ing them (in the form of currency inflows generated by direct investment activity abroad) is being seriously impaired. This fact, combined with the lack of an adequate sense of urgency on the part of the government and the consistent tendency to act belatedly and with insufficient vigor to correct our basic payments imbalances, can ultimately have serious repercussions.

By way of pointing up our concern about the continuing ability of the private sector to support public commitments abroad we should point out that our balance of payments was already showing a deterioration prior to the fourth quarter *due in a major degree to the increasing deficits in the public sector accounts.* The overall balance (on a liquidity basis) had shown some improvement in 1964 and 1965 but reflected no further improvement in 1966 and then moved in a strongly adverse direction in the first three quarters of last year to a seasonally adjusted annual rate of $2.3 billion, an increase of $0.9 billion over the entire year 1966. (See table below.)

SELECTED U.S. BALANCE OF PAYMENTS TRANSACTIONS

	1966	1967 [1]	Change
Merchandise trade surplus	+3.66	+4.35	+0.69
Capital outflows into direct private investment, net	−3.46	−2.89	+0.57
Income from direct private investment (including fees and royalties)	+5.09	+5.40	+0.31
Other long-term private capital outflows, net	−0.26	−1.14	−0.88
Short-term private capital outflows, net	−0.41	−1.02	−0.61
Government grants and capital outflows, net [2]	−3.45	−4.25	−0.80
Military expenditures	−3.69	−4.25	−0.56
Military sales	+0.85	+1.17	+0.32
Overall balance [3]	−1.36	−2.28	−0.92

[1] First 3 quarters at seasonally adjusted annual rates.
[2] Excluding "Military grants of goods and services," "U.S. Government pensions and other transfers," and "Official reserve assets."
[3] Detail does not add to total because only selected items are shown.

This overall deterioration in our payments balance occured despite a major improvement in the first three quarters of 1967 in both the merchandise and direct investment sectors. Our merchandise trade surplus (converted to a seasonally adjusted annual rate) showed an increase of $0.7 billion over 1966. At the same time, capital outflows into direct private investment abroad declined by $0.6 billion, and income from direct private investment (including fees and royalties from such investment) rose by $0.3 billion for a net improvement of $0.9 billion in the direct private investment sector. These improvements were more than offset, however, by large adverse movements in other sectors. There was a major adverse movement in government grants and capital outflows which increased by $0.8 billion in the first three quarters of last year (at seasonally adjusted annual rates) over 1966, and there was a large increase in the rate of military expenditures abroad (by some $0.6 billion) although this was offset to a significant degree by an increase in the rate of military sales abroad ($0.3 billion).

Adverse movements were also experienced in "other private capital outflows" with other private long-term outflows increasing by $0.9 billion and short-term outflows by $0.6 billion over 1966 in the first three quarters of last year (both at seasonally adjusted annual rates). These offset *in part* the favorable movements in the trade and direct private investment sectors. It can be seen, however, the major elements contributing to the adverse movements were in the government sector.

Inasmuch as the government sector continued to be the prime contributor to the balance of payments deficit (the merchandise trade and private investment sector together have consistently contributed to the plus side of the payments balance) and in light of the large increase in the payments deficit on government account last year, the government should, in our view undertake further intensive efforts to reduce the deficit in its own sector. We so conclude even though we must recognize the necessarily adverse effects of Vietnam developments on the government sector.

More importantly, in view of the private sector's historic role in reducing the payments deficit incurred in the public sector, the government should be careful to avoid taking steps which will impair the ability of the private sector to ful-