment abroad, foreign trade and gold? What steps, if any, should be taken to narrow the excess of payments over receipts?

Gold movements and dollar balances

Although it has lost \$4.7 billion of monetary gold in the past 3 years the United States still has ample gold reserves even above the 25-percent legal minimum reserve against outstanding Federal Reserve notes and deposits. The United States still has 46 percent of the free world's monetary gold and foreign withdrawals of gold were considerably smaller in 1959 than in 1958. Had it not been for speculation in gold during the latter half of 1960 and the differential between interest rates in the United States and in Europe the chances are that withdrawal of gold in 1960 would have been far less than it was. It is also probable that the country's international accounts would have been close to balance. It is significant that the governments of Western Europe have been slowing down their acquisition of gold as they have succeeded in replenishing their reserves. It is even more significant that even while withdrawing gold in 1960 foreigners have added substantially to their dollar holdings, thereby demonstrating continued confidence in the dollar. Even in 1960 when outward shipments of gold totaled \$1.7 billion additions to foreign dollar balances totaled \$1.8 billion.

As long as the leading countries of the world operated under the international free gold standard they were not conscious of any balance-of-payments problem because payments and receipts could not get far out of line with each other. Today, however, the correctives of the free gold standard are no longer operative and governments intervene whenever international payments greatly exceed receipts.

Although the United States has had an adverse balance in its international payments since 1950, it did not become large enough to occasion concern until 1958 when it suddenly increased from around \$1 billion to \$3.4 billion.

It would be misleading to compare changes in the balance of payments between 1958, 1959, or 1960, on the one hand, and 1956 or 1957 on the other because of the abnormal trade situation starting in the autumn of 1956 and extending through most of 1957. The Suez crisis occasioned such an abnormal increase in U.S. merchandise exports that in 1957 the excess of exports over imports reached a high point of \$6.5 billion compared with the more normal excess in the years immediately preceding the crisis of about \$3 billion. In 1958 the favorable trade balance receded to \$3.6 billion. It narrowed to \$1.1 billion in 1959 but recovered to \$4.5 billion in 1960.

The most appropriate years for comparison are 1954 or 1955 and 1958, 1959, and 1960. The increase in the adverse balance of payments between 1954 and 1958 can be accounted for largely by increased capital outflow, while over 70 percent of the increase in the adverse balance in 1959 can be accounted for by the narrowing of the export surplus and about 27 percent by the net outflow of capital. In 1960 the improvement in the trade balance was so great as to overshadow the increase in foreign investment. Had it not been for exports of gold to satisfy speculative demands the Nation's international payments in that year would have been close to balance.

Merchandise trade

Exports and imports of merchandise and services account for the great bulk of the international movement of dollars. U.S. exports increased only slightly less than the gross national product between 1950 and 1959. There were two big bulges in exports, the first in 1951 during the Korean war and the second in 1956–57, following the Suez crisis. The excess of merchandise exports over merchandise imports was actually greater in 1958 than in 1955. Most of the narrowing of the export surplus did not occur until 1959.

Between 1955 and 1959, U.S. nonmilitary exports increased $2 billion, or by 14 percent, compared with an increase in gross national product of 21 percent. Most of the failure of exports to increase by as much as the gross national product was accounted for by the falling off in exports of iron and steel mill products, petroleum, automobiles, and coal. Most of the other decreases in exports, including cotton and cotton manufactures, nonferrous metals and dairy products were offset by increases, including machinery, grains and grain preparations, chemicals, rubber products, oilseeds and oils, and office machinery. In 1960 exports expanded to $19.3 billion, or approximately the high level of 1957. The increases were spread over a wide range, including machinery, grains and grain preparations, aircraft, raw cotton, nonferrous metals and alloys, chemicals, and synthetic fibers. At the same time imports declined from $15.2 billion to $14.8 billion so that the excess of exports over imports reached the high level of $4.5 billion which was about the same as the export surplus in 1956.

Merchandise imports had increased 33 percent between 1955 and 1959, or about 12 percentage points more than the increase in gross national product. There have been conspicuous increases in imports of certain consumer goods, such as automobiles and cameras. Almost one-half of the increase in imports between 1955 and 1959 was accounted for by automobiles, petroleum products, and iron and steel mill products. However, imports of coffee, nonferrous metals, crude rubber, cocoa, ferroalloys, and wool decreased substantially. There were important changes in the composition of imports; foodstuffs and beverages declined, largely because of the big drop in the price of coffee, while imports of many manufactured goods increased. The decline in the value of imports in 1960 was accounted for principally by coffee, crude rubber, diamonds, wool, and sawmill products.

There is little evidence to support the assertion that the United States is being priced out of world markets in any general sense. However, this is not to say that certain domestic producers are not being injured by increased competition from imports. To solve this problem proposals have been made ranging all the way from those that would impose import quotas to those that would provide programs for assisting producers who are hard hit by imports, to adjust to lines of production that are less vulnerable to import competition.

Capital movements and earnings on investments

From 1951 to 1955 the inflow of earnings on U.S. investments abroad, together with the inflow of new foreign capital, exceeded the outflow of new U.S. foreign investment and payments of earnings on existing foreign investments in the United States by as much as $1 billion a year. In 1956, 1957, and 1958, however, the net outflow of dollars on account of new investment and earnings on existing investment exceeded the inflow by as much as $1.5 billion a year. In 1959 there was a net inflow of $185 million, but in 1960 there was again a net outflow amounting to $1.3 billion, of which over $800 million was short-term capital.

The largest part of the earnings received from U.S. investments abroad have been earnings on direct private investment. Such investment has been increasing in recent years, partly because of the formation of the European Common Market and the European Free Trade Association, which have provided inducements for U.S. capital to establish production facilities within those free trade areas.

It is still too early to know whether the United States is entering a new phase in its international financial position. If there is to be a substantial and persistent increase in the net movement of U.S. capital abroad it is to be expected that eventually there will be a changed relationship between merchandise exports and imports, with the latter expanding, relative to the former, as earnings on foreign investments come to exceed the outflow of new capital.

Areas in which action has been proposed

Some of the remedies that have been proposed to decrease the deficit in the balance of payments would involve major changes in foreign policy. Since the balance of payments deficit is a technical phenomenon, and subordinate to foreign policy, it would be shortsighted to allow important features of the latter to be sacrified merely for the sake of eliminating the former. The same reasoning applies to restrictions against merchandise imports and the subsidization of exports in view of the expressed liberal foreign trade policy of the United States.

Devaluation of the dollar, in terms of gold, would be evidence of a major departure from the policy of maintaining the dollar as an important international reserve currency and could lead to harmful competitive devaluation.

Certainly, the facts regarding the international payments and receipts of the United States do not suggest the need for such major departures from existing foreign policy objectives.

Among proposals that have been made that, for the most part, seem consistent with existing U.S. foreign policy objectives, are the following:

That payments "in kind" be substituted, wherever possible, for unilateral transfers, particularly for nonmilitary foreign aid and for the support of the U.S. Military Establishment abroad.

That the Western European countries assume a larger proportion of the cost of foreign aid to underdeveloped countries and of the cost of the common defense of the free world.

With respect to gold and the international payments system:

1. That assurance be given to other countries that the United States will continue to sell gold to foreigners at $35

per ounce. At the same time there seems little reason to continue buying gold at a fixed price. To deter speculation in gold it would seem logical for the world price of gold to find its own level as far as U.S. purchases of that metal are concerned.

2. That the present 25-percent legal minimum gold reserve requirement against Federal Reserve notes and deposits be reduced, or eliminated, so as to free almost $12 billion of gold for the settlement of international accounts.

3. That steps be taken to establish an International Reserve Bank to serve the countries of the Atlantic Community, or alternatively, that the International Monetary Fund be expanded to perform this function for its entire membership.

That U.S. industry do a better job in exporting, with respect to selling methods, market research, product styling, etc., and that efforts to liberalize international trade not be further throttled.

That neither inflation nor deflation be permitted to get out of hand.

What Does "International Balance" Mean?

The balance of international payments is a two-sided statement showing the funds flowing out of, and into, a country. Although it is not a debit-credit relationship of the double-entry-bookkeeping variety, which is always in balance, there is a tendency for correctives to keep total payments and total receipts in balance over a period of time. The most sensitive correctives are short-term capital movements and gold shipments.[1]

For balance-of-payments purposes gold is treated as merchandise. Sales of gold to foreigners yield dollar returns and appear as a receipt of dollars [+], while purchases of gold from abroad appear as a payment of dollars [−]. Movements of capital out of the country involve an immediate outflow of dollars while movements of capital into the country involve an inflow of dollars. In the long run, however, the investment of U.S. capital abroad results in a return of dollars in the form of interest and other earnings.

The only merchandise movements that are significant to the balance of payments are those involving dollars. Transfers on a barter basis, including exports given as direct foreign aid involving no dollars, have no direct effect on dollar movements. Thus, the item in official export statistics labeled "transfer of military supplies and services" does not appear as a merchandise export in the balance of payments

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[1] The principal items appearing as *dollar receipts* [+] are:

1. Exports of merchandise.
2. Sale of services, including—
   - Transportation services.
   - Expenditures by foreigners visiting the United States.
   - Interest received on American-owned capital invested abroad.
3. Capital movement (new investment of foreign capital in the United States).
4. Sale of gold to foreigners.

The principal items appearing as *dollar payments* [−] are:

1. Imports of merchandise.
2. Purchases of services, including—
   - Transportation services.
   - Expenditures by Americans visiting foreign countries.
   - Interest paid on foreign-owned capital invested in the United States.
3. Capital movement (new investment of U.S. capital in foreign countries).
4. Purchases of gold from foreigners.
5. Unilateral transfers of dollars in the form of foreign aid and gifts (such as CARE packages).
6. Expenditures for the support of the U.S. Military Establishment abroad.

because all purchases under the military assistance programs are made within the United States. The merchandise export figures shown in the chart may be too inclusive because some of the transfers are not for cash. The margin of error, however, is relatively small and for purposes of analyzing the balance of payments as a whole may be ignored.

International balance under the free gold standard

Before analyzing the current balance-of-payments problem it is necessary to understand how international balance used to be achieved under the old free gold standard system which prevailed prior to World War I. Since the balancing mechanism at that time was largely automatic countries were not conscious of such a thing as a "balance of international payments."

The leading currencies of the world were convertible into gold which moved freely from country to country. Unrestricted price changes within countries and the free international movement of gold provided the world with a multilateral trading system which worked so well that by the close of the 19th century it was looked upon as natural and permanent. International trade was relatively free, not in the sense that there were no trade barriers, but in that tariffs were applicable to all foreigners alike. There was no intended discrimination against customers or suppliers.

This near-automatic system came to prevail largely because of the United Kingdom's position in the world economy. She was the first country to experience the Industrial Revolution and was the hub of the trading world. The ready convertibility of the pound sterling into other currencies and into gold and her strong international creditor position made it convenient for traders everywhere to carry on international trade in terms of pounds sterling.

Convertibility meant that the British pound could be converted into gold at a fixed ratio at the will of the holder, whether a Britisher or a foreigner. The fact that the United Kingdom maintained convertibility made it easier for other countries to do so also. The United States remained on a free gold standard until 1933.

Under the free gold standard, currencies are legally defined in terms of their gold weights. The dollar was 23.22 grains of pure gold and the British pound sterling 113.0016 grains. The ratio of the weights of the two currencies (4.866+ to 1) was known as the "par of exchange."

Individuals anywhere could convert gold into currency, or currency into gold, at the legal ratio, or convert either currency into the other at the current exchange rate. Gold was not only the standard of value, domestically and internationally, but also provided a mechanism for keeping currencies in line with each other at roughly their parities. As a consequence, gold was distributed throughout the world according to need as determined by changing prices and foreign exchange rates.

For example, if commodity prices in the United States increased relative to prices in the United Kingdom there would be a tendency for commodity imports from the United Kingdom to increase. The increase in commodity imports, relative to commodity exports, would cause the dollar to weaken, relative to the pound sterling, on the foreign exchange market. The decline would not go beyond the "gold export point," the level at which it became profitable to convert dollars into gold and to ship the gold to the United Kingdom. Since gold was directly related to the supply of money and credit the export of gold would cause prices in the United States to halt their rise and those in the United Kingdom to increase. When price levels in the two countries came into line with each other the exchange rate was close to parity and there was a state of international equilibrium.

Usually, before the gold export point was reached, the decline in foreign exchange would attract short-term capital, thereby tending to bring international payments back into balance. The system worked well largely because the British Government and the Bank of England pursued liberal trade and monetary policies and served as world banker.

Before considering international balance under conditions of currency inconvertibility it might be helpful to trace the steps in the process of adjustment under the exchange rate mechanism of the free gold standard.

Illustration of adjustment to increased commodity imports under a system of free exchange rates and the free gold standard

1. An excess of U.S. commodity imports over commodity exports causes dollars to become more plentiful in terms of British pounds sterling, so that dollar exchange drops from $4.866 equals £1 (parity) to, let us say, $4.87 equals £1.

2. In consequence, £1 will now purchase more dollar exchange than previously and it becomes profitable to convert pounds into dollars for short-term investment in the United States.

3. The ensuing flow of short-term capital into the United States will increase the supply of short-term capital relative to the demand for it and cause the short-term interest rate to fall, thus tending to neutralize the effect of the decline in the exchange rate.

4. Meanwhile, since the dollar is now cheaper in terms of pounds sterling it becomes more profitable than before for foreigners to buy merchandise in the United States. Hence, U.S. exports will increase relative to imports, thereby tending to correct the assumed excess of imports over exports. The effect will be to raise the value of the dollar in terms of pounds and tend to bring it back to parity.

Observe that these correctives (capital movements and merchandise trade) have been brought about by fluctuations in foreign exchange rates without any manipulation of interest rates and without any shipment of gold.

5. If the adjustment mechanism just described fails to work promptly the value of the dollar in terms of pounds sterling will continue to fall until it reaches $4.886 equals £1. This is the "gold export point." Since it costs—or used to cost—about 2 cents to ship 1 pound sterling in gold from New York to London it will be more profitable to ship gold than to pay more than $4.886 for £1 in foreign exchange.

6. The movement of gold from New York to London decreases U.S. monetary reserves and increases those of the United Kingdom, thus serving to contract credit in the United States while expanding it in the United Kingdom.

7. In consequence, commodity prices in the United States will tend to fall relative to prices in the United Kingdom, thereby making

the United States a better market in which to buy and the United Kingdom a better market in which to sell. U.S. exports, therefore, will be stimulated while imports will be retarded.

8. Generalizing the illustration, changes in exchange rates, by inducing short-term capital movements, by making it profitable to ship gold, and by changing the relationship of exports to imports serve to distribute the world's gold among the nations in accordance with their needs and to prevent prices in all countries from getting out of line with each other. This is what economists mean when they refer to the "automatic equilibrium under the free gold standard."

It should be emphasized that the correctives under the free gold standard are freely fluctuating foreign exchange rates, the freedom to buy and sell gold, mobility of prices, and relatively free international movement of merchandise. The prices of the factors of production—wages and profits—are affected little, or not at all.

International balance under conditions of inconvertibility

Two World Wars and a major economic depression have shattered this world payments system. Currencies are no longer based on a free gold standard, but are "managed" in that the quantity of money and credit in circulation is determined by the fiscal and monetary policies of governments and central banks. The nexus between commodity price levels and gold has been broken. Monetary gold is now used only to settle international balances. Even international settlement is a matter of government policy. In practice, the U.S. Government buys gold at the fixed price of $35 an ounce and sells it at the same price to foreigners, on demand. The U.S. dollar is not freely convertible into gold domestically and the United States is no longer on a free gold standard.

As long as countries operated under the free gold standard they were not conscious of the balance of international payments because payments and receipts were never far out of line with each other. Now that the automatic correctives of the gold standard are no longer operative, however, countries watch their international payments with a keen eye so as to be in a position to intervene whenever weakness develops, meaning by "weakness" a tendency for outward payments to exceed receipts from abroad.

A country's balance of international payments is a barometer of its economy vis-a-vis the outside world. Adjustments that used to be prompt and near painless under the free gold standard now require considerable effort, time and strain. Strong pressures develop, therefore, to prevent them from occurring. As soon as there are unfavorable developments in a country's balance of international payments efforts are made to "correct" them, usually by preventing adjustment.

If foreign exchange rates were allowed to fluctuate freely there would be a persistent tendency for price levels to adjust to each other through changes in imports and exports of goods and services. Thus, if prices in the United States should rise to higher levels than in the United Kingdom, imports into the United States from the United Kingdom would increase, thereby causing the value of the dollar to fall in terms of pounds sterling. As the dollar falls in value relative to other currencies it would become profitable for foreigners to convert their money into dollars and to use them to buy certain goods in the United States, which would tend to "correct" the rising prices. This reasoning, which is known as the "purchasing power parity theory" because it emphasizes the attainment of international equilibrium through the adjustment of internal prices rather than through gold movements, probably would work if countries were willing to allow their economies to adjust to each other. However, since adjustments sometimes cause deflation at home by forcing certain wages down, governments resist. The home currency is not allowed to fall on the foreign exchanges and steps are taken to introduce exchange controls, export subsidies, quotas limiting imports, and other devices designed to preserve the status quo. In the absence of a free international gold standard wide variations in uncontrolled foreign exchange rates would make international commercial transactions hazardous and would be a serious deterrent to international trade.

Nevertheless, worldwide abandonment of the free gold standard and freely fluctuating foreign exchange rates has not eliminated the pressure of economic forces to adjust internationally. What has been eliminated is the sensitive mechanism making it possible for national economies to adjust to each other quickly and with a minimum of friction. Although gold is still used to settle international balances it no longer brings the purchasing power of national currencies into line with each other. Prices, wages, and other economic variables are now immediately and directly subject to international pressure and therefore can be out of line with each other for a long time.

The automatic correctives of the old payments system served to insulate the basic factors of production (principally labor) of national economies against each other by absorbing the shocks of adjustment. With these correctives no longer operative the factors of production become more sensitive internationally. When wages and employment have to absorb the shocks of adjustment, there is danger of unemployment, a slowdown in economic growth and economic recession.

It is conceivable that the leading countries of the free world could agree upon an international monetary system that would approach the automaticity of the free gold standard. There was hope, as World War II came to an end, that the United Nations would be able to establish an international currency and a world reserve bank. The most that they could agree to, however, was the establishment of an International Monetary Fund which, though constituting an important step toward international economic stabilization, is an inadequate substitute for the free gold standard.

Under the free gold standard system international gold movements were residual in that gold was shipped abroad to reestablish international equilibrium whenever other economic forces, such as exchange rates, merchandise trade, services, and capital movements failed to balance. Although gold is still used to settle international balances, it does not now move automatically. At the present time, therefore, gold can be more than a residual item in the balance of international payments. Independent movements of gold, such as those caused during the second half of 1960 by speculation on the free gold market in London, can be a cause, as well as a result, of a deficit in the balance of international payments.

Recent Changes in the U.S. Balance of International Payments

Over 95 percent of all dollar receipts from abroad are in payment for exports of goods and services. The remainder, amounting usually to under $600 million a year, consists principally of foreign funds seeking long-term investment in the United States.

On the payments side, imports of goods and services account for about 70 percent of the total. The remainder is accounted for principally by funds sent abroad for investment, for the support of the U.S. Military Establishment abroad, and for nonmilitary foreign aid in the form of grants. These percentages have remained fairly constant throughout the past decade.

The accompanying chart (chart I) shows the major changes in the balance of international payments of the United States in recent years. Since 1950, the balance of payments of the United States has shown an excess of dollar payments over receipts. In 1950 the adverse balance amounted to $3.6 billion. It was soon narrowed, however, to $300 million in 1951, and from 1952 through 1956 it ranged between $1 and $2.1 billion a year. In 1957, the year following the Suez crisis, the accounts showed a small net surplus ($500 million). In 1958, 1959, and 1960, however, there were adverse balances of $2.4 billion, $3.7 billion, and $3.5 billion, respectively.

Table 1.—*U.S. balance of international payments, 1949–60*

[In billions]

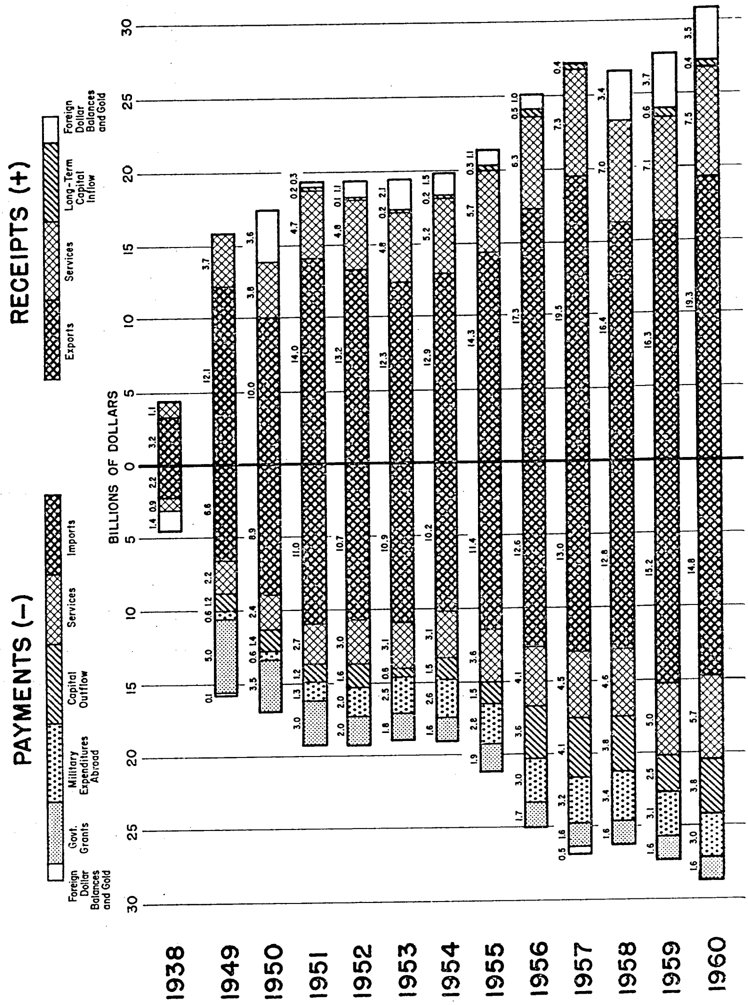
Year	Payments						Receipts			
	Merchandise imports	Services	Long-term capital (outflow)	U.S. military expenditures abroad	Government grants	Foreign dollar balances and gold	Merchandise exports	Services	Long-term capital (inflow)	Foreign dollar balances and gold
1949	$6.6	$2.2	$1.2	$0.6	$5.0	$0.1	$12.1	$3.7	---------	---------
1950	8.9	2.4	1.4	.6	3.5	---------	10.0	3.8	---------	$3.6
1951	11.0	2.7	1.2	1.3	3.0	---------	14.0	4.7	$0.2	.3
1952	10.7	3.0	1.6	2.0	2.0	---------	13.2	4.8	.1	1.1
1953	10.9	3.1	.6	2.5	1.8	---------	12.3	4.8	.2	2.1
1954	10.2	3.1	1.5	2.6	1.6	---------	12.9	5.2	.2	1.5
1955	11.4	3.6	1.5	2.8	1.9	---------	14.3	5.7	.3	1.1
1956	12.6	4.1	3.6	3.0	1.7	---------	17.3	6.3	.5	1.0
1957	13.0	4.5	4.1	3.2	1.6	.5	19.5	7.3	.4	---------
1958	12.8	4.6	3.8	3.4	1.6	---------	16.4	7.0	---------	3.4
1959	15.2	5.0	2.5	3.1	1.6	---------	16.3	7.1	.6	3.7
1960 [1]	14.8	5.7	3.8	[2] 3.0	[3] 1.6	---------	19.3	7.5	.4	3.5

[1] Annual estimates based on official figures for 1st 9 months of the year.
[2] From letter from the office of the Assistant Secretary of the Treasury.
[3] About one-half of the government grants represent payments in U.S. dollars.

The concern that is being felt over the present balance of payments position of the United States is not occasioned by the fact that it is adverse, as such, but by the fact that the negative balance is much larger than in most previous years and that during the past 3 years the United States has been losing substantial quantities of gold. Since the balance of payments is a composite of many variables it is easy to fall into the trap of blaming the adverse balance on the variable that one likes the least. Thus, those who oppose foreign aid are disposed to blame it while those who are opposed to the maintenance of large U.S. military forces abroad blame it on that. Similarly, those who dislike competition from commodity imports are disposed to blame them.

CHART I

U.S. BALANCE OF INTERNATIONAL PAYMENTS, 1938 AND 1949–60



From 1951 to 1954, the balance of international payments, although showing a deficit of $1 to $2 billion a year, was relatively stable. Merchandise exports ranged between $10 and $11 billion. Dollars sent abroad for new foreign investment amounted to $0.6 to $1.6 billion. Nonmilitary aid to foreign countries declined from $3 to $1.6 billion a year, while the cost of maintaining the U.S. Military Establishment abroad increased from $1.3 to $2.6 billion. Considered together, nonmilitary foreign aid and the cost of the oversea Military Establishment remained stable at slightly more than $4 billion per year.

During these years the overall adverse balance was between $1 and $2 billion a year. Little or no concern was expressed over it, however, and there continued to be concern over the persistent worldwide "dollar shortage," even though other countries were accumulating substantial dollar balances in the United States.

In 1958 there was deep concern over the large adverse balance which was accompanied by a substantial outflow of gold and by a large increase in the flow of American capital abroad. In 1959 the outflow of gold was much smaller than in the previous year and the adverse payments balance, which persisted, was accompanied by marked deterioration in the merchandise trade position of the country. In 1960 the outflow of gold again increased and, although there was an increase of $1.5 billion in net capital outflow, there was a net improvement on account of merchandise trade and services of $3.1 billion. The outward flow of gold in 1960 appears to be a major cause of the payments deficit.

The magnitudes that have remained constant, in and of themselves, cannot be the proximate causes of the sudden increase in the adverse balance. The causes have been multiple and some have been more important than others. The most appropriate years for comparison with 1958 and 1959 are the years immediately preceding the Suez crisis. The years 1956 and 1957 were abnormal because of the temporary bulge in exports occasioned by that crisis.

TABLE 2.—*Changes in net balances of principal components of U.S. balance of international payments, 1954–58, 1954–59, and 1959–60* [1]

[In billions of dollars]

	1954–58	1954–59	1959–60
Merchandise trade	+0.9	−1.6	+3.4
Services	+.3		−.3
Capital movement (net)	−2.5	−.6	−1.5
Cost of U.S. Military Establishment abroad	−.8	−.5	
Nonmilitary Government grants			
Net change in foreign dollar balances and gold movements	−1.9	−2.2	+1.6

[1] Plus indicates increase in dollar inflow or decrease in dollar outflow. Minus indicates increase in dollar outflow or decrease in dollar inflow.

The net excess of total dollar payments over total dollar receipts increased from $1.5 billion in 1954 to $3.4 billion in 1958, $3.7 billion in 1959 and $3.5 billion in 1960. As shown in table 2, the increase of $1.9 billion in total net outward payments between 1954 and 1958 appears to be explained by the net increase of $2.5 billion in the outflow of capital during the period. The net favorable trade balance (excess of exports over imports) actually increased by $900 million. Meanwhile, the cost of the U.S. Military Establishment abroad increased $800 million.

In 1959 the situation changed markedly. Comparing it with 1954, the net outward flow of capital increased by only $600 million but the favorable merchandise trade balance was narrowed by $1.6 billion. Thus, whereas the proximate cause of the increase in the balance-of-payments deficit in 1958, compared with 1954, appears to have been the increase in the outflow of capital, over 70 percent of the increase in the deficit in 1959 (over 1954) seems to have been occasioned by a narrowing of the favorable merchandise trade balance.

In 1960, because of favorable changes in merchandise trade, what should have been an improvement in the net balance of something like $1.6 billion was an actual improvement of only $200 million. There is a strong presumption that other forces were at work in 1960.

Merchandise Exports and Imports

It has frequently been asserted that contraction of its merchandise export surplus in 1959 indicated that the United States was being "priced out of world markets" either because of rising labor costs or because of the increased competitiveness of European and Japanese industry. Tending to support this assertion were figures showing that the $6.5 billion excess of exports over imports in 1957 had shrunk to $1.1 billion in 1959.

Which years to compare?

There is always danger in concentrating on changes between any two consecutive years. This is outstandingly so with respect to exports and imports between 1957 and any other year. When statistics over a period of years are considered, it is evident that 1957 was "abnormal." The crisis over the Suez Canal which developed in the autumn of 1956 caused a temporary spurt in exports, particularly to Western Europe and the Far East. The excess of exports over imports in 1957 was more than double the excess in any year between 1950 and 1955.

It is misleading to draw conclusions from a comparison of foreign trade in 1957, the year in which the export surplus was at its highest point at any time during the past decade, with trade in 1959 when the surplus was at its lowest point. The fact is that over the past 10 years the excess of merchandise exports over imports has averaged almost $3 billion annually. Historically, the United States has experienced an export surplus since 1889. In the early postwar years the large export surpluses were financed by the foreign aid program and supplied needed food and other material to Europe.

Table 3 shows the trend in exports, imports, and gross national product for the decade 1950–60, together with data for the first 10 months of 1960 converted to an annual basis. Only in 1959 did the increase in exports fail to exceed the increase in either imports or gross national product over 1950. In 1960 exports were 93 percent higher than their 1950 level, while imports were 66 percent higher and the gross national product 77 percent higher. There were two bulges in exports—the first in 1951 during the Korean war and the second in 1956–57 following the Suez crisis.

TABLE 3.—*U.S. foreign trade and gross national product, 1950–60*

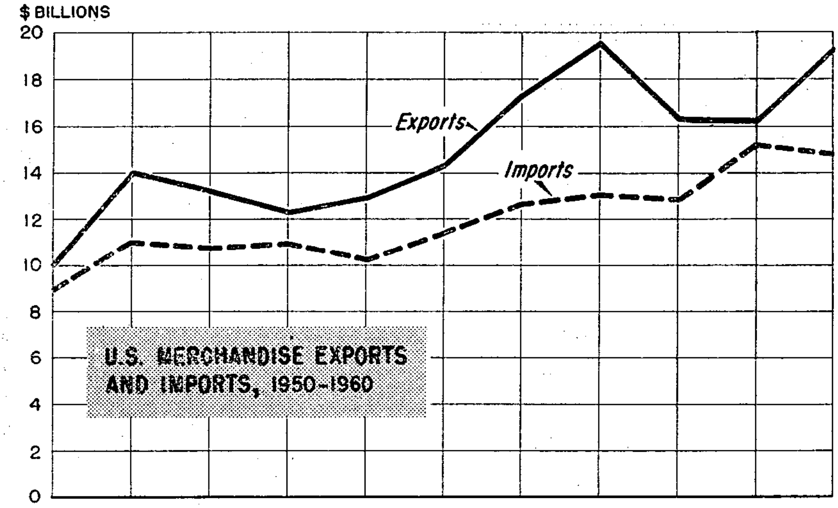
	Exports [1]	Imports [2]	Excess, exports over imports	Gross national product
	Billions			
1950	$10.0	$8.9	$1.1	$284.6
1951	14.0	11.0	3.0	329.0
1952	13.2	10.7	2.5	347.0
1953	12.3	10.9	1.4	365.4
1954	12.9	10.2	2.7	363.1
1955	14.3	11.4	2.9	397.5
1956	17.3	12.6	4.7	419.2
1957	19.5	13.0	6.5	442.8
1958	16.4	12.8	3.6	444.2
1959	16.3	15.2	1.1	482.1
1960 [3]	19.3	14.8	4.5	503.3
	Index numbers			
1950	100	100		100
1951	140	124		116
1952	132	120		122
1953	123	122		128
1954	129	115		128
1955	143	128		140
1956	173	142		147
1957	195	146		155
1958	164	144		156
1959	163	171		169
1960 [3]	193	166		177

[1] Excluding military shipments.
[2] General imports.
[3] Annual rate for first 10 months for exports and imports and for the first 9 months for gross national product.

Although declining from a high of $6.5 billion in 1957, the export surplus in 1958 was still higher than in any year since 1950, except only 1956.

As shown elsewhere in this report, the adverse balance in the international payments of the United States in 1958, compared with the period preceding the Suez crisis, was accompanied by a big increase in foreign investment but not by an undue narrowing of the export surplus (see chart II). In 1959, it was the reduced export surplus that reemphasized the deficit position of the U.S. balance of payments. The contrary movement of exports (down) and imports (up) in 1959 can be attributed largely to earlier economic recovery in the United States than in Europe, which had the effect of retarding the demand for American products in Europe and increasing the demand for European products in the United States.

CHART II


$ BILLIONS
20
18
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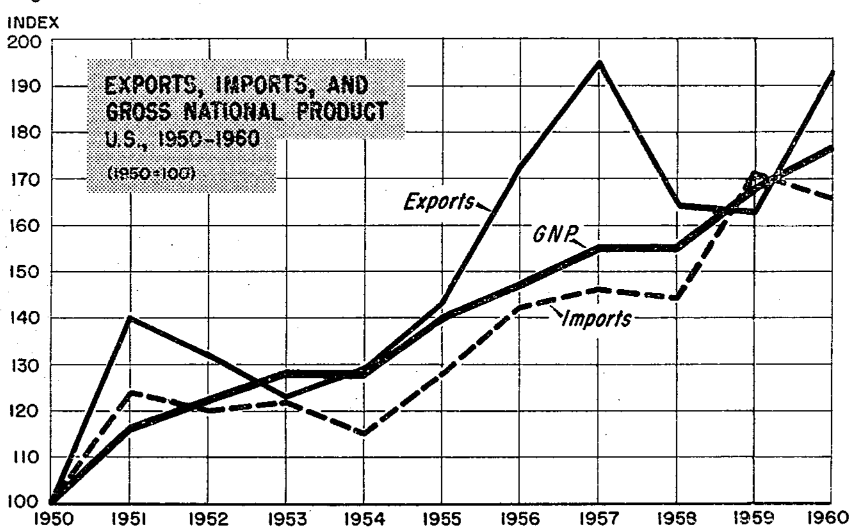
Exports
Imports
U.S. MERCHANDISE EXPORTS AND IMPORTS, 1950-1960


INDEX
200
190
180
170
160
150
140
130
120
110
100
EXPORTS, IMPORTS, AND GROSS NATIONAL PRODUCT U.S., 1950-1960
(1950=100)
Exports
GNP
Imports
1950
1951
1952
1953
1954
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1956
1957
1958
1959
1960

Merchandise exports

Merchandise exports have increased by more than 33 percent since 1955 and their rate of increase has been greater than the rate of increase of either imports or gross national product. Although exports declined in 1958 and 1959, they have since recovered to the peak level of almost $20 billion reached in 1957. Data for all of 1960 are not yet available, but during the first 10 months exports were $4 billion higher than in the comparable 1955 period. They were $2.7 billion higher than during the comparable period of 1959.[1]

Exports increased more rapidly than gross national product between the first 10 months of 1955 and the first 10 months of 1960 in the following commodity groups: machinery and vehicles; vegetable food products and beverages; chemicals and related products; metals and metal manufactures; inedible vegetable products; textile fibers and manufactures; and wood and paper. Percentagewise, the largest increase was in vegetable food products and beverages (58 percent higher in 1960 than in 1955). In terms of dollar volume the greatest increase was in machinery and vehicles ($1.5 billion). These increases, together with increases between the first 10 months of 1959 and the first 10 months of 1960, are shown in table 4.

Among individual commodities, exports of which have increased substantially more than the gross national product and which loom large in dollar volume, are: machinery (other than electrical); grains and grain preparations; aircraft; raw cotton; nonferrous metals and ferro-alloys; and chemical specialties. (See table 6.)

In three other commodity groups, also, exports increased between the first 10 months of 1955 and the first 10 months of 1960, but by less than the increase in gross national product (26.5 percent). Animal products, both edible and inedible, and miscellaneous exports, considered together, increased slightly less than 16 percent.

The only major commodity group showing an absolute decline between 1955 and 1960 is nonmetallic minerals. In terms of dollar volume the decline was small ($197 million). The principal items showing decreases in this group were petroleum and petroleum products and coal.

[1] The extent to which foreign economic assistance finances U.S. exports is not known. Something less than one-third of U.S. agricultural exports have been under Government programs in recent years. The amount has varied from year to year, but in fiscal 1960 approximately $1.3 billion of the total $4.5 billion of agricultural exports moved under governmental aid programs. Data for recent years are as follows:

Year ending June 30	Total agricultural exports	Commercial dollar sales	Under Government programs	Percent under Government programs
	(Billions)	*(Billions)*	*(Billions)*	*(Percent)*
1955	$3,144	$2,278	$866	28
1956	3,496	2,129	1,367	39
1957	4,728	2,771	1,957	41
1958	4,003	2,752	1,251	31
1959	3,719	2,459	1,260	34
1960	4,527	3,223	1,304	29

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TABLE 4.—*Exports, by commodity classes, 1955, 1959, 1960 (1st 10 months)*

[Volume in millions]

	1955	1959	1960	Volume changes		Percentage changes	
				1955–60	1959–60	1955–60	1959–60
Increases by more than gross national product: [1]							
Machinery and vehicles	$4,428.4	$5,054.5	$5,901.3	+$1,472.9	+$846.8	+33.3	+16.8
Vegetable food products and beverages	1,183.1	1,714.7	1,872.0	+688.9	+157.3	+58.2	+9.2
Chemicals and related products	901.3	1,229.9	1,409.2	+507.9	+179.3	+56.4	+14.6
Metals and manufactures	1,280.8	1,097.7	1,725.5	+444.7	+627.8	+34.7	+57.1
Vegetable products, inedible	720.6	993.9	1,128.5	+407.9	+134.6	+56.6	+13.5
Textile fibers and manufactures	939.4	814.1	1,346.6	+407.2	+532.5	+43.3	+65.4
Wood and paper	363.5	415.7	509.8	+146.3	+94.1	+40.2	+22.6
Subtotal	9,817.1	11,320.5	13,892.9	+4,075.8	+2,572.4	+41.5	+22.7
Increases by less than gross national product:							
Miscellaneous	876.5	947.1	1,032.7	+156.2	+85.6	+17.8	+9.0
Animal products, edible	227.7	244.4	264.5	+36.8	+20.1	+16.2	+8.2
Animal products, inedible	261.9	273.5	282.7	+20.8	+9.2	+7.9	+3.0
Subtotal	1,366.1	1,465.0	1,579.9	+213.8	+114.9	+15.7	+7.8
Decreases: Nonmetalic minerals	1,177.3	989.8	980.7	−196.6	−9.1	−16.7	−1.0
Total	12,360.5	13,775.3	16,453.5	+4,093.0	+2,678.2	+33.1	+19.4

[1] The gross national product increased 26.5 percent between 1955 and the 3d quarter 1960.

Although it is essential that exports should increase, it is not true that the United States has an "unfavorable" balance of trade or that foreign producers are displacing American producers in foreign markets in any general sense.

Nevertheless, exports have not been increasing as rapidly as they should be increasing in view of the continuing unilateral export of dollars. Outgoing dollars have been returning to the United States but not enough of them in the form of intensified demand for American merchandise. When it will become profitable for foreigners to increase their purchases of U.S. merchandise to the extent necessary to bring the international accounts into balance remains to be seen. It will depend primarily on costs and prices in the United States relative to costs and prices abroad.

National agricultural policy with respect to cotton and other crops has impeded U.S. exports at a time when foreign manufacturing industry has been becoming increasingly competitive. As long as U.S. foreign policy calls for the unilateral outflow of $4 to $5 billion per annum for the support of American troops and bases abroad and for nonmilitary foreign aid it is essential that exports increase substantially.

Merchandise imports

The large number of imported automobiles that one sees on the highways, the Japanese and German cameras displayed in photographic shops, and the popularity of Japanese-made transistor radios tend to reinforce a growing feeling that import competition is becoming increasingly severe.

Here, as in so many other phases of economic life, it is not easy to visualize the entire picture. Generalization based on only a small part of the picture is about the best that the layman can do. Like an iceberg, most of which lies submerged beneath the surface of the sea, the invisible part of the economy often is more significant than the part that is visible. Automobiles, cameras, and radios are consumer goods that are particularly ubiquitous. They make an immediate impact on millions of people, most of whom are unaware that the bulk of all imports are of goods that are not seen by the average citizen in the form in which they are imported.

Imports of certain consumer goods have increased to a degree that seems alarming to their American producers. For example, in 1960 the value of imported automobiles was 682 percent higher than in 1955 while, in the same period, imports of steel mill products increased 295 percent, leather manufactures 198 percent, cotton manufactures 121 percent, photographic goods 111 percent, and meat products 107 percent. Considered together, imports of these six commodities in the first 10 months of 1960 totaled over $1.6 billion and were over three times higher than their imports in 1955.

To conclude that these figures portray the situation with respect to imports generally, however, would be to describe the contours of the iceberg on the basis of the small part that is visible above the surface of the sea. These commodities, together, accounted for about 15 percent of total imports in 1960 and for 6 percent in 1955. Imports of the other 85 percent, totaling $8.7 billion in 1960, increased 15 percent in the same period, which was considerably less than the 26.5 percent increase in the Nation's gross national product in the same period.

TABLE 5.—*Imports, by commodity classes, 1955, 1959, 1960 (1st 10 months)*

[Values in millions]

	1955	1959	1960	Volume changes		Percentage changes	
				1955–60	1959–60	1955–60	1959–60
Increases by more than gross national product:[1]							
Machinery and vehicles	$361.3	$1,317.9	$1,253.1	+$891.8	−$64.8	+246.8	−4.9
Nonmetallic minerals	1,247.1	1,849.9	1,797.1	+550.0	−52.8	+44.1	−2.9
Metals and manufactures	1,601.3	1,918.2	2,040.2	+438.9	+122.0	+27.4	+6.4
Miscellaneous	341.3	634.4	683.7	+342.4	+49.3	+100.3	+7.8
Animals and products, edible	357.5	691.5	608.7	+251.2	−82.8	+70.3	−12.0
Textile fibers and manufactures	821.8	985.7	1,062.4	+240.6	+76.7	+29.3	+7.8
Animals and products, inedible	233.3	344.9	338.6	+105.3	−6.3	+45.1	−1.8
Chemicals and related products	212.0	287.5	298.7	+86.7	+11.2	+40.9	+3.9
Subtotal	5,175.6	8,030.0	8,082.5	+2,906.9	+52.5	+56.2	+.7
Increases by less than gross national product:							
Wood and paper	1,235.1	1,374.8	1,373.7	+138.6	−1.1	+11.2	−.1
Vegetable products, inedible	663.5	724.7	720.1	+56.6	−4.6	+8.5	−.6
Subtotal	1,898.6	2,099.5	2,093.8	+195.2	−5.7	+10.3	−.3
Decreases: Vegetable food products and beverages	2,208.5	2,174.2	2,142.3	−66.2	−31.9	−3.0	−1.5
Total (imports for consumption)	9,282.7	12,303.7	12,318.6	+3,035.9	+14.9	+32.7	+.1

[1] The gross national product increased 26.5 percent between 1955 and the 3d quarter, 1960.

Imports in eight broad commodity groups increased more than the increase in gross national product between the first 10 months of 1955 and the first 10 months of 1960. They were machinery and vehicles, nonmetallic minerals, metals and metal manufactures, animal and animal products (edible and inedible), textile fibers and textile manufactures, chemicals and related products, and miscellaneous. Percentagewise and in terms of volume the greatest increase was in machinery and vehicles, imports of which were 247 percent larger in 1960 than in 1955. Automobiles led the increase, followed by petroleum and petroleum products and iron and steel mill products.

Two commodity groups which increased, though by less than the increase in gross national product, were wood and paper products and inedible vegetable products. Imports of only one commodity group decreased between 1955 and 1960; namely, vegetable food products and beverages. Leading the decrease was coffee which declined $249 million between 1955 and 1960, largely because of declining price.

The changing "export surplus"

Increased imports were more significant than decreased exports in the narrowing of the export surplus in 1959. The excess of exports over imports declined from $2.9 billion in 1955 to $1.1 billion in 1959. During the same period exports increased from $14.3 to $16.3 billion, while imports increased from $11.4 to $15.2 billion. In 1960, however, imports declined to $14.8 billion (annual rate for 10 months) while exports increased $3 billion to $19.3 billion (annual rate for 10 months). During the decade 1950–59, exports varied by as much as $4 billion annually and imports by as much as $2.4 billion. The gains in exports in 1960 reversed the pattern of 1958 and 1959 in the narrowing of the export surplus, just as previous declines in the export surplus have been reversed.

Decreases in exports and increases in imports of automobiles, petroleum, and iron and steel mill products fully account for the narrowing of the favorable trade balance between 1955 and 1959. In this period imports of automobiles increased $759 million and exports decreased $149 million (total $908 million). Imports of petroleum products increased $502 million, while exports decreased $165 million (total $667 million). Imports of iron and steel mill products increased $448 million, but exports fell off by $267 million (total $715 million). These changes, together, amount to almost $2.3 billion, or considerably more than the $1.8 billion narrowing of the export surplus (from $2.9 billion in 1955 to $1.1 billion in 1959).

The picture with respect to these three commodities was quite different in 1960. Exports of automobiles during the first 10 months of 1960 increased to $19.2 million higher than their level during the first 10 months of 1959, while imports declined by $132.4 million (a net improvement in trade position of $152 million). Exports of petroleum and petroleum products in the same period increased $68 million and imports decreased $16 million (a net improvement in trade position of $84 million). Although imports of iron and steel mill products continued to increase in 1960 (by $18 million during the first 10 months) exports increased $202 million (a net improvement in trade position of $184 million). Thus, for the three principal products which accounted for the deterioration in the Nation's export surplus in 1959 the trade position improved by $420 million during the first 10 months of 1960.

It seems reasonable to conclude that the narrowing of the export surplus by over $900 million between 1955 and 1959 on account of increased imports and decreased exports of automobiles resulted primarily from decisions within the industry regarding the type of product offered for sale. The industry was slow to recognize the growing preference among consumers for smaller, more compact cars. It now appears, however, that the industry has responded to the change in consumer demand and not only has recaptured a part of the importers' share of the U.S. market but also is improving its position in export markets.

The increased imports and decreased exports of petroleum products in 1959 resulted from the rapid rate at which we are using such products, especially gasoline. The falling of exports and increasing imports of iron and steel mill products was largely, though not entirely, a result of the steel strike. The trend of exports and imports in 1960 with respect to these two commodities illustrates that trends in trade in recent years to a large degree are the result of differences in economic tempos of the economies of different countries. Temporary setbacks in U.S. exports do not, of themselves, establish the fact that U.S. exports are too highly priced.

TABLE 6.—*Exports that have increased more than the increase in gross national product, 1955, 1959, 1960 (1st 10 months)*

[Values in millions]

Product	Exports			Volume changes		Percentage changes	
	1955	1959	1960	1955–60	1959–60	1955–60	1959–60
Machinery	$1,543.1	$2,108.0	$2,385.2	+$842.1	$+277.2	+54.6	+13.1
Grains and preparations	785.8	1,183.0	1,348.0	+562.2	+165.0	+71.5	+13.9
Aircraft	621.4	611.6	1,139.2	+517.8	+527.6	+83.3	+86.3
Raw cotton	413.4	279.8	749.2	+335.8	+469.4	+81.2	+167.8
Nonferrous metal and ferroalloys	262.9	240.3	583.8	+320.9	+343.5	+122.1	+142.9
Chemical specialties	326.3	495.0	553.1	+226.8	+581.1	+69.5	+11.7
Oilseed and expressed oil	155.6	304.5	346.3	+190.7	+41.8	+122.6	+13.7
Rubber and manufactures	162.9	266.0	321.3	+158.4	+55.3	+97.2	+20.8
Industrial chemicals	132.7	205.6	262.2	+129.5	+56.6	+97.6	+27.5
Coal-tar products	60.7	83.9	139.2	+78.5	+55.3	+129.3	+65.9
Synthetic fibers and manufactures	190.6	208.6	260.8	+70.2	+52.2	+36.8	+25.0
Fruits and preparations	149.3	200.9	210.8	+61.5	+9.9	+41.2	+4.9
Paper-base stocks	79.1	83.6	136.5	+57.4	+52.9	+72.6	+63.3
Iron and steel scrap	141.1	126.6	197.4	+56.3	+70.8	+39.9	+55.9
Paper and manufactures	162.3	192.3	211.6	+49.3	+19.3	+30.4	+10.0
Meat and products	54.4	85.8	100.0	+45.6	+14.2	+83.8	+16.6
Books and printed matter	76.2	103.5	113.5	+37.3	+10.0	+49.0	+9.7
Scientific instruments	55.6	81.9	90.8	+35.2	+8.9	+63.3	+10.9
Vegetables and preparations	86.9	120.3	119.3	+32.4	−1.0	+37.2	−.8
Photographic goods	74.3	92.9	105.7	+31.4	+12.8	+42.3	+13.8
Fertilizer and materials	73.4	88.0	101.6	+28.2	+13.6	+38.4	+15.5
Railroad transportation equipment	84.1	78.9	110.5	+26.4	+31.6	+31.4	+40.1
Hides and skins	46.4	51.4	60.5	+14.1	+9.1	+30.4	+17.7
Musical instruments	25.2	34.0	35.2	+10.0	+1.2	+39.7	+3.5
Leather and manufactures	34.4	40.5	43.8	+9.4	+3.3	+27.3	+8.1
Total	5,798.1	7,366.9	9,725.5	+3,927.4	+2,358.6	+67.7	+32.0

TABLE 7.—*Exports that have increased less than the increase in gross national product, 1955, 1959, 1960 (1st 10 months)*

[Values in millions]

Product	Exports			Volume changes		Percentage changes	
	1955	1959	1960	1955–60	1959–60	1955–60	1959–60
Electrical machinery	$695.3	$793.9	$821.3	+$126.0	+$27.4	+18.1	+3.5
Tractors, parts and accessories	281.8	305.0	328.1	+46.3	+23.1	+16.4	+7.6
Medicinals and pharmaceuticals	188.0	238.1	230.0	+42.0	−8.1	+22.3	−3.4
Metal manufactures	321.0	374.4	352.7	+31.7	−21.7	+9.9	−5.8
Tobacco and manufactures	336.7	266.3	360.6	+23.9	+94.3	+7.1	+35.4
Sawmill products	74.9	72.7	89.2	+14.3	+16.5	+19.1	+22.7
Iron and steel mill products	518.2	324.8	527.1	+8.9	+202.3	+1.7	+62.3
Miscellaneous office supplies	26.2	28.1	29.0	+2.8	+.9	+10.7	+3.2
Cotton semimanufactures	42.5	41.4	45.1	+2.6	+3.7	+6.1	+8.9
Pigments, paints, and varnishes	88.4	89.5	90.7	+2.3	+1.2	+2.6	+1.3
Animal and fish oils and greases	101.3	102.6	103.2	+1.9	+.6	+1.9	+.6
Fish and products	19.0	19.8	20.0	+1.0	+.2	+5.3	+1.0
Total	2,693.3	2,656.6	2,997.0	303.7	+340.4	+11.3	+12.8

TABLE 8.—*Imports that have decreased, 1955, 1959, 1960 (1st 10 months)*

[Values in millions]

Product	Imports			Volume changes		Percentage changes	
	1955	1959	1960	1955–60	1959–60	1955–60	1959–60
Coffee	$1,095.0	$909.0	−$846.2	−$248.8	−$62.8	−22.7	−6.9
Crude rubber, including latex	357.3	310.6	277.8	−79.5	−32.8	−22.3	−10.6
Nonferrous ores and metals	1,041.1	902.8	971.3	−69.8	+68.5	−6.7	+7.6
Wool, unmanufactured	223.8	194.1	172.9	−50.9	−21.2	−22.7	−10.9
Ferroalloys, ores and metals	194.8	153.6	146.5	−48.3	−7.1	−24.8	−4.6
Cocoa or cacao beans	158.4	131.7	121.8	−36.6	−9.9	−23.1	−7.5
Sawmill products	277.0	287.7	267.8	−9.2	−19.9	−3.3	−6.9
Cotton, unmanufactured	33.7	24.2	25.3	−8.4	+1.1	−24.9	+4.5
Grains, fodders, and feeds	65.4	60.8	58.1	−7.3	−2.7	−11.2	−4.4
Drugs, herbs, leaves, roots, crude	27.2	20.5	20.4	−6.8	−.1	−25.0	−.5
Gums, resins, and balsams	28.8	23.5	23.5	−5.3	----------	−18.4	----------
Edible nuts and preparations	60.8	54.4	55.8	−5.0	+1.4	−8.2	+2.6
Sisal and similar fibers	32.3	34.1	27.3	−5.0	−6.8	−15.5	−19.9
Raw silk	26.4	18.9	23.3	−3.1	+4.4	−11.7	+23.3
Diamonds	178.9	206.0	178.2	−.7	−27.8	−.4	−13.5
Total	3,800.9	3,331.9	3,216.2	−584.7	−115.7	−15.4	−3.5

The narrowing of the export surplus in 1959 emphasized important changes in the composition of foreign trade, particularly imports. Tables 6, 7, and 8 show changes in trade that have tended to widen the favorable balance of trade. The first two tables list exports that have increased and table 8 lists imports that have decreased. Among exports that have increased substantially are various kinds of machinery, grains, aircraft, raw cotton, nonferrous metals and ferroalloys, chemicals, oil-seeds and expressed oils. Cotton exports showed tremendous recovery in 1960 owing in part to an adjustment in the governmental export program. Exports of aircraft increased by more than $500 million in consequence of the conversion from conventional to jet aircraft.

Most of the imports that decreased substantially between 1955 and 1960 were raw materials. The largest decline was in imports of coffee, owing to a drastic decline in price. Imports of crude rubber, nonferrous ores and metals, raw wool, and cocoa also decreased. It is significant that there were no important decreases in imports of manufactured goods during the period.

Tables 9, 10, and 11 show changes in exports and imports that have tended to narrow the favorable balance of trade. Table 9 lists the more important exports that have decreased and tables 10 and 11 list the imports that have increased. As already noted, automobiles, petroleum and petroleum products and iron and steel mill products account for the bulk of the narrowing, especially in 1959. There also have been significant decreases in exports of a number of raw materials, including coal and dairy products.

Imports of certain raw materials have increased, notably meat products, iron ore, fish, and sugar. The most important increases have been in manufactured goods including, in addition to those mentioned above, machinery, cotton and wool manufactures, distilled spirits, agricultural machinery, and paper products.

Imports of manufactured goods have been increasing, both absolutely and in relation to gross national product. In fact imports of manufactured goods in 1960 were more than double their 1955 level and accounted for 36 percent of total imports compared with 23 percent in 1955.

TABLE 9.—*Exports that have decreased, 1955, 1959, 1960 (1st 10 months)*

Products	Exports			Volume changes		Percent changes	
	1955	1959	1960	1955–60	1959–60	1955–60	1959–60
Petroleum and products	$542.1	$337.8	$406.6	−$135.5	+68.8	−25.0	+20.4
Automobiles, parts and accessories	1,162.5	1,049.2	1,068.4	−94.1	+19.2	−8.1	+1.8
Coal and related products	401.3	330.8	308.7	−92.6	−22.1	−23.1	−6.7
Small arms and ammunition	229.3	183.5	203.8	−25.5	+20.3	−11.1	+11.1
Dairy products	93.6	78.5	71.5	−22.1	−7.0	−23.6	−8.9
Articles for charity	160.6	127.7	146.9	−13.7	+19.2	−8.5	+15.0
Cotton finished manufactures	203.7	180.1	191.4	−12.3	+11.3	−6.0	+6.3
Lard and shortening	58.5	50.4	51.6	−7.2	+1.2	−12.2	+2.4
Explosives, fuses, etc	15.1	10.8	11.6	−3.5	+0.8	−23.2	+7.4
Vegetable oils, refined	71.3	95.8	68.7	−2.6	−27.1	−3.6	−28.3
Total	2,938.3	2,444.6	2,529.2	−409.1	+84.6	−13.9	+3.5

TABLE 10.—*Imports that have increased more than the increase in gross national product, 1955, 1959, 1960 (1st 10 months)*

[Values in millions]

Products	Exports			Volume changes		Percent changes	
	1955	1959	1960	1955–60	1959–60	1955–60	1959–60
Automobiles, parts and accessories	$71.2	$689.1	$556.7	+$485.5	−$132.4	+681.9	−19.2
Petroleum and products	822.6	1,266.6	1,250.7	+428.1	−15.9	+52.0	−1.3
Iron and steelmill products	113.6	431.2	449.2	+335.6	+18.0	+295.4	+4.2
Other machinery	156.3	374.8	469.1	+312.8	+94.3	+200.1	+25.2
Meat products	135.7	338.5	280.8	+145.1	−57.7	+106.9	−17.0
Iron ores and concentrates	149.7	251.3	290.3	+140.6	+39.0	+93.9	+15.5
Cotton finished manufactures	97.9	162.3	216.6	+118.7	+54.3	+121.2	+33.5
Wool, finished manufactures	97.4	145.4	181.1	+83.7	+35.7	+85.9	+24.6
Fish, including shellfish	174.3	254.3	253.2	+78.9	−1.1	+45.3	−0.4
Whisky and distilled spirits	101.7	155.6	166.0	+64.3	+10.4	+63.2	+6.7
Leather manufactures	27.9	65.9	83.2	+55.3	+17.3	+198.2	+26.3
Agricultural machinery	74.6	144.7	119.4	+44.8	−25.3	+60.1	−17.5
Clays and products	46.6	72.5	86.1	+39.5	+13.6	+84.8	+18.8
Industrial chemicals	63.2	92.2	99.4	+36.2	+7.2	+57.3	+7.8
Vegetables and preparations	35.8	65.2	66.0	+30.2	+0.8	+84.4	+1.2
Fruits and preparations	106.3	125.6	135.6	+29.3	+10.0	+27.6	+8.0
Silk finished manufactures	32.4	58.5	61.0	+28.6	+2.5	+88.3	+4.3
Tobacco, unmanufactured	71.6	94.2	98.0	+26.4	+3.8	+36.9	+4.0
Glass and products	42.4	76.7	68.2	+25.8	−8.5	+60.8	−11.1
Photographic goods	21.5	40.0	45.4	+23.9	+5.4	+111.2	+13.5
Art work and antiques	34.6	48.3	56.4	+21.8	+8.1	+63.0	+16.8
Leather	17.8	40.2	33.9	+16.1	−6.3	+90.4	−15.7
Hides and skins	48.2	75.9	62.8	+14.6	−13.1	+30.3	−17.3
Spices	31.1	33.6	44.2	+13.1	+10.6	+42.1	+31.5
Vegetable oils and fats, edible	18.8	26.1	28.3	+9.5	+2.2	+50.5	+8.4
Manufactures of hard fibers	25.4	36.4	34.4	+9.0	−2.0	+35.4	−5.5
Total	2,618.6	5,165.1	5,236.0	+2,617.4	+70.9	+100.0	+1.4

TABLE 11.—*Imports that have increased less than gross national product, 1955, 1959, 1960 (1st 10 months)*

[Volume in millions]

Product	Imports			Volume changes		Percentage changes	
	1955	1959	1960	1955–60	1959–60	1955–60	1959–60
Paper and manufactures	$543.6	$604.1	$627.1	+$83.5	+$23.0	+15.4	+3.8
Sugar, cane	368.3	451.2	436.9	+68.6	−14.3	+18.6	−3.2
Paper base stocks	263.2	286.1	281.7	+18.5	−4.4	+7.0	−1.5
Furs and manufactures	68.9	81.1	85.8	+16.9	+4.7	+24.5	+5.8
Jute burlaps	65.5	75.1	77.0	+11.5	+1.9	+17.6	+2.5
Wool semimanufactures	41.4	53.9	51.1	+9.7	−2.8	+23.4	−5.2
Synthetic fibers and filaments	57.5	72.7	65.8	+8.3	−6.9	+14.4	−9.5
Clocks, watches, and parts	51.2	57.7	58.4	+7.2	+0.7	+14.1	+1.2
Asbestos, unmanufactured	49.6	54.5	53.8	+4.2	−0.7	+8.5	−1.3
Dairy products	20.6	23.6	24.0	+3.4	+0.4	+16.5	+1.7
Flax, hemp, ramie manufactures	25.8	24.6	28.0	+2.2	+3.4	+8.5	+13.8
Fertilizer and materials	94.4	90.4	95.7	+1.3	+5.3	+1.4	+5.9
Total	1,650.0	1,875.0	1,885.3	+235.3	+10.3	+14.3	+0.5

The trade picture in perspective

It is in the field of foreign trade that the irony of the current concern over the Nation's balance of international payments deficit is most pronounced. The foreign aid programs were undertaken, in the first instance, to rebuild Western Europe, to refurbish its monetary reserves and to develop a strong free world economy. Now the United States is faced with a situation in which Europe and Japan not only have ample monetary reserves but also are competing successfully in world markets and in the American market itself.

Trade trends over the past few years demonstrate that exports and imports do not always move in the same direction. Given differences in the timing of trends of economic activity in the United States and abroad, significant changes in the magnitude of the export surplus are to be expected.

U.S. exports are not being priced out of world markets in any general sense. They could not have experienced a recovery of over $3 billion if they were, especially with respect to commodities most responsible for the recovery. Notwithstanding that a resurgent Western Europe and a newly quality-conscious Japan are equipped to compete more effectively than ever, U.S. exports have continued to increase more rapidly than either imports or gross national product. The great size of the domestic market is an advantage to exporting industries with regard to product innovation, marketing techniques and low production costs for many mass-produced goods. The recurrent nature of changes in economic trends are such that some observers believe that, sooner or later, another period of dollar shortage is probable.

Imports have grown almost as much as the gross national product. The striking thing about imports is the huge increase in imports of manufactured goods. There is no doubt that increases in some imports of manufactured goods have caused difficulties for certain domestic producers. American consumers, however, have gained. Countries with abnormally low wage scales but which are equipped with highly-efficient modern machinery, can compete successfully with American industry in similar lines of production. Again, however, perspective is essential. What seems pertinent to any long-range point of view is the fact that exporters of manufactured goods in the United States do not have the resources to compete in all lines simultaneously. Furthermore, competition from imports can serve as an important stimulus to domestic producers. Finally, wages in countries that only recently have become exporters of manufactured goods have a tendency to rise and, if history is a guide, will continue to do so. When this occurs the competitive advantage enjoyed by Western Europe and Japan in certain lines will be diminished.

Trade restrictions which, superficially, seem to offer a solution would not really solve the balance of payments problem. Expansion of trade and the reduction of quantitative restrictions imposed by foreign countries against U.S. exports offer hope for continuing a reasonable export surplus to cushion the current pressure on the dollar. Current difficulties with respect to international payments are not essentially a trade phenomenon, and restrictive trade policies would aggravate, rather than solve, the gold problem.

Services

Receipts for services rendered and payments for services received are second only to merchandise exports and imports in the U.S. balance of international payments.

Receipts for services rendered to other countries, or their nationals, amounted to $7.5 billion in 1960, while payments for services received totaled $5.7 billion. Receipts have remained fairly constant at about 40 percent of merchandise exports, while payments for services received have been equal to about one-third the volume of merchandise imports. However, they increased to 38 percent in 1960.

On the receipts side, in 1960, about $3 billion consisted of income on U.S. investments abroad, either private or governmental. Another $1.8 billion was for transportation services, while receipts from foreign nationals traveling in the United States accounted for about $1 billion. Income on investment has increased as a result of the worldwide advance in production and in the demand for the products of foreign branches and subsidiaries of American companies. The miscellaneous item includes receipts for certain military services rendered by the United States, which amount to about $300 million a year.

Transportation and travel are the largest items on the payments side, amounting to $2 and $1.9 billion, respectively, in 1960. Payments for transportation services received in 1960 were considerably larger than receipts for transportation services rendered by Americans. Expenditures by Americans traveling abroad, however, were almost $900 million larger than receipts from foreigners traveling in the United States (table 12).

TABLE 12.—*Income received, and payments made, for "services," 1950–60*

[In millions]

A. U.S. RECEIPTS

Year	Total	Transportation	Travel	Investment income	Miscellaneous
1950	$3,784	$1,033	$419	$1,593	$739
1951	4,740	1,556	473	1,882	829
1952	4,786	1,488	550	1,828	920
1953	4,800	1,198	574	1,910	1,118
1954	5,150	1,171	595	2,227	1,157
1955	5,723	1,420	654	2,444	1,205
1956	6,326	1,642	705	2,611	1,368
1957	7,343	1,999	785	2,881	1,678
1958	6,972	1,650	825	2,922	1,575
1959	7,126	1,717	870	2,948	1,591
1960 [1]	7,474	1,750	1,020	2,976	1,728

B. U.S. PAYMENTS

Year	Total	Transportation	Travel	Payments on investments	Miscellaneous
1950	$2,414	$818	$754	$345	$497
1951	2,670	974	757	355	584
1952	2,965	1,115	840	390	620
1953	3,119	1,081	929	450	659
1954	3,131	1,026	1,009	419	677
1955	3,587	1,204	1,153	502	728
1956	4,070	1,408	1,275	580	807
1957	4,467	1,569	1,372	653	873
1958	4,589	1,599	1,460	676	854
1959	5,005	1,712	1,575	822	896
1960 [1]	5,744	2,000	1,915	938	891

[1] Annual figure based on official figures for the 1st 9 months.

Capital Movements

Capital movements are movements of funds for investment for which no immediate quid pro quo, in the form of commodities or services, is received. They can be for either short- or long-term investment, the former being influenced largely by interest rates. Long-term investment is for the purpose of constructing or acquiring production facilities with a view to receiving income in the future. Investment can be either private or governmental. Private investment, in turn, can be either direct or portfolio. Direct U.S. foreign investment is the direct ownership of production facilities, either in whole or in part, in a foreign country by U.S. nationals. By portfolio investment is meant the purchase by Americans of securities issued by foreign companies.

Government investments are directly related to a country's foreign policy. Most outstanding U.S. Government foreign investment is a consequence of its foreign aid programs.

Capital investment by Americans abroad increases the outflow of dollars from the United States. The immediate effect on the balance of payments is similar to an increase of merchandise imports. The intermediate and long-run effects, however, are usually of greater significance than the short-run effects and serve to increase the inflow of dollars.

Shortly after investment funds flow abroad there is a tendency for some, or all, of the dollars to return to the United States to purchase American capital equipment and other exports. Sometimes the terms of the loan require that the dollar proceeds of the loan be spent in the United States. Such loans are known as "tied loans." Of course, eventually all U.S. dollars return to the United States, just as pounds sterling return to the United Kingdom and French francs return to France, since the money of any country is of value, ultimately, only in the country that issued it. In the case of direct foreign investment a large part of the loan proceeds usually flows back to the lending country fairly quickly.

In the long run, after the foreign investment has increased production in the recipient country, there is a tendency for dollars to flow back to the United States in the form of earnings on investment. This inward flow of dollars has a similar effect on the balance of payments as increased exports and, if continued over a considerable period of time, will necessitate increased dollar payments (just as a steady increase of exports would do) usually in the form of increased imports. Therefore, a country that engages in large-scale foreign investment over a long period of time must expect that eventually its merchandise imports will exceed its exports. This is because the investing country is receiving a return on its investment, the anticipation of which was the reason for investing the capital abroad in the first place. This was the situation in which the United Kingdom found itself in the latter part of the 19th century. Her persistent adverse balance of trade was a mark of her international economic strength.

Foreign investment is profitable to lenders and is usually advantageous to borrowing countries because it facilitates economic development and expansion. Development of the economically more backward areas of the world for some time has been an important element of U.S. foreign policy. As far as possible, private investment is favored over government investment because the individual enterprise system relies on private, rather than governmental, initiative.

As far as the balance of international payments is concerned, the most significant variable with respect to capital movement is the balance on capital account, including both capital movements themselves and earnings on existing investments.

The increase in the excess of international payments over receipts in the U.S. balance of international payments between 1955 and 1958 was accompanied by a substantial increase in outpayments on account of capital and outward earnings on investment. Between 1955 and 1959, in contrast, the increase in the excess of international payments over receipts was accompanied by a small increase in outpayments on account of capital but by a substantial narrowing of the export merchandise export surplus.

In 1960, compared with 1955, the increase in the excess of payments over receipts was accompanied, as in 1958, by a large increase in outpayments on account of capital but by substantial improvement in the merchandise trade surplus. The net movements of capital and earnings on capital account between 1950 and 1959 are shown in table 13.

TABLE 13.—*Movements of capital and earnings on capital, 1950–60*

[In millions]

Calendar year	Capital					Returns on capital investment			Net dollar flow on account of capital and earnings
	Private	Government (net)	Total outflow	Inflow of foreign capital (long term)	Net capital movement	Outflow	Inflow	Net	
1950	−$1,265	−$156	−$1,421	+$53	−$1,368	−$345	+$1,593	+$1,248	−$120
1951	−1,068	−156	−1,224	+182	−1,042	−355	+1,882	+1,527	+485
1952	−1,158	−420	−1,578	+141	−1,437	−390	+1,828	+1,438	+1
1953	−369	−218	−587	+206	−381	−450	+1,910	+1,460	+1,079
1954	−1,619	+93	−1,526	+244	−1,282	−419	+2,227	+1,808	+526
1955	−1,211	−310	−1,521	+346	−1,175	−502	+2,444	+1,942	+767
1956	−2,990	−629	−3,619	+530	−3,089	−580	+2,611	+2,031	−1,058
1957	−3,175	−958	−4,133	+361	−3,772	−653	+2,881	+2,228	−1,544
1958	−2,844	−966	−3,810	+24	−3,786	−676	+2,922	+2,246	−1,540
1959	−2,145	−354	−2,499	+558	−1,941	−822	+2,948	+2,126	+185
1960 [1]	−2,790	−996	−3,786	+448	−3,338	−938	+2,976	+2,038	−1,300
Comparisons: [2]									
1955 and 1958	−1,633	−656	−2,289	−322	−2,611	−174	+478	+304	−2,307
1955 and 1959	−934	−44	−978	+212	−766	−320	+504	+184	−582
1955 and 1960	−1,579	−686	−2,265	+102	−2,163	−436	+532	+96	−2,067
1959 and 1960	−645	−642	−1,287	−110	−1,397	−116	+28	−88	−1,485

[1] Annual figure on basis of 1st 9 months.

[2] Plus indicates increase in dollar inflow or decrease in dollar outflow. Minus indicates increase in dollar outflow or decrease in dollar inflow.

Source: U.S. Department of Commerce.

From 1951 through 1955, the inflow of earnings on U.S. investments abroad, together with the inflow of new foreign capital, exceeded the outflow of new investment (both private and governmental) and payments of earnings on existing foreign investments in the United States, by as much as $1 billion a year. In 1956, 1957, and 1958, however, the net outflow of dollars on account of new investment and earnings on investment exceeded the inflow by as much as $1.5 billion a year. In 1956 the excess of outflow over inflow was $1.1 billion and in 1957 and 1958 it averaged $1.5 billion a year. In 1959 the outflow (particularly on private account) decreased so that there was a small net inflow of $185 million. In 1960, however, the net outflow increased to $1.3 billion (see table 13).

Between 1955 and 1958, the annual outflow of private capital increased $1.6 billion and the annual outflow of Government capital increased $656 million. In the same 4-year period the annual inflow of new foreign capital declined $322 million, so that the increase in the net annual outflow was $2.6 billion. Since net earnings on capital (inflow) increased $478 million, the net increase in the annual outflow of dollars on account of capital investment and earnings, together, was about $2.3 billion. As shown in the following tabulation, this negative balance was countered to the extent of $700 million by improvement in the merchandise trade account.

Merchandise trade balance, the investment accounts and the balance of payments deficit, 1955–60

[In billions]

	1955	1958	1959	1960
Overall adverse balance in international payments	−$1.1	−$3.4	−$3.7	−$3.5
Merchandise trade surplus	+2.9	+3.6	+1.1	+4.5
Investment accounts	+.77	−1.54	+.2	−1.3

In 1959 there was a substantial decline in both private and governmental foreign investment so that, on balance, there was a small net dollar inflow on account of new investment and investment earnings, amounting to $185 million. Meanwhile, the merchandise export surplus was narrowed by $2.5 billion (from $3.6 billion in 1958 to $1.1 billion in 1959).

In 1960 there was a substantial increase in outward capital movement, particularly short-term private capital, so that the net outward movement of funds on account of capital and earnings thereon totaled $1.3 billion, which was much more than matched by a substantial improvement in the merchandise export surplus ($4.5 billion).

Table 13 shows the details regarding private and U.S. Government foreign investment. The bulge in private investment in 1956 and 1957 was accounted for primarily by direct investment. Although this type of investment has since decreased there has been a substantial increase in short-term capital movements. Portfolio investment [other long-term investment] consisting principally of bonds and stocks increased steadily through 1958 but in 1959 and 1960 was at about the same level as in 1957.

The increase in Government investment since 1956 can be explained largely by U.S. Government credits for the disposal of agricultural products.

The larger part of the earnings received from U.S. investments abroad are on direct investment. Receipts on portfolio investments are only about one-fourth as large. Table 15 shows the source of receipts on foreign investments, together with payments remitted to holders of foreign investments in the United States. The last column of the table shows the excess of earnings on U.S. investments abroad over remittances on foreign investments in the United States.

TABLE 14.—*U.S. private and governmental outflows of capital, 1950–60*

[In millions]

	Private				Government			
	Direct	Other long term	Short term	Total private	Long term	Repayments	Short term	Net
1950	$621	$495	$149	$1,265	$414	−$295	$37	$156
1951	528	437	103	1,068	458	−305	3	156
1952	850	214	94	1,158	847	−429	2	420
1953	721	−185	−167	369	716	−487	−11	218
1954	664	320	635	1,619	306	−507	108	−93
1955	779	241	191	1,211	383	−416	343	310
1956	1,859	603	528	2,990	545	−479	563	629
1957	2,058	859	258	3,175	993	−659	624	958
1958	1,094	1,444	306	2,844	1,272	−647	341	966
1959	1,204	845	96	2,145	1,016	−997	335	[1] 354
1960 [2]	1,114	859	817	2,790	1,060	−581	517	996

[1] Not including the $1,375,000 increase in the U.S. subscription to the International Monetary Fund.
[2] Annual figures based on official figures for 1st 9 months.

TABLE 15.—*U.S. receipts and payments on capital investment, 1950–60*

[In millions]

	Receipts				Payments on foreign investments in the United States [1]	Net receipts over payments
	Total	On direct investments [1]	On portfolio investments	On U.S. Government credits		
1950	$1,593	$1,294	$190	$109	$345	$1,248
1951	1,882	1,492	192	198	355	1,527
1952	1,828	1,419	205	204	390	1,438
1953	1,910	1,419	216	252	450	1,460
1954	2,227	1,725	230	272	419	1,808
1955	2,444	1,978	260	274	502	1,942
1956	2,611	2,120	297	194	580	2,031
1957	2,881	2,313	363	205	653	2,228
1958	2,922	2,198	417	307	676	2,246
1959	2,948	2,138	467	343	822	2,126
1960 [2]	2,976	2,208	499	269	938	2,038

[1] Not including undistributed profits of subsidiaries.
[2] Annual figures based on official figures for 1st 9 months.

Source: Survey of Current Business, December 1960.

Considering direct private investment only, returns in the form of earnings have been greater than the net outflow of capital in all years, including 1956 and 1957 (table 16). The capital position of the United States with respect to the balance of payments, however, is affected by all capital investments and earnings thereon, not by direct investments alone.

TABLE 16. *Direct U.S. foreign investment: Capital outflow and net return thereon, 1954–60*

[In millions]

Year	Capital outflow	Returns	Balance
1954	−$664	+$1,725	+$1,061
1955	−779	+1,978	+1,199
1956	−1,859	+2,120	+261
1957	−2,058	+2,313	+255
1958	−1,094	+2,198	+1,104
1959	−1,204	+2,138	+934
1960 [1]	−1,114	+2,208	+1,094

[1] Annual estimate based on figures for 1st 9 months.

Direct private U.S. investments are concentrated in Canada, Latin America and Western Europe. In other areas direct investments are small, except in certain petroleum-producing areas. Direct investment in manufacturing enterprises is concentrated in Canada and Western Europe.

One of the reasons for the increase in direct foreign investment in the past few years has been the formation of the European Common Market by Belgium-Luxembourg, the Netherlands, France, West Germany, and Italy. The recent formation of the European Free Trade Association by the United Kingdom, Norway, Sweden, Denmark, Switzerland, Austria, and Portugal should provide additional incentives to U.S. private investors. Table 17 shows the destination of new direct investment by geographical regions.

Outstanding U.S. direct investments, by industry and area in 1959, are shown in table 18. Table 19 shows outstanding U.S. Government credits and claims, also by regions. Together, they amounted to over $48 billion.

TABLE 17.—*New direct private investments, by geographical regions, 1956–60*

[In millions]

	1956	1957	1958	1959	1960 [1]
Western Europe	$486	$254	$173	$439	$518
Canada	542	584	398	427	385
Latin America	592	1,090	325	193	63
All others	239	130	198	145	148
Total	1,859	2,058	1,094	1,204	1,114

[1] Annual rate based on 1st 9 months.

Source: "Balance of Payments, Statistical Supplement" and "Survey of Current Business."

TABLE 18.—*Distribution of U.S. direct investments, by industry and area, 1959*

[In millions]

	Total	Mining and smelting	Petroleum	Manufacturing	Public utilities	Trade	Other
Canada	$10,171	$1,090	$2,465	$4,558	$636	$564	$858
Latin America	8,218	1,258	2,963	1,405	1,101	641	850
United Kingdom	2,475	(1)	492	1,607	9	240	126
Other Western Europe	2,825	50	961	1,320	35	341	119
All others	6,046	460	3,542	802	632	253	357
Total	29,735	2,858	10,423	9,692	2,413	2,039	2,310

[1] Less than $500,000.

Source: U.S. Department of Commerce, "U.S. Business Investments," 1960, p. 89.

TABLE 19.—*U.S. Government loans and claims, by area, 1959*

[In millions]

Region	Total	Long term	Short term
Western Europe	$9,378	$8,528	$850
Latin America	1,940	1,781	159
Other foreign countries	3,537	2,411	1,126
International institutions	3,476	3,472	4
Total	18,331	16,192	2,139

Source: Survey of Current Business, September 1960.

The U.S. Government has investments of almost $3.5 billion in international institutions, principally the International Monetary Fund and the International Bank for Reconstruction and Development.

It remains to be seen whether the United States is entering a new long-term phase in its international balance-of-payments position. If there is to be a substantial and prolonged increase in the movement of U.S. capital abroad relative to foreign capital invested in the United States, it is to be expected that eventually there will be a changed relationship between merchandise exports and merchandise imports, with the latter expanding in relation to the former as the income on existing investments abroad comes to exceed new capital outflow, allowing of course for unilateral payments in the form of military expenditures and foreign aid grants.

MILITARY EXPENDITURES AND FOREIGN AID

Unilateral transfers are one-sided transactions by which dollars are given to nationals of another country without there being a quid pro quo in any immediate or tangible form. In a sense, capital investment is a unilateral transfer, except that the funds are sent abroad in the expectation that there will be an inflow of funds in larger amount in the future. Portfolio investment is evidenced by the receipt of a piece of paper known as a security.

The most important unilateral transfers are expenditures for the support of the U.S. Military Establishment abroad and U.S. Government grants for nonmilitary aid.

Military expenditures abroad should not be confused with military supplies and services that are transferred to foreign countries as military assistance under the mutual security program. Military assistance, which totaled $4.3 billion in 1953, declined to $2.1 billion in 1959 and to $1.7 billion in 1960.[1] Although this expenditure comes out of the taxpayer's pocket, it does not add to the external flow of dollars, since the supplies and services are purchased within the United States. Therefore, they are not included in the balance-of-payments figures.

Cost of maintaining U.S. military forces abroad

The military expenditures that do affect the balance of international payments are the dollars that are transferred for the support of the U.S. Military Establishment abroad. These amounted to approximately $2.5 billion per annum in the period 1952–55. They increased to $3.4 billion in 1958 and totaled $3.1 billion in 1959. In 1960 they amounted to about $3 billion. These amounts do not cover the total cost of our foreign military operations, but only that part of military expenditure which is received by nationals of foreign countries.

Military expenditures abroad have enabled certain countries in Western Europe and Japan to increase their gold and dollar reserves. Of the $3.1 billion of military expenditures abroad in 1959, $1.5 billion was spent in Western Europe ($665 million in West Germany, $303 million in France, $297 million in the United Kingdom, and $116 million in Italy-Trieste), $428 million in Canada, and $381 million in Japan. U.S. military expenditures abroad totaled about $600 million per year during the 5 years preceding the Korean war and the creation of the North Atlantic Treaty Organization. Increased expenditures in the Far East brought the total expenditures for this purpose up to $1.3 billion in 1951. Military expenditures abroad doubled between 1951 and 1954.

As shown in the following tabulation, almost one-third of the total expenditure in 1959 was for the purchase of materials and supplies, which consisted largely of jet fuel, motor gasoline and other petroleum products, and fresh fruits and vegetables for the use of troops or for sale in commissaries, as well as other general supplies. Over one-fourth of the expenditure was by troops, civilian personnel and post exchanges.

Expenditures in connection with U.S. Military Establishment abroad, 1959

	Expenditures	Percentage distribution		Expenditures	Percentage distribution
	Millions			*Millions*	
Purchase of materials and supplies	$987	31.9	Offshore procurement for military assistance programs	$149	4.8
Expenditure by troops, civilian personnel, post exchanges, etc	873	28.3	Contribution to NATO multilateral construction program	68	2.2
Other expenditure for services	758	24.5	Purchase of equipment	38	1.2
Expenditure for construction	217	7.0	Total	3,090	100.0

Source: Survey of Current Business, U.S. Department of Commerce, December 1960.

[1] Annual rate based on 1st 9 months.

Some of the disbursements by U.S. military agencies do not provide dollar income to the foreign countries in which the disbursements are made, since they are made in foreign currencies that were originally acquired by the Government through the sale of agricultural products, excess property, and other goods and services, or received as counterpart funds under grant programs and as payments on loans and other credits. For the most part, the Military Establishment purchases these local currencies from the U.S. Treasury with appropriated dollars.

About half of the foreign outlays of the Armed Forces for services consists of out-of-pocket disbursements of U.S. personnel and their dependents, direct payments to foreign personnel, and the foreign outlays of post exchanges and clubs.

Contributions by the United States to the multilateral construction program of the North Atlantic Treaty Organization (NATO) has shown little fluctuation from year to year. By the end of June 1959 the cumulative cost to the United States for these installations constructed for the common use of the Allied forces was about $500 million.

Offshore procurement for the purchase of military equipment to be retransferred as grant aid to the producing countries or to other countries participating in the military assistance program amounted to $149 million in 1959.

The United States also receives dollars from other countries for the sale of certain military equipment. Such receipts are shown in the "services" section of this report. Most of the receipts result from the mutual security military sales program which enables our allies to purchase military equipment and services from the U.S. Government. Total receipts from military sales averaged $180 million annually during 1953–57. In 1959 they amounted to $300 million.

Because of the increase in the adverse balance of international payments of the United States, relative to the countries of Western Europe, it has been proposed that the latter bear a larger proportion of the cost of military defense than they now bear. There is no question but that the position of Europe has improved, while that of the United States has deteriorated, as far as the balance of international payments is concerned. Whether or not the Western European countries are paying a fair share of the total cost of the defense burden, however, is a different and more fundamental question.

Although it has no direct bearing on the balance of payments problem the following tabulation is presented to indicate the share of the cost of military defense that is being borne by selected countries, relative to their gross national products.

Ratio of total defense expenditure to gross national product, selected countries, 1958, 1959, and 1960 [1]

[Percent]

	1958	1959	1960
United States	10.3	9.7	9.6
France	7.0	7.1	7.5
United Kingdom	7.0	6.8	7.2
Canada	5.4	6.5	6.2
Netherlands	4.5	3.9	4.4
Italy	3.9	3.6	3.9
Norway	3.7	3.6	3.7
Germany	3.1	4.7	4.8
Denmark	2.9	2.7	2.9

[1] Expenditures for 1960 related to GNP figures for 1959.

Source: NATO and International Monetary Fund.

Nonmilitary grants

Present-day foreign aid is a postwar extension of the lend-lease philosophy of World War II, the theory underlying which is quite different from that underlying aid given in connection with World War I. At that time foreign aid took the form of interest-bearing loans which, at the end of the war, amounted to more than $11 billion, plus interest. Most of our allies defaulted and in 1932 President Hoover granted a moratorium on repayments, which was equivalent to canceling the indebtedness. From this experience the United States learned that the unilateral international transfer of billions of dollars can lead to problems that are practically insoluble.

The lend-lease program, inaugurated in 1941, made possible the transfer of billions of dollars' worth of war materials without raising the problem of monetary transfer after the war. The law authorizing lend-lease recognized that the financial and economic aspects of war cannot be separated from its military aspects and provided for a common pool of economic, as well as military, instruments of war. The theory of lend-lease was that the materials needed to wage the war should be made available among the allies in accordance with need and ability to supply. Repayment after the war was to be made in terms of unexpended war materials or other goods or services.

After the war numerous national and international organizations were created to provide postwar rehabilitation and reconstruction, including the United Nations Relief and Rehabilitation Administration. In 1947–48, the United States inaugurated the Marshall plan for the economic reconstruction of Europe. It contemplated that approximately $5 billion a year, for 4 years, would be made available by the United States to the Organization for European Economic Cooperation (the OEEC) which, in turn, was to apportion the proceeds among the cooperating countries. The rapid recovery of Europe and its present prosperity are evidence that the plan was successful.

The bulk of the foreign aid granted by the United States between 1947 and 1950 was economic in nature and most of it went to Europe. In 1948 the United States came to the military assistance of Greece and Turkey, which were threatened by Communist aggression. In 1950 the Communist invasion of Korea changed the complexion of the aid program into one that was primarily military. Since then the bulk of the funds spent for foreign aid have been for military defense.

Present programs of economic and technical assistance are complex. Aid is supplied in a variety of forms and the programs are administered by a number of agencies. Broadly speaking, aid is given either as outright grants or as Government loans. The latter, amounting to \$354 million (net) in 1959 and to \$996 million (net) in 1960 were discussed in the chapter on capital movements. Such loans are granted through the Export-Import Bank, the Development Loan Fund, out of U.S.-owned or controlled foreign currency holdings generated under Public Law 480, and through a number of international organizations, including the International Bank for Reconstruction and Development and the United Nations itself.

Nonmilitary aid in the form of grants amounted to \$1.6 billion in 1958, 1959, and 1960. The bulk of the grants are to Asiatic and African countries. Table 20 shows how the geographical destination of grant aid has changed, from Western Europe to Asia and Africa since 1948.

TABLE 20.—*Economic grants of the U.S. Government, by regions, 1948–60*

[In millions]

Year	Total	Western Europe	Latin America	Other (mostly Asia and Africa)	International institutions
1948	\$3,894	\$2,866	\$18	\$894	\$116
1949	4,997	3,951	30	912	104
1950	3,484	2,775	19	601	89
1951	3,035	2,317	17	657	44
1952	1,960	1,453	22	425	60
1953	1,837	1,138	28	578	93
1954	1,647	1,018	42	525	62
1955	1,901	807	68	945	81
1956	1,733	491	83	1,067	92
1957	1,616	317	112	1,103	84
1958	1,611	316	118	1,117	60
1959	1,623	310	105	1,123	85
1960 [1]	1,595	240	101	1,160	94

[1] Annual based on official figures for 1st 9 months.

Source: Survey of Current Business.

According to the U.S. Department of Commerce, economic assistance finances, either directly or indirectly, about one-eighth of all U.S. exports of goods and services. According to a recent release, the Department states that—

much of this assistance is in direct financing of U.S. exports, particularly farm products. About 37 percent of the gross outflow was devoted to financing agricultural exports. These Government programs thus financed about one-third of the fiscal year's \$4 billion of agricultural exports.[1]

It is difficult to ascertain how much of the \$1.6 billion of nonmilitary Government grants actually involve the foreign transfer of dollars. Direct cash transfers by the International Cooperation Administration amounted to \$49, \$60, \$100, and \$116 million in fiscal years 1957, 1958, 1959, and 1960 respectively. Furthermore, in fiscal 1960, offshore expenditures by the International Cooperation Administration totaled approximately \$500 million. These are aid dollars that are spent for the purchase of many different kinds of commodities from countries other than the United States.

[1] Press release of the Office of Business Economics of the U.S. Department of Commerce, OBE 59-90, Nov. 30, 1959.

Certain transfers of surplus agricultural commodities also involve dollar grants. It has been estimated that about one-half of all nonmilitary grant aid involves dollars, thereby exerting a direct effect on the payments side of the balance of payments.[1]

There is some feeling that, because of its outstanding economic growth in recent years, Western Europe should be asked to bear a larger proportion of the total cost of economic aid than it has been bearing. As far as can be ascertained, Western European countries spent approximately $1.1 billion on bilateral aid to underdeveloped countries (mostly their own oversea territories) in 1958. This figure is not altogether comparable with the $1.6 billion of grant aid given by the United States, since it includes aid to underdeveloped countries only.

According to the OEEC, the per capita physical output of Western Europe increased 18 percent between 1953 and 1958, compared with a decline of 1 percent for the United States. However, the per capita gross national product of the United States in 1958 was almost three times larger than that of Western Europe ($2,300 per capita, compared with $820). In 1953 it was slightly more than three times as large.

Whether or not the Western European countries are bearing a fair share of the cost of economic aid, it is evident that as far as their balance of payments positions are concerned they are in a better position now than they were a few years ago to bear a larger share of the cost.

Foreign Dollar Balances and Gold Movements

The recent deficits of international dollar payments over dollar receipts have taken the form of increasing balances to the credit of foreign banks or nationals in U.S. banks. Except in 1949 and 1957, U.S. payments exceeded receipts and the excess appears as the balancing item on the right (receipts) side of chart I. When the United States has an excess of dollar receipts over dollar payments the decreases in the balances held by foreigners appears on the left (payments) side of the chart.

Table 21 shows the annual changes in foreign-held dollar balances and international transfers of title to gold.[2] An outstanding fact is that, although sales of gold to foreigners in 1958, 1959, and 1960 totaled $4.7 billion, they have not occasioned a decline in foreign-held dollar balances. In fact, such balances increased in this period by $5.9 billion. If there were an appreciable loss of confidence in the U.S. dollar, the dollar balances would have decreased and foreigners would have converted dollars into gold.

This is not to say, of course, that continued loss of gold at the rate at which it was being sold in 1958 and 1960 could continue indefinitely, even though it undoubtedly could go on for several years without impairing confidence in the dollar.

[1] Data obtained from U.S. Department of the Treasury.

[2] Most of the gold that has been "exported" has not left the United States physically. It has been transferred in the vaults of the Federal Reserve Bank of New York to the accounts of the appropriate foreign countries. Such "earmarked" gold, amounting to $11 billion in 1960, is not part of the gold reserve of the United States.

TABLE 21.—*Increase in foreign gold and liquid dollar assets,*[1] *1949–60*

[In millions]

Year	Dollars	Gold	Net change, dollars and gold	Year	Dollars	Gold	Net change, dollars and gold
1949	+72	−164	−92	1955	+1,108	+41	+1,149
1950	+1,859	+1,743	+3,602	1956	+1,274	−306	+968
1951	+396	−53	+343	1957	+330	−798	−468
1952	+1,471	−379	+1,092	1958	+1,140	+2,275	+3,415
1953	+941	+1,161	+2,102	1959 [2]	+2,970	+732	+3,702
1954	+1,218	+298	+1,516	1960 [3]	+1,814	+1,700	+3,459

[1] Plus indicates increase in dollars held by foreigners or sale of U.S. gold to foreigners. Minus indicates decrease in dollars held by foreigners or purchase of gold from foreigners.
[2] Does not include U.S. contribution of $1.3 billion to the International Monetary Fund.
[3] Gold figure based on first 11 months as reported by the Federal Reserve Board. Dollar figure based on first 9 months as reported in the Survey of Current Business.

The largest recent sales of gold were in the second quarter of 1958 when over $1 billion was transferred to foreign account. In calendar 1958 foreign sales amounted to almost $2.3 billion. Although sales decreased to $732 million in 1959 (not including the $344 million transferred to the International Monetary Fund) they increased to $780 million during the first 9 months of 1960 (equivalent to an annual rate of $1.0 billion). It is estimated that sales in the fourth quarter will raise the figure for the year to $1.7 billion.

Nevertheless, it would be incorrect to characterize these gold shipments as a "run" on the dollar for there has been no evidence of any serious loss of confidence in the dollar as an international reserve currency. The dollar even withstood heavy speculation in the London gold market which caused the world price of gold to rise to over $41 per ounce in the autumn of 1960.

The largest sales of gold were in 1950, 1953, 1958, and 1960 (see table 22). The United Kingdom has been the largest purchaser. Next in importance have been Belgium, the Netherlands, France, and Italy. Since the close of World War II these countries have deemed their gold reserves to be inadequate. With improvement in their international economic position they hastened to convert part of their dollar balances into gold. Until recently the dollar balances were not large enough to permit them to do this because they were not able to generate a sufficiently large volume of merchandise exports.

TABLE 22.—*Sales of U.S. gold to foreigners, 1950, 1953, 1958, and 1959*

[In millions]

Sold to	1950	1953	1958	1959	Total
United Kingdom	$1,020	$480	$900	$35	$2,750
Italy			349		349
Latin America	172	132	69	31	404
Germany		130			130
Canada	100				100
France	85			266	351
Netherlands	80	65	261	30	436
Belgium	58	95	329	39	521
All others [1]	228	259	[2] 367	16	870
Total	1,743	1,161	2,275	732	5,911

[1] Including Bank for International Settlements.
[2] Switzerland $215 million.

Source: Federal Reserve Bulletin.

Notwithstanding the fact that its stock of monetary gold has diminished by almost $5 billion since 1949, the United States still has 46 percent of the total monetary gold reserves of the world (table 23). The United Kingdom ranks second, with 7.6 percent, and is followed by West Germany with approximately 7 percent. On September 30, 1960, the U.S. stock of monetary gold amounted to $18.7 billion.

TABLE 23.—*Gold reserves of central banks and governments, 1955–60*

	Million U.S. dollars				Percentage distribution			
	Dec. 31			Sept. 30, 1960	Dec. 31			Sept. 30, 1960
	1955	1958	1959		1955	1958	1959	
World	$37,620	$39,490	$40,185	$40,690	100.0	100.0	100.0	100.0
International Monetary Fund	1,808	1,332	2,407	2,564	4.8	3.4	6.0	6.3
United States	21,753	20,582	19,507	18,725	57.8	52.1	48.5	46.0
United Kingdom	2,120	3,069	2,736	3,108	5.6	7.8	6.8	7.6
Switzerland	1,597	1,925	1,934	1,980	4.2	4.9	4.8	4.9
West Germany	920	2,639	2,637	2,888	2.4	6.7	6.6	7.1
Netherlands	865	1,050	1,132	1,346	2.3	2.7	2.8	3.3
Italy	352	1,086	1,749	[1] 1,998	0.9	2.8	4.4	4.9
Belgium	929	1,270	1,134	1,094	2.5	3.2	2.8	2.7
France	942	750	1,290	1,627	2.5	1.9	3.2	4.0
All other	6,334	5,787	5,659	5,360	16.8	14.7	14.1	13.2

[1] July.

Source: Federal Reserve Bulletin, December 1960.

Maintenance of confidence in the U.S. dollar is important since the dollar has become an important international reserve currency. Confidence depends on its convertibility into gold and its stability of purchasing power. At present the dollar is convertible into gold—in practice, though not required by law—for the settlement of international balances at the fixed price of $35 per ounce. If the price of gold were to be raised, that is, if the dollar were to be "devalued" with respect to gold, or if there were what appeared to be well-founded rumors to that effect, there could be a stampede to convert dollars into gold.

It is difficult to measure the degree to which the purchasing power of various currencies has diminished, for inflation is a complicated concept. As far as can be ascertained from existing data regarding consumer prices and wholesale prices, inflation in the United States has not been greater than in most other countries.

Since 1953 prices of consumer goods in the United States, Canada, and Belgium have increased about 10 percent, which is less than in any of the other 9 countries shown in table 24 except Switzerland where they increased only 8 percent. In France they increased 34 percent, in Sweden 24 percent, in the Netherlands 22 percent and in the United Kingdom, Italy, and Norway, 21 percent.

In the same period wholesale prices increased 8 percent in the United States, which was higher than the increases in Canada, Germany, Belgium, the Netherlands, Italy, and Switzerland but lower than in the United Kingdom, France, Norway, and Sweden.

TABLE 24.—*Comparative price indexes, 1953–60*

[Monthly averages, 1953=100]

Country	Consumer price indexes		Wholesale price indexes	
	1957	1960	1957	1960
United States	105	110	107	108
United Kingdom	116	121	111	113
Canada	106	110	103	105
Germany	107	114	105	106
France	106	134	108	129
Belgium	107	110	106	103
Netherlands	115	122	107	104
Italy	113	121	103	99
Norway	112	121	113	111
Sweden	113	124	110	110
Switzerland	105	108	105	101

Source: OEEC Statistical Bulletin.

The monetary gold stock of the United States appears to be ample. In 1958, the gold stock of the United States equaled 4.7 percent of the country's gross national product. In the United Kingdom it equaled 4.8 percent, in West Germany 5 percent, and in Italy 4.1 percent. Switzerland had the highest holdings, relative to gross national product, with over 25 percent. The Netherlands and Belgium each had about 11 percent.

Of the present U.S. monetary gold stock of $18.7 billion, about $12 billion constitutes the 25-percent gold reserve against Federal Reserve notes outstanding and deposits at Federal Reserve Banks, as required by the Gold Reserve Act of 1945. The remaining $6.7 billion represents "free gold," or gold that can be used for settling international balances without impairing the legal reserve requirement.

It has been suggested that the United States reduce its 25-percent legal gold reserve requirement, or eliminate it altogether, since Federal Reserve notes and deposits are no longer legally convertible into gold. Any move in this direction could best be done at a time when confidence in the dollar is high, since the psychological effect of doing it when talk of devaluation is in the air could be unfortunate. Economically speaking, there appears to be little reason for maintaining the legal gold reserve requirement as long as currency and deposits are not convertible into gold.

Is there a "gold shortage"?

The world's stock of gold constitutes a huge reservoir into which there is a trickle of new gold production each year. Losses are light because gold is a highly durable metal. The quantity of gold that is available, relative to the need for it as circulating money, usually falls short of meeting the demand for it since its supply does not increase as trade and population expand. A cry for "easy money" is heard whenever commodity prices turn downward.

If it were not for the expansion of credit increasing industrial production throughout the world would cause commodity prices to fall. Such a phenomenon has been prevented by the use of bank credit and other money substitutes. The central banks of Europe and the Federal Reserve System of the United States have made it possible for relatively small quantities of gold to support large credit structures.

It has been proposed that the United States, the United Kingdom, Canada, and other countries of the Atlantic Community organize an international reserve bank which would pool gold reserves much as is done within the United States by the Federal Reserve System. Alternatively, it has been proposed that the International Monetary Fund be expanded to perform these functions.

Theoretically, there is little need for substantial gold reserves, either domestically or internationally. In a peaceful world, in which economic forces were allowed to work with a minimum of interference, only a small quantity of gold would be needed. The large volume of interbank debits and credits that are cleared in a major city clearing-house daily gives some idea of what the strain on gold and other currency would be if, instead of balancing credits against debits, all payments had to be made in money.

The fact that sales of gold to foreigners declined precipitously in 1959, while foreign dollar balances increased, and that sales of gold in 1960 were less than the net addition to foreign dollar balances indicates that there is not yet reason for alarm as far as U.S. monetary gold reserves are concerned. The United Kingdom and other countries that are now in a favorable balance of payments position will not try to amass as much of the world's gold as they can merely for the sake of accumulating it. Now that their monetary reserves have been largely restored the probability is that they will curtail their gold withdrawals from the United States. Indeed, it is in their own self-interest to preserve the integrity of the dollar because a large proportion of their own reserves are in dollars rather than in gold. The United Kingdom, by way of illustration, was so concerned over the unfavorable turn in the U.S. balance of international payments in 1959 that it repaid $250 million of its obligations to the Export-Import Bank in advance.

The fact that the United States has a deficit in its international payments, while Western Europe and Japan have surpluses, illustrates the seesaw nature of the international balance of payments. Since balance is relative it would be as impossible for all countries to have a "favorable" balance simultaneously as it would be for both ends of all the seesaws on a playground to be "up" at the same time. Worries over balance-of-payments deficits would be greatly diminished if the gold reserves of the free world could be successfully pooled.

Speculation in gold

Heavy speculation in gold on the free gold market in London during the latter half of 1960 ran the price of gold to a temporary high of $41 per ounce. Looked at the other way, the rise in the dollar price of gold represented a fall in the gold value of the dollar from 13.71 grains of fine gold ($35 per ounce) to 11.70 grains.

There are, of course, no statistics to which we can turn to learn who has been selling dollars short. Producers of new gold, such as Russia and South Africa, could be doing it. There is reason to suspect that some of the speculation has been by American nationals. The recent order by President Eisenhower forbidding the holding of gold abroad by Americans is difficult to enforce.

Statistics showing capital movements provide a clue as to what probably has been happening. In 1960 the outflow of short-term capital reached $817 million (annual estimate based on official figures for the first 9 months of the year) the highest level for the decade.

Only $96 million of short-term capital left the country in 1959 and $306 million in 1958.

Speculation provides the most plausible explanation of the large outflow of American gold in 1960, inasmuch as the balance of international payments of the United States was much stronger in 1960 than in 1959. The merchandise trade surplus was higher in 1960 than in 1959 by $3.4 billion, net receipts on account of services were down by only $300 million while capital outflow was $1.5 billion higher. There was little change in the level of unilateral transfers in the form of military expenditures abroad and nonmilitary foreign aid. If it were not for speculation in gold it could be expected that the improvement in the international accounts would have reduced the payments deficit to a figure substantially less than the $3.7 billion reached in 1959. Instead, it was reduced to only $3.5 billion.

It seems probable that the reason for the substantial withdrawal of gold during the latter half of 1960 was the purchase of gold from the U.S. Treasury by the Bank of England to replenish the gold that it has been paying to those who have been exchanging dollars and other currencies for gold for speculative purposes. Those who believe that the United States is going to devalue the dollar have only to hold gold while selling dollars short outside the United States. Then, if devaluation comes they will realize the difference between the old and the appreciated value of gold as pure dollar profit. The fact that the United States stands ready to buy gold, as well as to sell it, at the fixed price of $35 per ounce places a protective floor under such speculation.

Although the cessation of speculation in gold would not solve the balance of payments problem, it would at least render it soluble. As long as the drain on gold for purposes of speculation continues the problem is almost insoluble.

Several ways have been suggested to stop the speculative drain. One of them[1] would have the United States announce in advance that, although it will continue to sell gold freely at $35 per ounce, it will reduce its minimum buying price by successive steps according to an announced schedule thus appreciating, rather than devaluing, the dollar in terms of gold. An even simpler way[2] would be for the United States to continue to redeem dollars in gold at $35 per ounce (i.e., to continue selling gold) but to abandon the guarantee to buy it from foreigners at the minimum price of $35 per ounce. The abolition of the fixed buying price would be opposed, of course, by foreign producers of gold. There would be nothing to prevent the United States, meanwhile, from buying gold from domestic mines at $35 per ounce or any other price. Although it is important that the United States support the international value of the dollar in terms of gold, there seems to be little reason for the United States to continue to support the world price of gold in terms of dollars.

Conclusions

The fact that the United States has an adverse balance in its international payments is not a cause for alarm as far as the basic economic strength of the country is concerned. However, there is a serious problem with respect to gold and confidence in the dollar that cannot be ignored.

[1] Proposed by Prof. Fritz Machlup, of Princeton University.
[2] Proposed by Dr. William Blitz.

There is danger that solutions might be applied that go unnecessarily beyond the area of money and finance into the area of foreign policy. In particular, there is danger that the larger objectives of foreign policy will be sacrificed because of preoccupation with the relatively superficial problem of maintaining balance between international monetary payments and receipts.

The balance of payments problem consists of two parts: The first an explanation of what is happening with respect to the flow of dollars into and out of the country, and the second an explanation of why receipts have failed to increase so as to balance the increased dollar outflow. Credit money (as opposed to the precious metals) is of ultimate value only in the country that issues it and there is a tendency for money to return to its home base. Thus, U.S. dollars tend to return to the United States, British pounds sterling tend to return to Great Britain, and so on.

An analysis of international dollar payments and receipts, in and of itself, does not constitute an explanation of why receipts are lagging behind payments. Under the old free gold standard, the unimpeded international movement of gold would have brought about adjustment of prices between countries, thereby effecting balance in international payments fairly quickly. In the absence of an automatic adjustment mechanism there is fear in almost every country that the adjustment of its economy to the economies of other countries will have deflationary effects which all are loathe to face.

After World War II European countries were unable to generate sufficient exports to balance the aid payments that the United States was making to them under the Marshall plan. Indeed, it was because Europe lacked this capacity that the Marshall plan was necessary in the first place. The monetary reserve positions of the European countries were weak and it was necessary for them to acquire gold or build up their dollar balances in the United States. The fact that the United States maintained parity between the dollar and gold made it a matter of indifference to them whether they accumulated gold or dollars. The dollar had become the world's major international reserve currency.

All through the period of the "dollar shortage" the United States was incurring a deficit in its balance of payments of about $1.5 billion a year, the amount by which other countries were increasing their dollar reserves. Unilateral dollar payments by the United States for maintenance of its Military Establishment abroad and for nonmilitary grant aid, remained fairly constant between 1949 and 1960 at $4 to $5 billion a year.

By 1958 Western Europe and Japan had become competitive in world markets and able to generate exports in volume. According to the theory of adjustment, the steady unilateral outflow of funds from the United States should have stimulated a return of dollars in the form of demand for U.S. exports. Merchandise exports, in fact, did increase, relative to merchandise imports between 1950 and 1958, increasing 64 percent, compared with an increase of 44 percent in merchandise imports. Because of the sharp increase in imports in 1959, however, the increases in exports and imports in the 1950–59 period were 63 and 71 percent, respectively.

If services and merchandise trade are considered together, dollar receipts in the period 1950–58, including interest and other earnings on foreign investment, increased 70 percent, compared with an increase on the payments side of 54 percent. Thus, until 1958 there was a tendency for dollar receipts on current account to increase more rapidly than dollar payments.

However, the increase was not substantial enough to offset the unilateral transfers of approximately $5 billion a year, together with the large increase in U.S. foreign investment after 1955. The excess of dollar payments over dollar receipts loomed large in 1958 and 1959 because other countries did not spend enough dollars for U.S. merchandise and services. Instead, they chose to add to their monetary reserves in the form of dollar balances and, in 1958 as in 1953, to replenish their gold holdings. Commodity prices, interest rates, and national monetary policies all played a role. In 1959 they chose to curtail purchases of gold and again to add to their dollar balances.

In 1960 the balance of payments of the United States improved greatly. The merchandise export surplus increased to $4.5 billion from its $1.1 billion level in 1959, a net improvement of $3.4 billion. There was only a small decline ($300 million) in net income on account of services, while U.S. military expenditures abroad and nonmilitary foreign aid remained unchanged. On the other hand, the net outflow of capital, a substantial proportion of which was short-term, increased by $1.5 billion. On balance, therefore, there appears to have been an improvement with respect to these principal items of slightly over $1.5 billion and one would expect the deficit of $3.7 billion of 1959 to have been reduced by something between $1 and $2 billion in 1960. Instead, the deficit decreased merely to $3.5 billion, of which $1.8 billion was in increased foreign-held dollar balances and $1.7 billion in gold outflow.

Had it not been for speculation in gold during the latter half of 1960, the international payments of the United States probably would have been close to balance. At least, the deficit would have been reduced to approximately its pre-1958 level. The balance of payments deficit, which in 1958 coincided with intensified foreign investment and in 1959 with a failure of merchandise exports to keep pace with increased merchandise imports, has become largely a problem of speculation in gold. Gold movements in 1960 appear to have been an active, rather than merely a passive, factor in international payments.

Proposed solutions to the balance of payments problem range all the way from those that would be inconsistent with major foreign policy objectives, such as drastic cutbacks in the U.S. Military Establishment abroad and in foreign aid, to those that would assist the forces of adjustment within the framework of existing foreign policy, such as the encouragement of better exporting methods and by taking action to curtail speculation in gold.

AREAS IN WHICH ACTION HAS BEEN PROPOSED

Suggestions with respect to gold and the international payments system

(1) *Devaluation of the dollar in terms of gold.*—Many foreign countries maintain their reserves in both gold and dollars with the result that the United States has become a major banker for the free world. International confidence in the dollar, therefore, is vital. Unless at least 13.71 grains of fine gold can continue to be obtained from the

U.S. Treasury for each dollar presented by a foreign holder (i.e. $35 per ounce) foreigners will convert much of their dollar holdings into gold. If the United States were to raise the price of gold (devalue the dollar) above its present level of $35 an ounce confidence in the dollar would be undermined and a "run" on gold would be imminent. Instead of solving the problem of international imbalance devaluation of the dollar would aggravate it and could precipitate widespread financial crisis.

(2) *Assurance that the present price of $35 per ounce of gold will be maintained.*—Such assurance by the United States would be one way of enhancing confidence in the dollar among foreigners who hold a substantial proportion of their reserves in dollars. Assurance could be by Presidential announcement or by a declaration of Congress. Although it would afford no permanent guarantee against devaluation it could allay fears that a change is imminent.

(3) *The United States to continue to sell gold for foreign-held dollars at the fixed price of $35 per ounce, but to terminate the guarantee to buy gold from foreigners at that, or any other, fixed price.*—The assurance that the United States stands ready to buy gold at the fixed price of $35 per ounce encourages speculation in gold. A person having, or obtaining, gold abroad who believes that the United States will devalue the dollar has only to sell dollars short and to sell his gold to the U.S. Treasury after devaluation occurs, thereby reaping large dollar profits. The cost and risk of the transaction are small since the speculator can lose no more than the cost of the transaction itself. If the United States does not devalue the dollar, he can always present his gold to the U.S. Treasury and receive dollars for it at the fixed price of $35 per ounce. There is reason to believe that a substantial amount of the gold that has left the United States in recent months has been to replace gold that the Bank of England has been paying to speculators who have been converting currency into gold for this purpose.

If the United States, while continuing to redeem foreign-held dollars in gold at $35 per ounce, were to terminate the guarantee to purchase gold for dollars at that price, speculators would have to take a chance of loss since they would no longer be assured of the minimum price of $35 per ounce. Such action by the United States would discourage speculation in gold and should stimulate the return of substantial quantities of gold to the United States.

Stated succinctly, the United States would give assurance that, although it intends to support the dollar in terms of gold, it has no intention of supporting the world gold market in terms of dollars. The United States, of course, would purchase gold at the world market price whenever it deems it necessary to do so to replenish its gold reserves. One variant of the proposal would be for the United States to announce that it intends to reduce the price of gold (i.e., appreciate the dollar) in several stages, to be announced in advance.

(4) *Reduction, or elimination, of the 25-percent legal minimum gold reserve requirement.*—The present 25-percent legal minimum gold reserve requirement against Federal Reserve notes and deposits is an anachronism since notes and deposits are no longer convertible into gold. Because of the requirement approximately $12 billion of the $18.7 billion monetary gold stock of the United States is set aside for this purpose and cannot be used to settle international balances. If

the requirement were reduced or abandoned, there would be a substantial addition to the approximately $6.7 billion of "free gold" now available for the settlement of international balances.

Most countries have given up the minimum gold reserve requirement for their central banks. In Europe, the only countries retaining a provision that central banks maintain a minimum gold reserve are Belgium and Switzerland.

Little concern was manifested, either in the United States or abroad, when Congress reduced the reserve requirement from 40 percent against Federal Reserve notes and 35 percent against deposit liabilities to 25 percent against both in the Gold Reserve Act of 1945. Further action would best be taken at a time when confidence in the dollar is unquestioned. Action taken at a time when there is serious concern over the dollar might have unfortunate psychological effects.

(5) *International pooling of gold reserves.*—The centralization of gold reserves on a national basis, which the establishment of the Federal Reserve System in 1914 made possible, did much to allay fears of financial panic and was a vast improvement over the old national banking system.

What applies within a country could also apply internationally if the political means for effecting it could be found. It has been suggested that the countries of the Atlantic Community—particularly the United States, Canada, and the United Kingdom—pool their gold reserves by forming an Atlantic Community Reserve Bank. As an alternative, the authority of the International Monetary Fund could be expanded to enable it to perform this function.[1]

Economically, such a solution to the problem of "international liquidity" would be logical. The difficulties are essentially political and involve questions of national sovereignty as related to money.

The substitution, wherever feasible, of payments "in kind" for unilateral dollar transfers

Since what is of concern is the excess of international dollar payments over receipts, a logical solution would be to try to substitute nondollar payments for dollar payments wherever possible. The present excess of payments over receipts does not signify any economic or financial incapacity within the United States. The close to $5 billion that is being paid abroad currently to maintain our overseas Military Establishment and for nonmilitary foreign aid exerts no unbearable strain on the country's domestic economy.

It would seem logical to substitute payments "in kind" for dollar payments to cover part of the cost of maintaining our troops and military installations abroad. It might even be feasible to persuade American overseas military personnel to accept part of their compensation, including a small premium, in the form of savings certificates that could be spent only in the United States.

No one seems to know exactly how much of the $1.6 billion of nonmilitary grant aid is in the form of dollars. Offshore procurement, which accounted for $500 million in fiscal 1959, clearly necessitates the use of dollars. Even some of the aid that is given in the form of surplus agricultural commodities involves dollars. The best available estimates indicate that approximately one-half of the $1.6 billion involves the transfer of dollars. It seems reasonable to suppose that

[1] Proposals along this line have been made by Prof. Robert Triffin, of Yale University.

perhaps $1 billion of the $3.8 billion now being spent to support the U.S. Military Establishment abroad and as nonmilitary grant aid, together, could be transferred from the "dollar" category to the "in kind" category.

The requirement that the proceeds of dollar loans granted by the Development Loan Fund be spent entirely in the United States was a step in this direction, although there is some question as to whether the move was adequately explained to the public at the time it was announced. A similar result could be achieved by reducing offshore procurement. Such a move, as well as the "Buy American" requirement of the Development Loan Fund, would add to the cost of foreign aid, although probably not substantially.

Transfer to our allies of a larger share of the cost of military defense and economic aid

The rapid economic recovery of Western Europe raises the question of whether those countries should not be called upon to pay a larger proportion of the cost of the common military defense and economic developmental aid. Immediately following World War II, when the Marshall plan was inaugurated and the North Atlantic Treaty Organization was formed, it was understood that Europe would not be expected to make huge dollar expenditures because of the then worldwide dollar shortage.

In view of Europe's economic recovery and the disappearance of the dollar shortage, it has been suggested that Europe assume a larger share of these costs. Whether or not the Western European countries are bearing a fair share of the cost of military defense and economic developmental aid, they are now in a better position to pay than they were a few years ago as far as their balance of payment positions are concerned.

The fact that the United States has been spending $3 billion a year for quite a few years to maintain U.S. military bases throughout the world indicates that the American people believe the maintenance of an adequate global military posture is vital to this country's self-interest.

If the maintenance of U.S. military forces abroad is essential to world peace, it would be foolish to abandon the effort merely because of temporary international payments difficulty. The size of our foreign Military Establishment should be determined as part of the overall defense picture, not as an aspect of the balance of payments problem. The same reasoning applies to nonmilitary foreign grants as an essential part of foreign policy.

The military equipment and supplies that are being furnished to other countries under the mutual security program (military assistance) and which amount to between $2 and $2.5 billion a year, are not included in the expenditures herein referred to. Military assistance is given "in kind," rather than in dollars, and does not directly affect the balance of international payments.

Try to increase merchandise exports, relative to merchandise imports

Governmental restriction of imports would widen the export trade surplus by reducing imports. Within a short time the effect would be to throttle exports also. For more than 25 years the United States has led the movement for the mutual reduction of tariffs and other trade barriers. It has done so through the reciprocal trade agreements program and by leadership in the formation of the General Agreement on Tariffs and Trade.

The imposition of intensified restrictions against imports would be an announcement to the world that the United States had abandoned leadership with respect to international economic cooperation. Other countries would follow suit and world trade would become engulfed in a contracting spiral that would aggravate economic problems everywhere.

At the same time, those domestic producers who are being hard hit by import competition feel they should not have to bear the full burden of competitive imports that are deemed necessary because of economic foreign policy. Some of them feel that, notwithstanding the requirements of foreign policy, imports should be restricted, while others believe that some form of assistance to facilitate adjustment to less competitive lines of production would be in order.

In the past, the home market has been so large that most U.S. manufacturers have looked upon foreign markets as not much more than convenient sales outlets whenever there has been contraction in the home market. This has been the case especially since World War II while dollars were in short supply and Europe was not able to compete internationally. Since U.S. production costs could not be seriously undercut by Europe there was little reason for most U.S. producers to fear European competition.

Now, however, the situation is changing. European producers of manufactured goods not only have recovered from the war, but they have become competitive. It is important that U.S. exports increase, but if the increase is brought about by governmental subsidy it will only aggravate the problem by inviting retaliation. Other governments can play the same game. Competitive export subsidization by all countries would lead to the intensification of barriers against imports everywhere and result in a contracting spiral of world trade. Only by improving productive efficiency, by the reduction of costs, and by better selling methods can exports be increased. It is particularly important that U.S. manufacturers style their products for export to satisfy the demands of foreign buyers.

Now that the Western European countries and Japan have improved their balance of payments positions, there is no legitimate reason for them to continue discriminating against U.S. goods. Discrimination was tolerated during the period of the dollar shortage because other countries were not able to generate the exports needed to acquire dollars. This is no longer the case and the United States, quite appropriately, has appealed to other countries, particularly the members of GATT, to abandon their discriminatory import restrictions.

Response to the appeal had been gratifying. It is estimated that the reductions in dollar discrimination announced in 1959 will make possible an expansion of at least $300 million a year in U.S. exports. The movement needs to be continued and the U.S. Government should call attention to such barriers wherever they exist.

The European Common Market (Belgium, Netherlands, Luxembourg, France, West Germany, and Italy) and the European Free Trade Association (United Kingdom, Norway, Sweden, Denmark, Switzerland, Austria, and Portugal) are sympathetic with the idea of liberalizing trade and have announced their desire to negotiate with the United States for that purpose. Once the discriminations against

U.S. exports have been terminated in accordance with the principles of the International Monetary Fund and the General Agreement on Tariffs and Trade, the next step is to seek the reduction of other trade barriers on a mutual basis.

Curb inflation and deflation

The importance of curbing inflation and deflation can hardly be overemphasized in any analysis of the balance of payments problem. U.S. dollars that reach the hands of foreigners through the sale of merchandise, through investment, foreign aid, or in any other way are of value, ultimately, only in the United States. The problem of the balance of payments is: Why outstanding dollars have been sluggish in returning to the United States, relative to the rate at which dollars are being paid out?

Fundamental to all economic analysis is the operation of compensatory, or corrective forces. In the absence of rigidities of one kind or another, dollars now extant will either return to the United States to purchase merchandise or services, or be accumulated in the form of dollar reserves. Clearly, there is a limit to the dollar reserves that are needed by other countries. If the forces of inflation should gather momentum the United States would become a poor place in which to buy because of high prices, and dollars would be converted into gold, even if gold reserves are accumulated to a greater degree than necessary.

Already there are signs that the forces of international economic adjustment are at work. Adjustment could be upset, however, if inflation in the United States should get out of hand or if there should be pronounced deflation with a consequent withdrawal of foreign funds.

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