Senator SPARKMAN (presiding). Thank you, sir. Mr. Humphrey.

STATEMENT OF DON HUMPHREY, PROFESSOR OF INTERNATIONAL ECONOMICS, FLETCHER SCHOOL OF LAW & DIPLOMACY, TUFTS UNIVERSITY

Mr. HUMPHREY. The competitive position of the United States in world trade has greatly improved since 1959. According to reports from Europe, the outlook is for continued improvement. The odds now favor relatively greater upward pressure on European wages and prices than on our own. The favorable prospect depends on our keeping enough restraint on wages and prices to avoid inflation, even when unemployment and idle capacity are eliminated.

If the American economy were operating more nearly at capacity, we would import more, so that our large surplus of exports over imports would be somewhat reduced. That is why full recovery may delay the complete elimination of our foreign deficit. In considering magnitudes, we need to distinguish the deficits that we have actually experienced from the still larger deficits that we might have faced with full employment. The deterioration of our competitive position, during the last half of the 1950's, contributed to a slack in the domestic economy because we failed to produce and sell enough exports to balance the international accounts.

The other side of the picture is that the surplus countries have been overexporting, as compared with the requirement for balance-of-payments equilibrium. Thus, while underexporting has meant unemployment in the United States, overexporting contributed to an excess of demand in the surplus countries. This disparity is further exacerbated by the flow of capital. When the surplus countries employ high interest rates to hold down demand and prices, this attracts capital from the United States, where low interest rates prevail in an effort to stimulate domestic output. From this we can see how the overall payments picture may not improve as rapidly as our competitive position.

In the end, full recovery would have a favorable effect on capital movements. Capacity output will raise profits and interest. This will not only keep the extra funds at home which have been moving abroad, it is expected to attract foreign capital. The trouble is that these favorable effects on capital movements come rather late in the recovery, while imports of merchandise may increase temporarily faster than exports with each step of domestic expansion. In fact, business may accumulate inventory in anticipation of higher domestic requirements.

All of this brings us to the prescription of higher interest rates and budget deficits. While there are many possible ways of curbing balance-of-payments deficits, there is only one good method: that is to make price competitive. For the rest, the choice, I'm afraid, is between the undesirable and the unthinkable. We can agree, I assume, that it would be a miscarriage to sacrifice $30 billions of potential output for the sake of speedier elimination of a foreign deficit, which is so very small by comparison and is already diminishing. We can cut taxes, as may be needed to restore the momentum of domestic recovery, and bear with our foreign deficit a little longer. Sophisticated Eu-