Another major factor behind the movement in the trade balance since 1959 has been U.S. price performance relative to the other industrial countries. From 1959 to 1964, prices in the United States were fairly stable, while prices in Europe, the United Kingdom, and Japan rose markedly. This relative price improvement, operating through a long and sometimes unpredictable lag process, contributed to the improvement in the balance of trade during those years.

Since 1965, however, U.S. prices, under the pressure of excess demand, have risen somewhat faster than in most industrial countries, contributing to the deterioration in our trade balance. From 1964 to 1968 the U.S. export unit value index has risen by 8.9 percent, while the import unit value index has gone up by only 3.8 percent. Even if the domestic demand for output is slowed in 1969 and 1970, the lagged effects of past and continuing price increases will continue to pose problems for us.

The growth in U.S. merchandise exports—9.2 percent in 1959–64 and 7.2 percent in 1964–68—covers a divergence between the growth rate of exports of manufactured goods, which rose in the latter period, and that of foodstuffs and crude materials, which fell sharply.

After growing at a rate of 10.2 percent per year from 1959 to 1964, the rate of growth for food exports began to fall in 1965 and 1966. These exports have actually declined in the last 2 years, falling by 1968 to about the 1964 level of $4.6 billion.

This abrupt halt in the growth of foodstuff exports, which were 18 percent of total exports in 1964, has slowed the total growth of exports even though the growth rate of manufactured goods exports has picked up. One of the factors is the increase in grain production in some of the less developed countries, which is welcome in itself. Of greater concern for our food exports in the coming years is agricultural policy in the European Economic Community (EEC), now again being discussed in Europe. The EEC system of high internal support prices, variable import levies, and export subsidies for agricultural products results in the retention of unneeded resources in farm production, increasing agricultural surpluses within the Community, and intensifying price competition in third-country markets. As long as the EEC continues this system, it is hard to visualize any major gain in U.S. agricultural exports, though the United States, with its highly efficient farming, has a strong comparative advantage in many important agricultural products.

A structural factor operating both on imports and exports is the United States-Canada Automotive Products Agreement which permits free trade in autos and parts across the United States-Canadian border. The rationalization of production that this agreement has encouraged has increased both exports and imports, but imports have so far shown the larger increase. The automobile manufacturers are still adjusting to the possibilities opened by the agreement, so its effects on exports and imports can be expected to continue for some time.

When we turn to U.S. earnings on investment abroad, we find a more reassuring picture. These earnings have shown steady and rapid growth throughout recent decades. During the 1960's, the average annual rate was about 12 percent. This is somewhat greater than the growth rate of U.S. direct investment abroad, which reached $59.3 billion at the end of 1967. The total foreign investment in the United States reached $2 billion at the end of 1967. Almost 60 percent of the