

ment, and net outflows of private capital of U.S. residents. Ordinarily, military expenditures abroad are reported as part of the balance of goods and services. I took them out of there, because this is one of the items that are usually regarded as autonomous or disturbing factors. I wanted to show it as part of the financial transfers which, if all goes well, induce matching flows of goods and services.

The table indicates that the financial transfers, in the 17 years from 1950 to 1966, varied from a low of \$5.6 billion in 1953 to a high of \$13.9 billion in 1964. The balance of goods and services (exclusive, of course, of military expenditures) varied in the same period from a low of \$2.4 billion to a high of \$11.4 billion. By and large, the years of high financial transfers were also years of high export surpluses. For example, the year with the lowest financial transfers, 1953, was the year with the second lowest export surpluses. The year with the highest financial transfers, 1964, was also the year of the highest export surpluses. The difference between financial transfers and export surplus I have called "transfer gap." This transfer gap varied between \$1 billion and \$5 billion. In the last six years it varied only between \$2.2 billion and \$3.2 billion.

My table, partly to make it less clumsy, omits inflows and backflows of foreign capital, private and official. The net inflow of foreign capital, inclusive of unrecorded transactions and inclusive of the dollar accumulations by monetary authorities, is equal to the difference between the transfer gap and the change in our gross reserves. Another reason why I omitted figures for foreign capital was the impossibility of separating autonomous inflows and those that were merely accommodating (that is, financing the deficit).

If we succeeded in achieving full adjustment, the surplus in the balance of goods and services would match the net deficit on the other accounts. Why full adjustment has not been attained and why, therefore, a transfer gap has remained throughout the years is a controversial question. Probably several factors have accounted for the lack of adjustment.

Virtually all theoretical analyses of the transfer problem include as necessary conditions for full adjustment relative price and income deflation in the paying country and relative price and income inflation abroad. Perhaps these conditions have not been met, chiefly because we have, for very good reasons, been unwilling to allow production and employment in the United States to be sufficiently depressed to "push out" enough of our products to achieve an adequate export surplus. Likewise, foreign nations have been unwilling to allow a rate of inflation sufficient to "suck in" enough goods from the United States.

Another important factor in the incomplete working of the adjustment process may have been the policy of some countries to offset the external effects of their price and income inflations by devaluations of their currencies. France, for example, devalued the franc in 1957 and 1958 with the result that the franc became undervalued and France could within a few years accumulate a gold reserve of almost \$6 billion.

THE TRANSFER PROBLEM

It is sometimes said that the theory of the adjustment mechanism—a theory explaining how the trade balance adjusts to remove imbalances of payments—was not designated for countries or periods in which large amounts of financial transfers disturbed the balance of payments. This is not so. The classical debate of this problem of adjustment started when Britain had extraordinarily large military expenditures on the Continent during the Napoleonic Wars.

The discussion of the adjustment to large financial transfers was resumed when France had to pay indemnities after the Franco-Prussian War, and again when Germany had to pay reparations after the First World War. It was in connection with the discussions of the German transfer problem that some economists raised doubts as to whether the balance of goods and services could ever be flexible enough to allow adjustment to large transfer commitments.

In Table 2, some of the dollar figures of Table 1 were transformed into percentages of gross national product. It is significant that all the figures in question are minute fractions of our GNP. Exports of goods and services, in the period of 17 years, varied from 4.7 to 6.0 per cent of GNP. Imports (excluding military expenditures) varied from 3.6 to 4.6 per cent. The export surplus is, of course, a still smaller fraction. It varied from 0.7 to 2.0 per cent, of GNP.

The financial transfers varied from 1.5 to 2.3 per cent of GNP. It may be worth pointing out that there has been no consistent increase in financial transfers relative to GNP. On the contrary, from 1964 to 1966 they declined from 2.2 to