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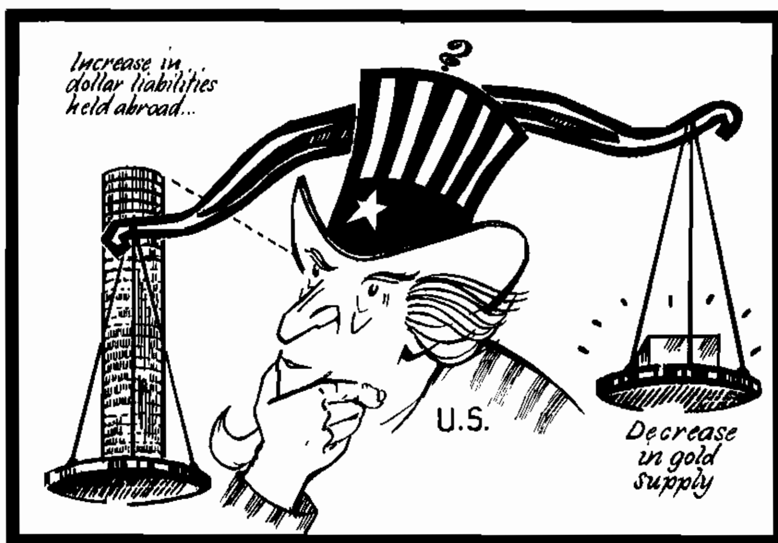

THE BALANCE OF PAYMENTS PROBLEM, THE DOLLAR, AND UNITED STATES WORLDWIDE RESPONSIBILITIES

PART I

by

Professor William A. Dymsza

(This is the first part of a two-part series which Professor Dymsza has prepared for the *Review*. Part I focuses on definitive information concerning the U.S. balance of payments. Part II, to be published in the next issue, will provide an analysis of the policies pursued by the United States in reaction to the balance of payments problem. Ed.)

The balance of payments problem of the United States has received major attention from business, the financial community, the military, and government since 1958. The problem has been dramatized by a gold outflow of over $9 billion since 1958.

During the same time short-term liquid dollar liabilities have increased by about $11 billion. The substantial gold outflow, the increase in liquid dollar liabilities held abroad, and the persistent deficits have cast some doubt about the stability and soundness of the United States dollar.

THE UNITED STATES POSITION AS LEADER OF THE FREE WORLD

The United States balance of payments problem should be placed in perspective in terms of the political, military, financial, and economic role this country has assumed as leader of the non-Communist world. The role of world leadership that the United States has assumed has not only contributed in a major way to the deficits, but it has also made positive resolution of the problem highly difficult.

The following aspects of the United States role of world leadership are especially significant with respect to the balance of payments problem.

(1) The United States is the world banker, and the dollar is the major international trade and reserve currency.

(2) The United States has assumed major military responsibilities and entered into collective security arrangements, such as NATO, in order to promote its own national security and that of the free world. As a result the United States has substantial military expenditures in conjunction with American troops and bases overseas.

(3) The United States has placed major emphasis in its foreign policy on assisting economic development and modernization of less-developed countries. As a result it has engaged in major foreign aid programs, consisting of loans, grants, and technical assistance, including some programs through the United Nations and international organizations. Foreign aid is one of the major instruments of foreign policy in dealing with the less-developed countries, where two-thirds of the people in the non-Communist world live. The United States is also trying to encourage increased foreign investments in and trade with these countries.

(4) Under the Reciprocal Trade Agreements Act, the Trade Expansion Act of 1962, and GATT (General Agreement on Tariffs and Trade), the United States has long pursued policies to reduce tariffs and other trade barriers and establish unconditional most-favored-nation treatment in order to expand world trade. At the present time the United States is engaged in the "Kennedy Round" negotiations under the Trade Expansion Act of 1962. These negotiations are especially striving to reduce the common external tariffs of the European Common Market.

(5) Related to the dollar as a world currency and its policies of encouraging freer trade, the United States has long maintained convertibility of the dollar and encouraged other countries to eliminate exchange controls and establish convertibility of their currencies.

As we shall see later, the above commitments assumed by the United States in its role of world leadership have been major factors in the deficits experienced in this country's balance of payments. Moreover, the United States has experienced major conflicts between resolving its balance of payments problem and pursuing policies mentioned above to foster its worldwide objectives.

The U.S. balance of payments has led to widespread controversy and differences of opinion with respect to appropriate definitions of equilibrium and deficit disequilibrium and with respect to analysis of the causes of the deficits. It has led to considerable differences of opinion on the impact of the deficits on the dollar as a world currency and even more so with respect to policies to resolve the problem. In the following sections, we shall briefly discuss the balance of payments concept, concepts of deficit and equilibrium, major factors involved in the deficit, and the deficit in terms of the United States dollar as a world currency. In Part II of this paper, to be published next month, we shall analyze policies designed to achieve equilibrium in the United States balance of payments.

BALANCE OF PAYMENTS CONCEPT

Until the widespread discussion of the U.S. problem during the last few years, the balance of payments concept was not well known in this country. However, the concept has been widely and frequently

discussed in newspapers, magazines, and specialized publications, but some of the articles have been more confusing than enlightening.

Method of International Accounting. In essence, the balance of payments is a double entry method of accounting that summarizes the international transactions between residents of one country and the rest of the world during a specified period, usually a year. The term "residents" refers to business companies, other private institutions, individuals, and governmental bodies. The transactions include buying and selling merchandise and services, capital inflows and outflows, transfers of earnings on investment, foreign aid, gifts and loans, private gifts, and gold movements.

The international transactions are summarized in the balance of payments as debits or credits. Debits are frequently referred to as "payment transactions" as they usually involve outflows of funds, while credits are termed "receipts" because they usually lead to inflows of funds. Yet, this is not fully accurate, as there may be no movement of funds. Rather we may think of debits as transactions such as transactions such as merchandise imports that typically but not necessarily entail payments sooner or later to foreign countries. On the other hand, credits such as merchandise export items are transactions that ordinarily but not necessarily in time lead to receipts from residents of foreign countries.

Current Account and Capital Account. The balance of payments is frequently divided into the current account, unilateral transfers, and capital account. Current transactions are those involving exports and imports of merchandise and services. The merchandise transactions are referred to as visibles, while service transactions are termed invisibles. Service transactions include transfers of interest and profits on foreign investments. Services have been of growing importance in international trade.

Unilateral transfers are those made with no commercial *quid pro quo*. They include private transfers such as remittances to relatives overseas and private charitable contributions overseas. Government transfers comprise grants under foreign aid programs and social security retirement benefits paid to citizens living overseas. Sometimes unilateral transfers are considered as part of the current account along with goods and services. The balance

on current account including unilateral transfers is an important one in analyzing a country's balance of payments situation. This balance is also a part of the Gross National Product.

The capital account comprises private and governmental investments and loans overseas and foreign investments and loans into the country. Private investments are frequently classified as long-term and short-term, the latter being those made normally for less than a year. But the breakdown is not always clear. Of greater significance, longer-term private investments are classified as direct and portfolio. Direct investments are those made by business firms in foreign countries that are partly or completely under their managerial control. They involve not only provision of capital but also some technology, business know-how, and managerial direction. Portfolio investments, on the other hand, comprise purchases of foreign bonds and other securities with no managerial control in order to earn interest or dividends. Government loans comprise longer-term credits made under foreign aid and other programs with some schedule of repayment of principal along with interest. Government credits, however, may also be short-term in character.

Finally, net changes in movements of monetary gold are considered as monetary or settlement items. Besides monetary gold, net changes in holdings of foreign exchange are also settlement transactions. These transactions may be classified separately as monetary transactions or may be treated as part of the capital account. In Exhibit 1, we show a model of the balance of payments for the United States.

EXHIBIT I

BALANCE OF PAYMENTS MODEL FOR THE UNITED STATES

I. CURRENT ACCOUNT	Debits	Credits
A. Merchandise Trade (Visibles)		
1. Exports		x
2. Imports	x	
B. Services (Invisibles)		
1. Tourist Expenditures		
a. By foreigners in U.S.		x
b. By Americans overseas	x	
2. Transportation		
a. Provided by U.S. shipping companies, airlines, etc.		x
b. Provided by foreign shipping companies, airlines, etc.	x	
3. Banking and Insurance Services		
a. Provided by American institutions to foreigners		x
b. Provided by foreign institutions	x	
4. Interest, Dividends and Royalties on Investments		
a. Received on foreign investments		x
b. Paid to foreigners on investments in U.S.	x	

	Debits	Credits
5. Military Expenditures		
a. Paid to foreigners for services provided in conjunction with U.S. troops and bases overseas	x	
II. UNILATERAL TRANSFERS (May be considered as part of Current Account)		
A. Private		
1. Personal and Institutional remittances to nonresidents	x	
2. Remittances from overseas (insignificant)		x
B. Government		
1. Foreign aid grants	x	
2. U.S. Government pensions paid overseas	x	
III. CAPITAL ACCOUNT		
A. Private Long-Term		
1. Direct Investments		
a. Made by foreign companies in the U.S.		x
b. Made by U.S. companies abroad	x	
2. Portfolio and Securities		
a. Purchase of American securities by foreigners		x
b. Purchase of foreign securities by Americans	x	

	Debits	Credits
B. Government Long-Term		
1. Repayment of U.S. Government loans		x
2. Government loans to foreigners	x	
C. Private Short-Term		
1. Increase by Americans of bank and short-term security holdings overseas	x	
2. Increase by foreigners of bank balances and short-term security holdings in U.S.		x
IV. GOLD AND MONETARY ACCOUNT (May also be considered as part of Capital Account)		
A. Gold		
1. Outflow or export		x
2. Inflow or import	x	
B. Foreign Exchange		
1. Increase of convertible currencies held by U.S. monetary authorities	x	
2. Increase of liquid dollar holdings by foreign monetary authorities		x

Source: A model somewhat similar for this one is shown and explained in Chapter 8 in Snider, Delbert, *Introduction to International Economics*, Homewood, Ill.: Richard D. Irwin, 1965.

Balance of Payments in Balance. The balance of payments must be in balance in the sense that debits have to equal credits. Like other double entry methods of accounting every transaction conceptually involves a debit and a credit. If every international transaction was recorded, the total of debits would equal the total of credits. While it is very different, the balance of payments as a concept has to balance for the same reasons that a company's balance sheet must be in balance.

We can see the double-entry nature of the balance of payments as follows. A United States merchandise or service export is a credit item, but it must somehow be paid for by residents of foreign countries or matched by an increase in debt to Americans. Along the same line, a merchandise or service import has to be paid for by Americans or matched by an increase in debt to foreigners. In the last analysis, the largest part of imports of goods and services is paid for by foreign exchange earned by Americans through exports. Similarly U.S. exports are largely paid for by dollars earned by foreigners in selling goods and services to this country. Any differences are made up by investments and unilateral transfers, and are ultimately settled in credit or debit transactions or gold movement.

The fact that the balance of payments has to be in balance and that the United States has had deficits is frequently a source of confusion. However, the key matter is not that debits have to equal credits in the accounting sense, but rather how the balance is achieved as a result of all the transactions in which this country engages during the course of the year. As we shall see, the United States has been achieving a balance by an outflow of gold and an increase in short-term liquid debt to foreigners.

Actually, the U.S. balance of payments consists of estimates made by the Balance of Payments Division of the U.S. Department of Commerce. Like in most other countries, there is no complete record kept of all international transactions of this country. On the basis of data available from governmental and private sources and some surveys conducted, the Department of Commerce makes the best estimates possible of international transactions. Some data, especially that involving governmental expenditures and merchandise imports and exports is highly reliable. Other data, such as direct and portfolio investments

overseas and in this country, may not be quite as reliable, but the data has improved greatly in recent years. Finally, we find that data on short-term capital movement, especially so-called hot money seeking higher returns or, especially, greater security, may be quite unreliable. The balance of payments is brought into balance by an item called errors and omissions. There is a commonly held hypothesis that the errors and omissions item largely represents unrecorded capital movements. Yet, it can also include errors on other transactions, such as tourist expenditures, which still are quite imperfect estimates. The errors and omissions in the U.S. balance of payments have not been large in relation to total transactions. During the past five years they have averaged a little over two per cent of the total debits or credits. However, we should keep in mind that the balance of payments still largely comprises estimates with some possible margin of error, even though the Department of Commerce utilizes the best data available.

THE CONCEPTS OF DISEQUILIBRIUM AND EQUILIBRIUM

The United States has had deficits in its balance of payments (or a disequilibrium) every year since 1950, except the year 1957, and is striving to achieve an equilibrium. What do we mean by equilibrium and disequilibrium in terms of the U.S. problem? A clear definition of the meaning of equilibrium and disequilibrium should be helpful in understanding the problem and in analyzing policies to deal with it. While on the surface it should be relatively easy to define these concepts, it turns out that there are disagreements on the theoretical and policy definitions. We shall try to clarify the meaning of equilibrium and disequilibrium from a policy point of view, starting with the former.

Specifically, how can we reconcile the fact that the balance of payments must be in balance even when a deficit disequilibrium exists? The deficit does not represent the balance on all items in the balance of payments, which is necessarily zero, but rather the balance of certain selected transactions. In one approach to balance of payments analysis a distinction is made between (1) autonomous or independently motivated transactions and (2) financing or compensatory transactions. The independently motivated transactions are those such as exports and imports of goods and services, long-term capital

movements, and recent foreign aid grants and loans. The excess of debits over credits on these transactions comprises the deficit. The other transactions, referred to as compensatory ones, finance or settle the deficit. They may include net changes in gold, holdings of convertible currencies, and liquid dollar liabilities.

However, the distinction between autonomous or independently motivated and compensatory or settlement transactions is not always obvious. Motivations behind various transactions are hardly clear. Therefore, distinction between autonomous and compensatory transaction in practice may become blurred. Since different classifications of transactions and some discretionary judgment is involved, balance of payments statisticians prefer to use the term "above the line" transactions rather than autonomous or independently motivated transactions and "below the line" transactions rather than compensatory or settlement transactions.

Thus, the U.S. balance of payments would be in equilibrium if debits equaled credits in "above the line" transactions. However, since debits exceed credits in these transactions and settlement or "below the line" transactions are necessary to achieve a balance, this country's balance of payments has a deficit disequilibrium.

However, we should emphasize that the determination of balance of payments equilibrium and disequilibrium is not pure science, but a mixture of analysis and policy. A number of different concepts of the deficit and of equilibrium have been used to analyze the United States balance of payments. Differences have developed as to which transactions should be "above the line" and "below the line." As indicated in hearings before the Joint Economic Committee of Congress in June 1965, no single concept of the deficit is best for all analyses.[1] Several different concepts of deficits, and surpluses as well, may be appropriate in this country and other countries, depending upon the purposes of the analysis undertaken. Furthermore, the determination of the deficit also depends upon policy considerations, since the Government is faced with responsibilities to deal with a persistent deficit.

The Liquidity Concept of Deficit. Since 1965 the U.S. Government has been using two concepts of the deficit: (1) the liquidity balance and (2) the

official settlements balance. The liquidity deficit is similar to the balance on overall transactions that the Balance of Payments Division of the Department of Commerce has been basically using since the early 1950's.[2] However, in some years the Department of Commerce made adjustments for special transactions, such as advance repayment of loans to the United States or prepayment on military sales. It no longer makes these adjustments. This concept of the deficit has been generally accepted as the deficit in this country and abroad.

The liquidity concept of the deficit is measured by the net change in official monetary reserves and in liquid dollar liabilities to foreigners. The U.S. official reserves include monetary gold, convertible currencies, and the United States' position in the International Monetary Fund, but the situation is dominated by gold. The liquid dollar liabilities are those to foreign central banks and governments and those held by foreign private banks, business firms, and individuals. They are held in the form of bank deposits, U.S. Treasury obligations, bankers' acceptances, and other liquid claims on this country.

In other words, under the liquidity concept, all transactions in the balance of payments are considered as independently determined or "above the line," except changes in official monetary reserves, especially gold, and liquid dollar liabilities. The latter transactions are considered as settlement or "below the line" transactions.

The liquidity concept of the deficit is based on the U.S. role as world banker and, especially, the dollar as an international reserve currency. It measures the net change in international liquidity of the United States with the rest of the world as a result of all transactions in the balance of payments. It emphasizes the change in the liquid claims of foreigners, both official and private, in relation to the gold and other reserve assets held by this country. It is concerned with the capability of the United States to maintain the gold value of the dollar at $35 an ounce.

However, the liquidity concept of the deficit has been criticized on theoretical and policy grounds. The concept may overstate the deficit. Under this definition, there is a divergent treatment of private short-term capital inflows and outflows.

U.S. private short-term investments are placed "above the line," while private foreign short-term investments in dollar holdings are placed "below the line" and are treated as settlement items. At least a part of American short-term capital movements might be settlement items. Furthermore, private groups may accumulate dollars for short-term investments in liquid working balances that yield a return and also are used to conduct expanded international business. From this standpoint the private accumulations of dollars could be appropriately considered as an "above the line" investment item. This would reduce the size of the deficit in a number of years. Moreover, from the worldwide point of view, it is logical that the amounts of deficits in balances of payment would be offset by the amounts of surpluses. However, under the liquidity concept, deficits and surpluses are not symmetrical, because of the differences in treatment of short-term capital inflows and outflows. In other words, under this definition deficits exceed surpluses in the world. This is another limitation of the concept.

The Official Settlements Concept of Deficit. The official settlements concept of the deficit, on the other hand, considers the deficit as the change in the monetary reserves (gold, foreign exchange, and the International Monetary Fund position) and in liquid dollar liabilities to foreign monetary authorities (foreign central banks and governments).[3] A distinction is made between changes in liquid dollar liabilities held by foreign monetary authorities and those held by private foreign individuals and organizations. Changes in liquid liabilities held by private groups are placed "above the line," as they are looked upon as capital movements, while those acquired by monetary authorities are placed "below the line" and are considered as settlement items. In other words, the official settlement approach does not count changes in liquid dollar liabilities held by private individuals and organizations as part of the deficit. Rather, it basically concentrates on the settlement transactions between the United States monetary authorities (the Treasury and the Federal Reserve) and foreign monetary authorities in determination of the deficit.

The principal reasons for the use of the official settlements concept are as follows. The United States and foreign monetary authorities have the responsibility for maintaining existing stable exchange rates under the present international monetary

system. In the process of maintaining existing exchange rates, the monetary authorities buy or sell foreign exchange and ultimately gain or lose gold, or experience an increase or decline in liquid liabilities held by foreign governments or central banks. The United States is only obligated to convert on demand liquid dollar assets held by foreign monetary authorities into gold at $35 an ounce. Foreign private accumulations of liquid dollar holdings may be appropriately considered as capital movements rather than settlement transactions. Foreign private banks, business firms, and individuals acquire increased dollars for investment purposes and for the conduct of expanded international business. Another advantage of the official settlements concept is that it is symmetrical in treatment of private capital and other items. If all countries used this definition, the combined deficits and surpluses would equal zero, except for acquisitions of new mined gold.

While the official settlements concept is superior to the liquidity concept on some analytical and policy grounds, it has some limitations. The distinction between private holdings and those held by foreign monetary authorities may break down. Sometimes commercial banks may hold liquid dollars for central banks. Furthermore, private foreign dollar holdings can readily be shifted to foreign official holdings and this would increase claims on U.S. gold. A related problem is that after privately held dollar balances shift from one country to another in financing trade, they may be changed from private to official holdings. This could increase the U.S. deficit without any basic changes in this country's transactions. Thus, in some ways the liquidity concept of the deficit more fully reflects the position of the dollar as a reserve currency and gauges the potential foreign liquid claims against gold. On the other hand, the liquidity concept is a highly conservative one that shows the deficit at its worst.

Basic Deficit. Another concept of deficit that was used by the President's Council of Economic Advisors for several years and has been preferred by many economists is the basic deficit.[4] This concept is used by the International Monetary Fund and by many foreign countries. It essentially distinguishes between a country's basic international transactions (such as exports and imports of goods and services, long-term private capital movements, and unilateral transfers) and transitory and volatile movements

(such as short-term capital, gold movements, and errors and omissions). The former transactions are placed "above the line" while the latter are "below the line." Thus the deficit is determined by the net short-term capital movements which tend to be more volatile and by gold and errors and omissions.

The basic deficit is conceptually a sound, logical definition. The distinction between the basic transactions and the more volatile or extraordinary international transactions is an illuminating one. Moreover, the definition is a symmetrical one. If all countries used this definition the sum of deficits and surpluses in balances of payments would be zero, except for new mined gold. However, the basic deficit concept may not be fully adequate for the United States, because of the role of the dollar as an international trade and major reserve currency. It does not adequately reflect the capacity of the United States to maintain the value of the dollar in relation to gold, as a result of changes in its balance of payments. However, the concept is highly useful in longer-term analysis of the balance of payments.

Comparison of Deficits Under the Three Concepts. Table 1 shows the deficits in the U.S. balance of payments under the liquidity, official settlements, and basic definitions. As we can see, the United States has had deficits on the basis of all definitions for every year, from 1950 to 1965, except for 1951 and 1957. Furthermore, under all definitions the deficits have been substantial and persistent from 1958 to the present, except that the basic transactions deficit is small in 1964 as a result of a considerable U.S. short-term capital outflow that year. However, the deficits have generally been smaller under the official settlements and basic transactions concepts than under the liquidity concept. While the differences are not substantial during the period 1950 to 1957, from 1958 to 1965 the deficit under the official transactions concept and under the basic transactions concept average about $600 million less than under the liquidity concept.

This data shows a practical problem in changing from the *liquidity* to either the *official transactions* or *basic transactions* concepts of the deficit regardless of the merits of the case. It would be looked upon as a way to reduce the size of the deficit. While the liquidity concept tends to

TABLE I

LIQUIDITY, OFFICIAL SETTLEMENTS, AND BASIC DEFICITS IN THE UNITED STATES BALANCE OF PAYMENTS

(Billions of Dollars)

	Liquidity Deficit	Official Settlements Deficit	Basic Deficit
1950	-3.6	-3.3	-3.4
1951	-0.3	+0.5	+0.7
1952	-1.0	-0.8	-1.6
1953	-2.1	-2.1	-2.6
1954	-1.6	-1.5	-1.1
1955	-1.1	-0.7	-1.5
1956	-0.9	-0.3	-1.0
1957	+0.5	+1.1	+0.4
1958	-3.5	-3.0	-3.7
1959	-3.7	-2.3	-4.7
1960	-3.9	-3.4	-1.8
1961	-2.4	-1.3	-0.9
1962	-2.2	-2.7	-2.1
1963	-2.7	-2.0	-1.9
1964	-2.8	-1.5	-0.3
1965	-1.4	-1.3	-2.3

Source: Liquidity and Official Settlements Deficits shown in *Economic Report of the President*, January 1966, "The Annual Report of the Council of Economic Advisors" (Washington: U.S. Govt. Print. Off., 1966), Appendixes, Table C-78 most recent data for 1960 to 1965 shown in "U.S. Balance of Payments: First Quarter 1966" in *Survey of Current Business*, June 1966, Table 3, p. 30. Basic deficit 1950 to 1962 shown in Salant, Walter, et al. *The United States Balance of Payments in 1968* (Washington: Brookings Institution), Table I-1. Calculated by author for other years.

overstate the deficit, it has been used for such a long period of time by the U.S. Government that it is widely considered here and abroad as the appropriate concept.

This discussion shows that there is no perfect concept of the deficit and that all three definitions discussed have definite advantages and weaknesses. The basic deficit has been abandoned as a measure by the U.S. Government, as it does not adequately reflect the role of the U.S. dollar as an international reserve currency and this country's capacity to continue this role. Still, it is highly useful for a longer term analysis of the balance of payments.

After a careful study for the Bureau of Budget, the Review Committee for Balance of Payments Statistics led by Dr. Bernstein, former Research Director of the International Monetary Fund, recommended that the Government use the official settlements concept rather than the liquidity concept.[5] After hearings and its own study, the Joint Economic Committee of Congress recommended in July 1965 that the U.S. Government use both the liquidity and official settlements concept of the deficit.[6] Since that time the Government has been showing both concepts of the deficit.

However, while recognizing that all definitions have their limitations, the author prefers the official settlements over the liquidity concept of the deficit because he considers that it is logically sounder and more realistically measures the extent of the deficit. The liquidity concept has the serious disadvantages of overstating the deficit and of not being symmetrical on a worldwide basis. Furthermore, the official settlement concept represents a more desirable equilibrium that would permit private dollar holdings to grow modestly as international business expands.

The Concept of Equilibrium. Once the concept of deficit or surplus disequilibrium is defined, it is easy to specify the meaning of equilibrium in the balance of payments. In essence, equilibrium involves having no deficit or surplus. It involves a position in the balance of payments that can be sustained indefinitely. It therefore relates to a country having a fully satisfactory international reserve position and being able to maintain the value of its currency in international transactions. In a broader sense, a satisfactory equilibrium also

involves reasonable balance in the domestic economy and the ability of a country to pursue its national and international economic objectives. In other words, the achievement of equilibrium should not be at the expense of high and stable levels of employment, satisfactory economic growth, and other objectives of economic policy.

From the standpoint of a reasonable concept of equilibrium that interrelates U.S. domestic and international economic policies, the author considers that the official settlements concept is superior to the liquidity one. Along with other considerations, it would enable private foreign holdings of dollars to grow moderately as international business expands and would continue the present role of the dollar as an international trade currency.

THE SIZE OF THE DEFICITS

Using the official settlements concept which the author prefers, the United States has experienced deficits in its balance of payments every year from 1950 to the present, except 1951 and 1957. The deficits from 1950 to 1956 averaged a little over a billion dollars and were not seriously regarded. As a matter of fact, the U.S. Government, through its foreign aid and other programs, allowed the deficits from 1950 to 1956 to occur. After the so-called dollar shortage that prevailed in the post-World War II period, it was considered beneficial to permit Western European and other countries to increase their holdings of gold and dollar reserves. These early deficits thus contributed to an expansion and some redistribution of international liquidity in a moderate fashion.

The large and substantial deficits began rather unexpectedly in 1958 when the deficit amounted to $3 billion and a gold outflow of $2.3 billion took place. The deficits have been large and persistent despite many actions taken by the Government. They averaged close to $3 billion in the years 1958 to 1960, about $2 billion from 1961 to 1963, and about $1.5 billion in 1964 and 1965, despite more comprehensive government programs. The deficit in 1966 is expected to be at least as large or possibly larger than in 1965. Thus the concern arises because of the size of the deficits, their persistence despite more comprehensive governmental actions, and the gold

outflow and increase in liquid dollar liabilities associated with the deficits.

BASIC FACTORS INVOLVED IN DEFICITS

Some Transitory and Cyclical Factors. In view of the size of the deficits and their persistence, the disequilibrium in the U.S. balance of payments would have to be characterized as a structural and deep-seated one. Yet, temporary or transitory factors aggravated the deficits in many years. For example, the deficit in 1958 was aggravated by a decline in cotton exports as the U.S. Government for a time kept export prices above those prevailing in world markets. Furthermore, the changeover from propellor-driven to jet aircraft held back aircraft exports. The steel strike in 1959 contributed to a sharp increase in imports that year. Some transitory factors have been involved in many other years. For example, during recent months, the German Government has fallen behind in military purchases in this country to offset military expenditures.

Economic fluctuations here and abroad have also been a factor in the deficits. The slowing down of booming economic conditions in Western Europe held down American exports in 1958 and 1959. With the establishment of convertibility by Western European countries, large short-term capital outflows took place in 1960-61, encouraged by widening interest rate differentials. At that time interest rates fell in the United States during the recession of 1960-61 while they rose or continued high in Western Europe as prosperity continued. More recently, high interest rates in this country, resulting from tighter monetary policy by the Federal Reserve System to deal with inflationary pressures, have encouraged an inflow of short-term funds from abroad. Moreover, during the present economic expansion, merchandise imports have risen more rapidly than exports since 1964. Thus, a combination of temporary and cyclical factors have contributed to the deficits, and there have been many changing factors from year to year. Still these transitory and cyclical factors are not sufficient to account for the size and persistence of the deficits.

Structural Factors. Thus the deficits should be considered as structural. What we mean by a structural disequilibrium is that it reflects in many ways some fundamental changes in the role of the United States in the world economy and some basic

internal and external changes. Although the United States continues to be a major factor in the world economy, it is not as predominant as it was in the first decade after World War II. While in the early postwar period the United States accounted for almost half of the world's production, this has dropped to about one-third of the total in recent years. The United States continues to be the largest exporter and importer of goods and services, but its relative position has declined in terms of other nations.

More specifically, some of the major structural changes that have taken place within the American economy and in its relationship to other countries are as follows:

(1) Economic Growth and Modernization of Western Europe and Japan.

Partly through American aid initially as a catalyst, but largely through own efforts, the Western European countries reconstructed and modernized their economies, stabilized their currencies, and achieved a high and sustained rate of economic growth. Most of them have had higher rates of investment than the United States, and in many fields they have closed the technological gap between them and the United States. The establishment of the European Common Market has also encouraged greater specialization and larger size plants to take advantage of economies of scale; a considerable rationalization and integration of firms in which smaller, less efficient firms have been merged into larger ones; and many steps toward increased research, improved technology, product development, modern marketing, and efficient business administration.

To some extent the Western European countries and Japan have been resuming their pre-World War II economic role. However, in other respects, they have been entering a new stage of vigorous economic growth with rapidly increasing standards of living, mass consumption of automobiles and other durable goods, modernization of their industries, and increased competitive strength. As a result they have become more competitive in relation to the United States in their own countries, foreign markets, and American markets.

(2) The Internationalization of American Business.

Since 1950 U.S. business has become increasingly international-minded, especially with respect to foreign investments and business organization. Many American companies are entering the stage of multinational corporations, with a substantial part of sales and profits made overseas. They are being organized so that they can make decisions with respect to production, finance, marketing, technology, and management on a worldwide basis. In making investments they consider rates of return overseas as well as in the United States to maximize profits over the longer term.

One of the most striking aspects of the internationalization of American business has been the sharp increase in direct investments overseas. From 1960 to 1965 direct investments involving dollar flows have averaged over $2 billion a year. The book value of direct investments has more than quadrupled since 1950, increasing from about $12 billion in 1950 to about $49 billion in 1965. These direct investments have been made in foreign enterprises, such as manufacturing, petroleum, mining, transportation, banking, retailing, and insurance, that are wholly or partly controlled and managed by American companies. When these investments are made in U.S. companies they not only provide capital but also technological, marketing, and managerial know-how, and exercise complete or partial direction of the operations. At the same time the companies make use of local funds, labor, and available managerial and technical talents.

From 1950 to 1957, the largest increase in direct investments were to Canada in manufacturing, petroleum, and mining, although considerable petroleum, and mining investments were made in Latin America and manufacturing investments were made in Europe. Since 1958 American companies have substantially increased direct investments in Western Europe, especially in manufacturing, but also in petroleum, distribution, and banking. The sharp increase in investments has been fostered by the rapid economic growth in Western Europe, favorable cost conditions, and availability of productive and skilled labor. The establishment of the European Common Market has also fostered investments. Many companies have set up plants to sell within the high income free trade

area being established in order not to be faced by the common external tariffs. The direct investments have also been encouraged by the establishment of convertibility of currencies since 1958. Thus, American companies have been making these investments basically because of favorable economic conditions and expectations of relatively high long run profits with minimum risks. On the other hand, direct investments to less-developed countries have increased slowly because of unfavorable and uncertain opportunities for profits and possibly high risks.

(3) <u>The More Cosmopolitan American Consumer and Rise in Imports</u>.

During the last decade the American consumer has become more internationally-minded with respect to purchase of foreign goods. As a result of more sophisticated tastes of Americans for foreign goods, imports of finished manufactures have increased sharply. As is well known there has been a sharp increase in imports of a wide variety of finished manufactures such as automobiles, sewing machines, typewriters, photographic equipment, instruments, and a variety of other goods. The increased imports have not only been the result of more cosmopolitan tastes of American consumers, but also increased competitiveness of European and Japanese manufacturers, their adaptation of products to the American markets, and more effective marketing of these products.

During the last decade merchandise imports have been rising more rapidly than exports. Since 1956 they have grown by 68 per cent, while exports have grown by 52 per cent. Merchandise imports have resumed their prewar relationship of about 3 per cent of the Gross National Product. The statistics clearly show the shift in the structure of imports towards relatively larger imports of finished manufactures. Imports of finished manufactures have increased from about 20 per cent of total imports in the years 1951 to 1955 to about 35 per cent in the years 1961 to 1965. During the same period imports of crude material declined from about 41 per cent of total imports to about 31 per cent. Finished manufactured imports have been rising about 13 per cent a year since 1955. The data shows that these imports have a high income sensitivity. In other words, they rise sharply in relation to an increase in personal income and Gross National Product. Professor Angell has developed a regression equation that shows that

when the real increase in Gross National Product exceeds 3.5 per cent in the United States, imports rise about 3 times as rapidly as the Gross National Product.[7]

(4) Foreign Travel by Americans.

Americans have not only become more cosmopolitan with respect to consumption of imported goods but also with respect to travel overseas. In 1965 over 2.6 million American travelers went overseas (an increase of 18 per cent over 1964) and spent over $3 billion including expenditures on transportation to foreign carriers.[8] These travel expenditures have been increasing by about 8 per cent a year since 1955. Receipts from foreign visitors in the United States have also been increasing rapidly during the last few years and amounted to $1.4 billion in 1965. However, the gap between American tourist expenditures overseas including transportation and foreign expenditures in this country has increased from $1.2 billion a year in 1961 to about $1.7 billion in 1965. Foreign travel expenditures also have a high income sensitivity. They increase sharply as real personal income rises in the United States.

(5) Capital and Money Markets in the United States.

During the last few years the United States has also been a major source of portfolio and medium-term and short-term bank loans. Canadians, Western Europeans, the Japanese, and others have been raising capital through issues of bonds and other securities in the United States. Moreover, American banks have substantially increased short- and medium-terms overseas.

From 1960 to 1965 net portfolio and bank and other loans averaged over $2 billion a year. Thus U.S. lending has taken place because this country has the most developed, diversified, and comprehensive capital and money markets in the world. Furthermore, interest rates have been considerably lower in this country than overseas. The overseas lending also reflects growing confidence on the part of American creditors in foreign countries. However, it also results from a major failure of Western European countries to develop their own capital and money markets.

(6) Price Competitiveness of United States Exports.

Has the United States been pricing itself out of world markets? A frequently advanced thesis a few years ago and occasionally at this time is that the United States has become less competitive in world markets over the years because of rising prices in this country. Emphasis was placed on the decline in U.S. exports of manufactures from about 25 per cent of the world total in the years 1953 to 1956 to about 21 per cent in the years 1960 to 1961. While relative price comparisons between the United States and foreign countries are difficult because of inadequacies of data, several studies have indicated that price competitiveness of the United States declined in some key products during the period 1953 to 1960.[9] However, the decline in price competitiveness was not a general pricing of American products out of world markets nor an overall greater inflation in this country than in others. The data is inconclusive that the United States had relatively more inflation than other major industrial nations. Rather, it reflects a relatively larger rise in prices of certain key products, such as steel, machinery, and vehicles during the period 1953 to 1960 than in other major industrial nations (excluding the United Kingdom).

Of special importance were the rapid rise in labor costs and prices in the steel and basic metal industries in the United States between 1953 and 1961. Labor costs in the basic metal industries rose by 20 per cent in the United States, while these costs fell in other industrial nations, such as Germany and Japan, or remained stable. Labor costs in the United States rose more rapidly than the productivity per man-hour in these industries and prices rose. The largest increase in labor costs and prices took place in steel. Average steel prices rose by 20 per cent in the United States between 1953 and 1961. Higher steel prices greatly contributed to the rise in prices in machinery and transport equipment and adversely affected the American export position in these industries. Moreover, the United States, which was formerly a net exporter, became a net importer of steel products.

Studies for the Joint Economic Committee of Congress emphasized cost-push and market power inflation in these industries.[10] Labor unions with strong bargaining power obtained higher wages, and

companies with strong market power in turn raised prices. Price increases in some cases exceeded wage increases as administrative costs rose and companies also increased profit margins, at least until 1958. Another study by Professor Benoit emphasizes that relatively larger price increases in the United States reflected lags in productivity per man-hour in this country between 1953 and 1960 compared to Western Europe and Japan.[11] According to this analysis, productivity in the United States lagged because many industries operated considerably below capacity, as the economy operated at less than full employment and the economic growth of the country slowed down.

Studies also indicate that the price competitiveness of the United States in major manufactures has improved since 1960. The United States attained a high degree of price stability from 1958 to the early part of 1965 as wholesale prices remained practically constant. American business has made new investments in industry to improve efficiency and cut costs, has increased expenditures on research and development, and has operated plants at fuller capacity during the economic expansion since 1961. As a result productivity has risen much more rapidly in this country. Moreover, labor costs have risen more in line with productivity increases until 1965. On the other hand, since 1959 wages and prices have generally risen more rapidly in Western Europe and Japan than in this country. However, we should emphasize that the more rapid wage and price increases in Western Europe and Japan have not been fully reflected in an increase in their export prices as they have managed to keep themselves highly competitive in world markets. Nor has the United States regained the competitive position in world markets that it had in the early and middle 1950's. The United States' share of exports of manufactures has been 21 per cent of the world total in 1965 compared to 25 per cent in 1955. Along this line we should emphasize that many nonprice, as well as price factors, are highly important in competitive position, including design of products, adaptation of products to foreign markets, market research, effort devoted to exporting, servicing of products, advertising, delivery dates, and credit terms.

Since early 1965 the United States has been experiencing renewed inflation, starting with a demand-pull and shifting into a cost-push type of inflation. As a result of increased military expenditures for the war in Vietnam on top of a

relatively full employment economy, wholesale prices have been rising about 3.5 per cent a year, and some key industrial prices have been rising more rapidly. Moreover, unions have been pressing for wage increases in excess of the nation's average productivity growth. In turn, business companies have been increasing prices as costs have risen. The wage and price guidelines have been breaking down. The renewed inflation is weakening the price competitiveness of our exports and also encouraging imports to rise.

SUCCESSES OF SOME MAJOR U.S. POSTWAR ECONOMIC POLICIES

Thus, paradoxically, the United States balance of payments problem stems from the success of many of our postwar international economic policies. Many of the objectives of U.S. postwar policy have been achieved. Western European countries and Japan have experienced a vigorous economic growth and modernization, initiated in part by U.S. economic assistance. These countries have established convertibility of currencies, something long advocated by the United States. Furthermore, merchandise imports have been rising in spectacular fashion during the last decade. U.S. companies have been increasing direct investments overseas very rapidly. The U.S. Government positively encouraged increased imports and also fostered private investments overseas. However, private investments have been going primarily to Western Europe and other advanced countries and have not been going in any substantial amounts to less-developed countries. But otherwise U.S. international economic policies have had many successes that have contributed to U.S. balance of payments difficulties.

WORLDWIDE RESPONSIBILITIES AND THE DEFICITS

As we indicated at the beginning of this article, the balance of payments disequilibrium of the United States results in part from the worldwide responsibilities assumed by this country, as well as from the basic economic changes in the U.S. position in the world. Some of the so-called structural disequilibrium is a result of U.S. worldwide military and foreign policy commitments pursued by this country as leader of the free world. In other words, the United States has not been experiencing a purely

economic structural disequilibrium in its balance of payments. Some of the disequilibrium might be termed a policy one, resulting from this country's national security, foreign aid, and other commitments in the world. Military expenditures in conjunction with U.S. troops stationed abroad and bases maintained overseas have averaged over $3 billion a year since 1958 (although there have been some offsets in military equipment sales in recent years). Foreign aid loans and grants have averaged close to $4 billion a year, even though a major part of the aid has been spent for goods and services in this country. These commitments have been long-standing ones to advance U.S. worldwide objectives as leader of the non-Communist world. The United States has had a major dilemma because it has not wanted to sacrifice these major worldwide objectives in the achievement of equilibrium in its balance of payments.

From another point of view, even though the United States has shown considerable competitive strength in the world economy its competitive strength has declined somewhat and is not sufficient enough to continue all of the American worldwide commitments without a disequilibrium in its balance of payments. Table II shows that the United States has had a substantial excess of exports of commercial merchandise and services over imports of goods and services, excluding military expenditures. This excess averaged over $5 billion from 1960 to 1963, was about $8 billion in 1964 when U.S. merchandise exports increased more sharply than imports, and was $6 billion in 1965. Yet, this balance has not been sufficient to provide for military expenditures, foreign aid commitments, and private capital investments. Like all classifications of the balance of payments into segments, this one has its limitations. Yet, it does indicate the U.S. competitiveness in goods and services, even though impressive, has not been sufficient for this country to maintain its worldwide commitments and for private business to expand foreign investment overseas. Another major problem is the relationship of the balance of payments problem to the dollar; we turn to this now.

TABLE II

BALANCE ON COMMERCIAL MERCHANDISE TRADE
AND ON SERVICES EXCLUDING MILITARY EXPENDITURES

(Billions of Dollars)

	1960-1961 Average	1960-1963 Average	1964	1965
Merchandise Exports	19.7	21.4	25.3	26.3
Less: Exports Financed by Government Aid Programs	2.0	2.5	2.8	2.8
Commercial Exports	17.7	18.9	22.5	23.5
Less: Merchandise Imports	14.6	16.8	18.6	21.5
Balance on Nongovernment Financed Merchandise Trade	3.1	2.1	3.9	2.0
Exports of Services	7.8	9.3	10.9	11.9
Less: Serviced by Government Aid Programs	0.4	0.6	0.6	0.6
Exports of Services Not Financed by Government Programs	7.4	8.7	10.3	11.3
Less: Imports of Services (Excluding Military)	5.4	6.2	7.0	7.7
Balance on Nongovernment Financed Services	2.0	2.5	3.3	3.6
Balance on Commercial Goods and Services	5.1	4.6	7.2	5.6

Source: Calculated by author from U.S. Balance of Payments Statistics

THE DEFICITS AND THE DOLLAR AS A WORLD CURRENCY

Evolution of Dollar As World Currency. The balance of payments problem especially makes the dollar vulnerable because of the role of the dollar as an international trade and reserve currency. As a result of the predominant position of the United States in the early post-World War II years and the foreign aid and lending functions assumed by this country during the period of "dollar shortage," the dollar evolved into the principal currency for the conduct of international trade. Moreover, since the U.S. dollar has long been fixed in terms of gold at $35 an ounce, since the dollar was considered as good as gold, and since worldwide confidence developed in the stability of the currency, foreign central banks and governments began to hold dollars as international reserves in place of gold. The dollar also became a reserve currency because monetary gold stocks have increased slowly since World War II. Thus, U.S. deficits in the balance of payments have been the major source of international reserves and international liquidity since 1950 and even more so from 1958 to the present.

The U.S. deficits have provided international liquidity, especially for Western European countries, by a gold outflow from this country and by foreign accumulation of liquid dollar holdings.

Gold and Liquid Dollar Liabilities. As Table III shows, the United States' monetary gold has declined from almost $23 billion at the end of 1957 to about $13.5 billion in the middle of 1966. At the same time foreign countries have increased liquid dollar assets from about $15 billion at the end of 1957 to about $26 billion in the middle of 1966, excluding holdings of international organizations. Of special importance, liquid dollars held by foreign monetary authorities, convertible into U.S. gold on demand, were about $14 billion in the middle of 1966. Moreover, private dollar holdings can be readily shifted into official holdings convertible into gold. To meet these potential dollar liabilities, the United States has $13.5 billion in gold and another billion and a half dollars in convertible currencies and automatic drawing rights at the International Monetary Fund.

Thus, prima facie, U.S. monetary reserves seem hardly sufficient to meet liquid liabilities

TABLE III

UNITED STATES OFFICIAL RESERVE ASSETS AND LIQUID DOLLAR LIABILITIES

(Billions of Dollars)

End of Year, June 30

	1949	1957	1960	1965	1966
U.S. Official Reserve Assets:					
Gold	24.6	22.9	17.8	13.8	13.5
I.M.F. Gold Tranche Position	1.5	2.0	1.6	0.9	0.7
Holdings of Convertible Currencies				0.8	0.7
TOTAL				15.5	14.9
Liquid Liabilities to Foreigners (excluding international organizations)					
Official Banks and Governments	3.4	9.1	11.7	14.5	14.5
Private	3.1	5.7	7.0	11.4	12.3
TOTAL	6.5	14.8	18.7	25.9	26.8

Source: *International Financial Statistics*, and *Supplement to 1965/1966 Issue*, Washington, D.C.: International Monetary Fund, and Lederer, Walther, and Parrish, "The U.S. Balance of International Payments: Second Quarter 1966" *Survey of Current Business*, September 1966, Table 7.

to foreign monetary authorities and completely insufficient to meet total potential claims against gold.

Furthermore, part of the gold stock of the United States is required for domestic monetary backing, even though this was reduced by changes of the law in 1966. Under the present law, the Federal Reserve Banks are required to maintain a reserve of 25 per cent in gold certificates, against Federal Reserve Notes issued, which make up most of the currency of this country. The gold certificates held by the Federal Reserve Banks are related to the gold held by the U.S. Treasury. Therefore, in effect, at the present time about $7 billion in gold is required to back the Federal Reserve notes issued. This gold would not be presently available to meet international claims. However, in case of international pressures, the Federal Reserve could suspend the gold certificate reserve requirement on Federal Reserve notes; moreover, the law could be changed, as it has been in the past.

Strength of U.S. Position as Banker and Investor. The situation is hardly as critical as it may appear from this discussion. It is not unusual for banks to have demand liabilities far in excess of cash and liquid assets to meet such claims. In fact, that is a major aspect of private commercial banking in the United States and overseas. Commercial banks usually have substantial demand liabilities (checking accounts) and also major medium-term loans and investments, not readily converted into cash. The United States is in a position like many commercial banks: it has been borrowing on short-term and in turn making long-term investments and loans.

As shown in Table IV, the U.S. investments and assets overseas far exceed foreign investments in this country and liquid dollar liabilities. The value of U.S. private and governmental investments and credit overseas exceeded $104 billion at the end of 1965. In turn, foreign investments and claims in the United States were $59 billion at that time. However, most American investments overseas are long-term and are not available to meet possible claims arising out of liquid dollar liabilities. Moreover, even U.S. private short-term investments overseas (that amounted to about $10 billion at the end of 1965) are not readily available to this country to meet liquid dollar liabilities held abroad. Yet, the

TABLE IV

UNITED STATES INVESTMENTS AND CREDITS OVERSEAS
AND FOREIGN INVESTMENTS AND CLAIMS
IN THE UNITED STATES

U.S. Investments and Credits Overseas		
Private Investments		
Long Term		
Direct Investments	49.2	
Portfolio	21.6	
Total		70.8
Short Term		10.1
Total Private		80.9
Government Credits		
Long Term	20.3	
Foreign Currencies and Short Term	3.2	
Total		23.5
Total U.S. Investments Versus Foreign Investments and Claims in the U.S.		104.4
Long Term		
Direct	8.8	
Portfolio	17.6	
Total		26.4
Short Term		18.2
Total Private		44.6
U.S. Government Liabilities		
Short Term		14.4
Total Foreign Investments in U.S.		59.0

Source: Pizer, Samuel and Cutler, Frederick. "Foreign Investments, 1965-66." *Survey of Current Business*. September 1966, Table 14.

overall data on U.S. assets and liabilities, both private and governmental, basically shows a position of strength, as long as international confidence is maintained in the dollar.

Evaluation of Vulnerability of Dollar. The most vulnerable aspect that could impair the confidence of the dollar is the declining monetary reserves of the United States, principally gold, in relation to foreign official and private liquid dollar liabilities. The continuation of balance of payments deficits would decrease U.S. gold holdings or increase liquid dollar liabilities, probably both. However, foreign countries have shown growing reluctance to increase holdings of dollars as international reserves. The tendency is for foreign countries, especially noticeable in the case of France but also true to some extent of other countries, to take a higher proportion of any surplus in gold rather than dollars. At some point, which is difficult to define precisely and categorically, the continuation of sizeable deficits would probably lead foreign countries to make large demands on gold. Or there would be considerable pressure to devalue the dollar. Even expectations of a possible dollar devaluation could lead to substantial demands for gold. The chain of events cannot be fully foreseen, but in the process confidence in the dollar could be impaired.

However, there is no necessity for a run on U.S. gold stocks. The major foreign countries of the non-Communist world and the United States have a common interest in not impairing the role of the dollar as an international trade and reserve currency. They have a common interest in not allowing the present international monetary system with the dollar as a key currency to break down.

Many lines of cooperation have developed between the United States and other monetary authorities. This includes swap agreements among central banks, some harmonization of interest rates, and standby credits. The Federal Reserve has negotiated a number of swap agreements with foreign central banks under which lines of credit in foreign currencies are established and dollars may be exchanged for foreign currencies. Furthermore, ten major countries of the International Monetary Fund have signed a General Agreement to Borrow under which they have made $6 billion in standby credits available to supplement the resources of the International

Monetary Fund. Moreover, the role of the Fund has been reinforced since most member nations have increased their quotas by 25 per cent. Thus, the resources of the Fund have been increased to $20.6 billion. The increased resources of the Fund and the standby credits are available to the United States to reinforce the dollar. The United States has also worked out cooperative arrangements with the Basle group countries that are members of the Bank for International Settlements. In addition, during the last six months the lines of credit under swap arrangements worked out by the Federal Reserve System with other central banks were increased from $2.8 to $4.0 billion.[12] Thus, the United States has taken a number of positive actions in conjunction with other countries to avoid a run on gold and threats to the dollar.

However, some economists and financial experts do not regard the balance of payments deficits of the last few years as a serious threat to the dollar. At recent meetings sponsored by the Chamber of Commerce, Dr. Howard S. Piquet of the Library of Congress Legislative Reference Service maintained that the United States has no need to worry about its balance of payments deficits. Rather, it should recognize its role of world banker and take steps to strengthen its position in that respect. At the same meetings Mr. William F. Butler, Vice President of the Chase Manhattan Bank, stated that the present international financial structure has been improved considerably by augmenting the resources of the International Monetary Fund and by the swap agreements. He felt that the world could live with U.S. deficits of one to two billion dollars a year. More recently at the National Foreign Trade Convention in New York, Mr. Rudolph A. Peterson, President of the Bank of America, indicated that the United States has overemphasized the balance of payments deficits and has not given sufficient emphasis to the strength of the American economy as the strongest one in the world and to the vital leadership role of this country as banker to the world.

Nevertheless, while there cannot be any certainties and we have to think in terms of judgmental probabilities, the author believes that continuation of U.S. balance of payments deficits of $1.5 to $2 billion could ultimately weaken confidence in the dollar. It would lead to continued gold outflows and increases in dollar holdings abroad. One aspect would be the decrease in the

value of U.S. gold holdings against official and private liquid dollar assets held by foreigners--the total potential claims against this country's gold. Another aspect would be the continuing willingness of foreign monetary authorities and private groups to hold increasing dollar assets. Some increase in dollars could be used to provide additional international liquidity and also as working balances to conduct international trade, as long as confidence was fully maintained in the dollar. Like any currency, international or domestic, one ingredient of confidence could be limitation in the supply or increases in liquid dollar holdings. Continued accumulation of dollars in excess of the willingness of foreign monetary authorities or private groups to hold them would probably lead to conversion into gold. Another aspect of the problem is the confidence in the United States maintaining the fixed ratio of $35 an ounce of gold. Any lack of confidence in the determination or ability of the United States to maintain the value of dollar in terms of gold could also lead to demand for gold.

Thus, although there do not appear to be any serious threats to the dollar at this time, continuing balance of payments deficits could lead to new pressures. It could even undermine the swap agreements and the other international cooperative monetary measures developed so elaborately during the past few years. The author, therefore, believes that the United States should strive positively and with determination to attain equilibrium in its balance of payments to avoid possible difficulties. Another reason for trying to achieve equilibrium is that agreement on international monetary reform or change is unlikely as long as the deficits continue. Once the deficits do not exist, and our deficits are no longer providing international liquidity, there will be a greater probability of changes that would positively improve the functioning of the international monetary system.

FOOTNOTES

1. See Subcommittee on Economic Statistics, Joint Economic Committee, United States Congress, *Balance of Payments Statistics of the United States*, Hearings before Subcommittee and Report of Subcommittee, Washington, D.C.: Government Printing Office, 1965.

2. For a comprehensive discussion of the liquidity concept and justification for its use see Lederer, Walther, *The Balance on Foreign Transactions: Problems of Definition and Measurement*, Princeton, N.J.: International Finance Section, Princeton University, 1963.

3. The official settlements concept was recommended by the Bernstein Committee Report: *The Balance of Payments Statistics of the United States*, Report of the Review Committee for Balance of Payments Statistics to the Bureau of Budget, Washington, D.C.: Government Printing Office, 1965.

4. The basic transactions concept was used by President Kennedy in his Balance of Payments message in 1963 as one concept of the deficit. It has also been used by the President's Council of Economic Advisors and by the United States Treasury as one concept of the deficit in the early 1960's. The Brookings Institution Report made for the Council of Economics Advisors, Salant, Walter S., et al., *The United States Balance of Payments in 1968*, Washington, D.C.: The Brookings Institution, 1963, also used the basic deficit concept. The concept is explained and justified in this report. Lary, Hal., *Problems of the United States as World Trader and Banker*. Princeton, New Jersey: Princeton University Press, 1963. A National Bureau of Economic Research Study also uses and provides justification for the basic transactions and concept.

5. See Bernstein Committee Report and Hearings before Subcommittee on Economic Statistics, Joint Economic Committee, *op. cit.*

6. See Report of Subcommittee on Economic Statistics, Joint Economic Committee, *op. cit.*

7. Angell, James W., "The Longer-Run Prospects for the U.S. Balance of Payments," *Political Science Quarterly*, Volume LXXXI, No. 3, (Sept. 1966).

8. See article by Miller, Etienne H., "Foreign Travel Payments Continue to Rise in 1965," *Survey of Current Business*, Volume 46, No. 6, (June 1966), p. 15-17 and 43.

9. See especially Balassa, Bela, "Recent Developments in the Competitiveness of American Industry and Prospects for the Future," *Factors Affecting the United States Balance of Payments*, Part I, Subcommittee on International Exchange and Payments, Joint Economic Committee of Congress, Washington, D.C.: Government Printing Office, 1962; and Salant, Walter S., *op. cit.* Chapter III.

10. See Eckstein, Otto and Fromm, Gary, "Steel and Postwar Inflation," Study Paper No. 2; and Wilson, T.A., "An Analaysis of the Inflation in Machinery Prices," Study Paper No. 3, "Study of Employment, Growth and Price Levels," Joint Economic Committee of Congress, Washington, D.C.: Government Printing Office, 1959.

11. Benoit, Emile, *Europe at Sixes and Sevens*, New York: Columbia University Press, 1961, Chapter IV.

12. For a summary of recent swap agreements and other operations see, "Treasury and Federal Reserve Foreign Exchange Operations," *Federal Reserve Bulletin*, Volume 52, No. 9, (Sept. 1966), p. 1316-1326.

BIOGRAPHIC SKETCH

Professor William A. Dymsza holds a Ph.D. in International Economics from the University of Pennsylvania. He has held professorial positions at Boston College, University of Maryland, University of Hawaii, and Rutgers University. He has been assigned as Chief Economist, Office of Price Stabilization, Boston, Mass.; and as Program Coordination Officer to the U.S. State Department Economic and Technical Mission to Vietnam, Cambodia, and Laos. During his tenure at the University of Hawaii, the professor was Co-Director of the Hawaiian Sea Ferry Study.

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