

July 1963

FEDERAL RESERVE BANK OF ST. LOUIS

# Review

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*The United States is currently attempting to reduce its payments deficits. The range of feasible deficit-reduction policies appears to be limited when viewed in the context of a domestic economy requiring stimulation and an international position in which the United States is the principal reserve currency nation, a major trading nation, and a leading proponent of free-market principles.*



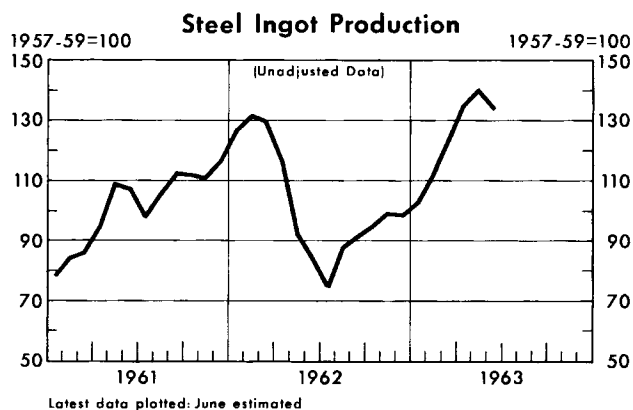
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# Output Continues to Expand

**M**OST MEASURES of the economy's performance have shown significant increases since January. Despite the upturn, however, there has been little improvement in the intensiveness of resource utilization. The rate of monetary expansion has slowed, though it remains above that of the first half of last year.

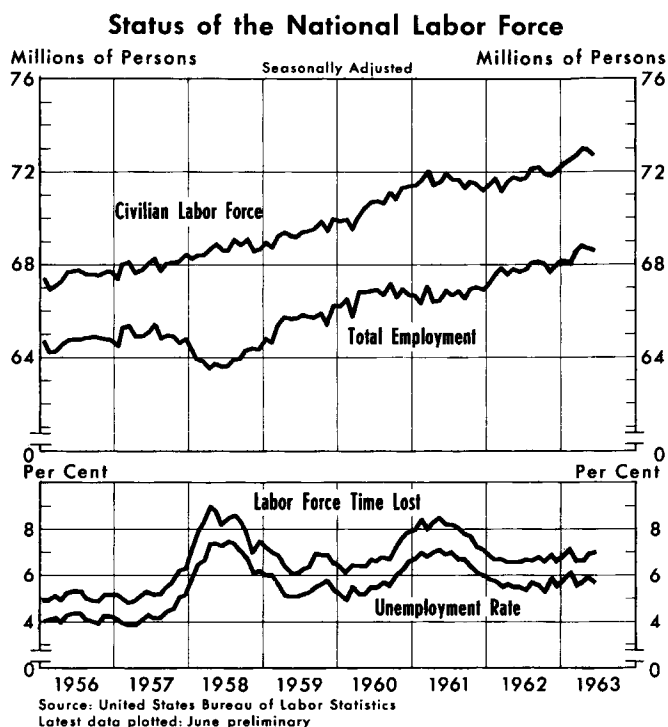
## Business Developments

From January to May industrial output increased 4 per cent, from 119 per cent of the 1957-59 average to 124 per cent. A strong demand for steel, partly resulting from uncertainty with respect to labor contract negotiations, and increased production of such consumer durables as home appliances, television sets, and radios have been major factors in the sharp rise in industrial output. Steel production increased sharply from January through April, but the increase slowed considerably in May. There was a decline in steel production in June and early July. Auto production, which has been at a high level all year, changed little in May and June after adjustment for seasonal variation.



Construction activity has been unchanged on balance so far this year. Expenditures on new construction, seasonally adjusted, were down in the February-April period, but subsequently, due to rising expenditures for residential construction, regained their late 1962-early 1963 levels.

Accompanying the expansion in industrial output, total civilian employment has increased since early this year. Employment in the March to June period averaged 68.7 million, up 0.8 per cent from the January-February average. Employment in manufactur-



ing, which declined on balance from the middle of last year to the beginning of this year, has since increased, more than regaining mid-1962 levels. In June employment was 1.3 per cent above a year ago. This year-to-year increase has been comparable to rates of change which have prevailed over the past 12 years. From February 1962 to early 1963 employment has remained relatively stable at around 68.0 million.

The rise in employment so far this year has been about the same as the increase in the labor force. Over the past 12 years the labor force has grown more rapidly than employment. The unemployment rate, 5.9 per cent in May and 5.7 per cent in June, has varied only slightly over the past year and one-half. A larger than usual number of teenagers in the labor force have been unable to find jobs this summer (see box on page 3).

Personal income was practically unchanged during the first few months of the year but has increased sharply since March. The annual rate of increase from January to May was 3.8 per cent, largely reflecting a rise in wage and salary payments. The rise in income has not been accompanied by a corresponding increase in retail sales. Total retail sales in

June were \$20.3 billion, about unchanged from January, and remained on the plateau which was reached in November 1962.

### Financial Developments

Interest rates on three-month Treasury bills, which have fluctuated around the 2.90 per cent level since late December, rose in late May to about 3.00 per cent. Yields on Treasury bills continued about this higher level in June and rose further in early July.

During the first half of last year such rates were relatively unchanged, at about 2.70 per cent. Normally, rates tend to fall during the first half of the year, reflecting a seasonal decline in the demand for funds. Most long-term rates also have moved up thus far this year; in the first half of 1962 these rates edged down. The contrast between the behavior of interest rates this year and last year probably reflects a stronger demand for funds thus far in 1963 than in 1962 and a reduction in the rate of monetary expansion since April this year.

## Teenage Unemployment

OF THE 4.1 MILLION PERSONS UNEMPLOYED in mid-June (seasonally adjusted), 1.0 million, or 24 per cent, were "teenagers" (persons between the ages of 14 and 19). The number of unemployed teenagers has risen sharply since mid-1962 while the number employed has declined. Consequently, since mid-1962 the unemployment rate among teenagers has risen, reaching 16.0 per cent in June of this year. The only other times this rate has risen so sharply during the past 11 years were in periods of recession. As the accompanying chart shows there has been an upward trend in this rate since 1952, the first year charted. Total unemployment has also shown an upward trend since 1952.

Over the past 11 years the proportion of unemployed who are teenagers has, on the basis of yearly averages, varied between 16 and 20 per cent. However, since January of this year, the proportion has expanded markedly (see table).

### UNEMPLOYMENT

Months, 1963	Seasonally adjusted, in thousands		Per cent of total
	Total	Teenage	
June	4,118	982	23.8
May	4,313	1,159	26.9
April	4,128	985	23.9
March	4,062	905	22.3
February	4,415	949	21.5
January	4,177	849	20.3
<b>Annual averages</b>			
1962	4,012	823	20.5
1961	4,806	917	19.1
1960	3,931	793	20.2
1959	3,813	731	19.2
1958	4,681	757	16.2
1957	2,936	571	19.4
1956	2,822	540	19.1
1955	2,904	506	17.4
1954	3,578	555	15.5
1953	1,870	348	18.6
1952	1,932	390	20.2

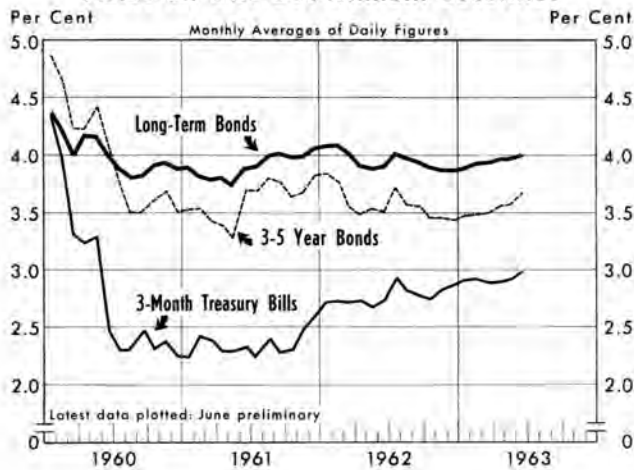
### Teenage Unemployment Rate



Source: U.S. Department of Labor  
 Latest data plotted: June preliminary

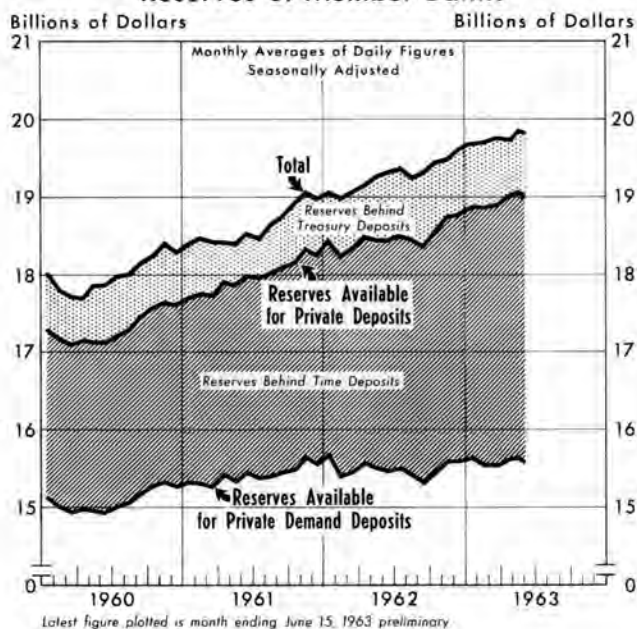
Shaded areas represent periods of business recession.

### Yields on U.S. Government Securities



Accompanying the rise in interest rates, excess reserves of member banks have declined, and borrowings from Reserve Banks have risen. Higher yields available on high-grade, short-term investments raise the opportunity cost of holding excess reserves, a nonearning asset. Excess reserves declined from an average of about \$550 million in late 1962 to \$430 million in April, \$460 million in May, and \$370 million in June. The June average is probably about the minimum of excess reserves which banks find it convenient to hold. During the past two years the monthly average of excess reserves has varied between a high of \$622 million (November 1961) and a low of \$370 million (June 1963). Since 1951, excess reserves had never been below \$400 million.<sup>1</sup>

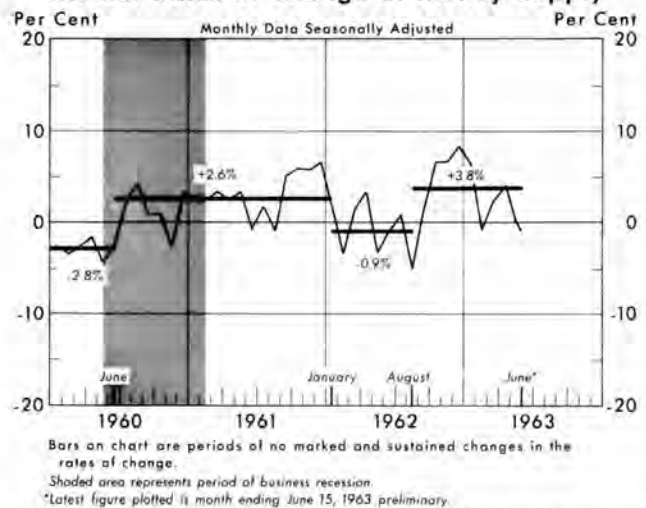
### Reserves of Member Banks



<sup>1</sup> For a discussion of the behavior of excess reserves see, "Excess Reserves," in the April issue of this bank's Review.

With the Treasury bill rate and the Federal funds rate approximately at the discount rate, it has become a matter almost of indifference in terms of cost whether short-term reserve adjustments of member banks are made in the money market or by borrowing from the Federal Reserve. Borrowings from Reserve Banks, which had fluctuated around \$100 million from early 1961 to April 1963, increased to about \$200 million in May and \$235 million in June. Since excess reserves have declined and borrowings from the Federal Reserve (primarily by banks other than those holding the excess reserves) have increased, the excess of excess reserves over borrowings, so-called free reserves, has declined from slightly under \$400 million in late 1962 to about \$135 million in June.

### Annual Rates of Change of Money Supply



One factor in the rise in interest rates in May and June may have been a decrease in the rate of monetary expansion. The money supply increased at an annual rate of 0.5 per cent from April to the first half of June compared with a 3.0 per cent rate of increase during the first four months of this year and an average annual rate of 3.6 per cent in the last five months of 1962. Nevertheless, monetary expansion was greater thus far in 1963 than during the same period last year. During the first five and one-half months of 1962 the money supply declined slightly. Total member bank reserves, an important factor influencing the ability of banks to expand loans and investments and their deposits (money), increased at an annual rate of 2.3 per cent from December to mid-June. This was substantially below the rate of increase in late 1962 but about the same rate as in the corresponding period last year. However, time certificates and savings deposits, which must be supported with reserves but are not included in the money supply, absorbed more reserves last year than this year. These deposits rose 20 per cent (annual rate) from December to mid-June of 1962 compared with 15 per cent (annual rate) so far in 1963.

# U. S. Balance-of-Payments

## Deficits in Perspective

**A** DEFICIT IN THE U. S. BALANCE OF PAYMENTS at an annual rate of \$3.2 billion is indicated by preliminary Department of Commerce estimates for the first quarter of 1963. This rate is well above the \$2.2 billion figure for 1962, but last year's deficit was held down by a number of special transactions. In every year since 1950 (except 1957), the United States has paid out more to the rest of the world than it has received (Table I). The cumulative net deficit has been settled by sales of gold amounting to \$8.0 billion and foreign accumulations of liquid dollar assets (U. S. liabilities) of approximately \$18 billion.

The prospect of a 1963 deficit, no smaller, and perhaps considerably larger than the \$2.2 billion deficit of 1962, has sharpened public discussion, both here and abroad, of factors affecting the U. S. balance of

payments. Some economic writers insist that large U. S. payments deficits will continue in the absence of such drastic measures as direct restrictions on imports, severely restrictive monetary policy, devaluation, or flexible exchange rates. Others, pointing to the improvement in our payments situation since 1960 (1960 deficit, \$3.9 billion; 1961 deficit, \$2.4 billion; 1962 deficit, \$2.2 billion; Table I), argue that the current policies of promoting exports, guarding against inflation, and reducing the net payments burden of Government military and aid expenditures will in time solve the problem of continuing deficits.<sup>1</sup>

<sup>1</sup>For a more complete discussion of the various points of view, see H. B. Lary, *Problems of the United States as World Trader and Banker*, National Bureau of Economic Research, 1963, and the compilation of studies in *Factors Affecting the United States Balance of Payments*, Joint Economic Committee, Congress of the United States, 1962.

### I. U. S. Balance of Payments, 1946-62

(In billions of dollars)

	(1)	(2)	(3)	(4)	(5)
Period	Payments <sup>1</sup>	Receipts <sup>1</sup>	Surplus (+) Deficit (-)	Liquid liabilities Decrease (-) Increase (+)	U. S. gold Losses (+) Gains (-)
1946	-13.7	+14.9	+ 1.3	-0.6	-0.6
1947	-16.1	+20.7	+ 4.6	-1.7	-2.9
1948	-16.8	+17.8	+ 1.0	+0.5	-1.5
1949	-16.4	+16.6	+ 0.2	-0.0 <sup>3</sup>	-0.2
<b>1946-49</b>			<b>+ 7.0</b>	<b>-1.8</b>	<b>-5.2</b>
1950	-17.5	+14.0	- 3.6	+1.8	+1.7
1951	-19.8	+19.5	- 0.3	+0.4	-0.1
1952	-19.8	+18.8	- 1.0	+1.4	-0.4
1953	-19.6	+17.5	- 2.2	+1.0	+1.2
1954	-19.7	+18.2	- 1.6	+1.3	+0.3
1955	-21.8	+20.7	- 1.1	+1.1	+0.0 <sup>3</sup>
1956	-25.7	+24.8	- 0.9	+1.2	-0.3
<b>1950-56</b>			<b>-10.7</b>	<b>+8.2</b>	<b>+2.5</b>
1957	-27.6	+28.1	+ 0.5	+0.3	-0.8
1958	-27.1	+23.6	- 3.5	+1.3	+2.3
1959	-28.5	+24.8	- 3.7	+3.0	+0.7
1960	-31.9	+28.0	- 3.9	+2.2	+1.7
1961	-32.7	+30.3	- 2.4	+1.7	+0.7 <sup>2</sup>
1962	-34.3	+32.1	- 2.2	+1.3	+0.9
<b>1958-62</b>			<b>-15.7</b>	<b>+9.4</b>	<b>+6.3</b>

<sup>1</sup> Includes net unrecorded transactions.

<sup>2</sup> Beginning with the first quarter of 1961, net of change in convertible currencies held by U. S. monetary authorities.

<sup>3</sup> Less than \$50 million.

Note: Detail may not add to totals due to rounding.

Source: U. S. Department of Commerce, 1946 to 1961 data, *Balance of Payments Statistical Supplement*, Revised Edition, 1962 data, *Survey of Current Business*, June 1963.

The purpose of this article is to review the more distinctive aspects of the U. S. payments situation within the context of the international payments system and the changing pattern of international reserves from 1946 to 1962. This article examines the elements of strength and weakness in our external position as we attempt to reduce our balance-of-payments deficit. It notes that the key role of the dollar in the international financial mechanism is an important factor influencing the nature of the policies adopted or rejected by the United States. It also notes that the choice of actions to strengthen our balance-of-payments position is influenced by our preference for relatively free markets.

### Important Features of the International Payments System

The international payments mechanism of the free world is marked by certain specific characteristics. In the first place, there is the general prevalence of fixed exchange rates. For most currencies there is an officially declared parity expressed in terms of a specified quantity of gold or dollars. Member countries of the International Monetary Fund are charged with the responsibility of permitting only small fluctuations in the market prices of their currencies above and below these parities.

According to the Bretton Woods Agreement of 1944, which established the International Monetary Fund, the par value of the currency of each member country is expressed in terms of gold or of United States dollars of the weight and fineness in effect on July 1, 1944. Member countries are committed, in general, to maintain these parities either by freely buying and selling gold within a narrow range of prices or by operating to keep rates of exchange against other currencies within a small predetermined range. In practice, the policy of the United States Treasury to buy and sell gold at the fixed price of \$35 per ounce is the cornerstone of the world's present exchange rate structure.

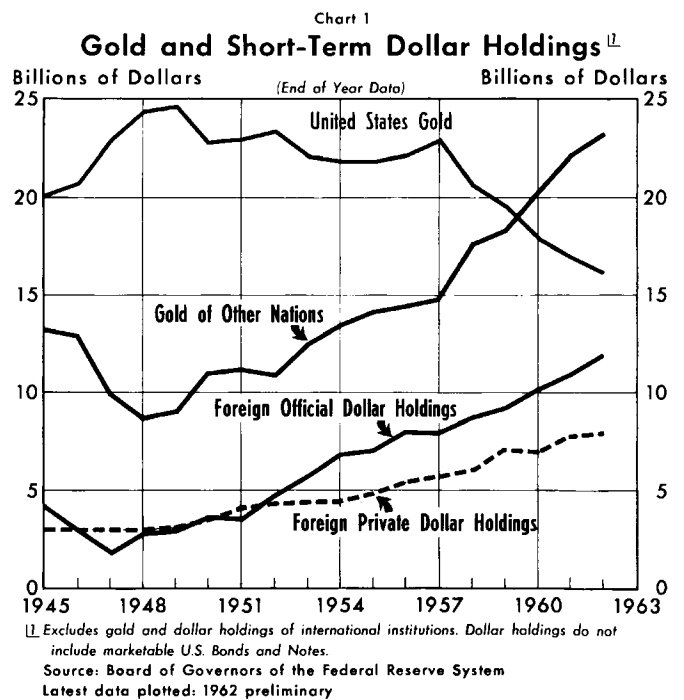
The Bretton Woods Agreement attempted to establish a system of limited exchange rate fluctuations, in which temporary deficits in a country's external accounts would be financed by running down its reserves and by drawing "strong currencies" from the International Monetary Fund. The Agreement imposed an obligation on deficit and surplus countries to restore equilibrium by gradual, cooperative policies. Nevertheless, the Articles of Agreement do permit a country to change unilaterally its par value by as much as 10 per cent from its initial par value or to make larger changes with the agreement of the Fund, if it is suffering from a "fundamental disequilibrium" in its balance of payments. Changes have been in-

frequent, but at certain times, September 1949, for example, and again in 1957 and 1958, or to a lesser extent in the spring of 1961, the changes in particular parities have been significant.

Because of the infrequency of change in currency parities and the limited range of market fluctuation permitted, payments imbalances are reflected primarily in reserve changes. Deficit nations lose reserves; surplus nations acquire reserves.

Central banks and Treasuries keep their international reserves in two forms, in gold and in foreign exchange.<sup>2</sup> The United States keeps its reserves almost exclusively in the form of gold, but most other countries hold dollars or sterling—the so-called reserve currencies—as supplements to their gold reserves. An additional source of reserves is available in times of emergencies. All members of the International Monetary Fund have unrestricted rights to a certain amount of the Fund's holdings of currencies and conditional rights to larger amounts.

The dollar is the most important "key" or reserve currency. It has become convenient for foreign commercial banks to hold large operating balances of United States dollars and a matter of policy for many important foreign monetary authorities to hold part of their official reserves in dollars, mainly deposits with U. S. banks and U. S. Treasury obligations. At the end of 1962, foreign private short-term dollar holdings amounted to approximately \$8 billion and foreign official dollar holdings amounted to about \$12 billion (Chart 1).



<sup>2</sup>See this Review, May 1962, for a more complete discussion of international reserves.

The dollar is also the leading medium of international exchange—i.e., a very large part of all international transactions are accomplished by transfers of dollar bank accounts. If the United States incurs a deficit in her balance of payments, dollar balances held by foreigners increase. Insofar as foreigners choose to hold an increasing volume of dollar balances, U. S. gold reserves are not subject to pressure. Dollars acquired by foreign official institutions, however, may be used to purchase gold from the United States Treasury, causing U. S. gold reserves to decline. When the United States develops a surplus payments position, a position typical of the period prior to 1950, foreign dollar balances decline and foreign monetary authorities may also sell gold to the U. S. Treasury.

## Changing Patterns of International Reserves, 1946-1962: From Dollar Shortage to Dollar Glut

### *Period, 1946-49*

The United States entered the postwar period with gold reserves of \$20.1 billion, about 60 per cent of the world's monetary or official gold reserves. The rest of the world, using both gold and dollars as official reserves, held \$13.2 billion in gold and \$4.2 billion in dollar balances.<sup>3</sup> This reserve total of \$17.4 billion, although substantial in the aggregate, represented the sum of many small reserve positions distributed throughout the world (Chart 1).

The dominant feature of the international payments situation in this period was the one-sided strength of the United States. With the United States virtually the sole source of supply for many industrial goods needed by a war-torn world, the distribution of reserves was grossly inadequate to cope with the payments imbalances which developed in the early years of the postwar period, 1946-49. To finance their relief and reconstruction needs, foreign countries dipped into their official reserves by selling gold and liquidating dollar balances in the amount of \$7 billion during this four-year period.

The total reserves loss of foreign nations during this period would probably have been even larger had it not been for the aid rendered by the United States. Final deliveries under relief and rehabilitation programs inaugurated during the war were continued by

<sup>3</sup>In addition, countries in the "sterling area" held \$9,809 million of reserves in sterling assets at the end of 1946. Although these assets could not be freely converted into gold or other currencies, they still represented an important addition to the international purchasing power of many countries.

the U. S. in this period. In 1946 this country made a special loan of \$3.75 billion to the United Kingdom. Export-Import Bank loans were also used to finance the heavy purchases of U. S. goods. In 1948 the Marshall Plan for European Recovery was put into operation. Despite the large aid payments and loans which averaged \$5.5 billion a year, net of repayments, the U. S. balance of payments was in surplus through these four years (Table I). For the entire period the U. S. surplus amounted to \$7 billion. This surplus was "settled" by a decline of \$1.8 billion in U. S. liquid liabilities to foreigners and by sales of gold to the U. S. amounting to \$5.2 billion. At the end of 1949 we had \$24.6 billion in gold reserves and only \$2.9 billion in dollar liabilities to foreign official institutions (Chart 1).

The U. S. aid programs enabled foreign countries to rebuild their economies at a much faster pace than would have been possible had those countries been forced to rely solely on their limited export earnings to finance imports.

A significant feature of this period, at least up to the last quarter of 1949, was that the par values of most currencies were admittedly too high relative to their internal purchasing power. Foreign nations had experienced varying degrees of inflation during the war period but most currency parities remained unchanged from the levels maintained during the war. Although the Bretton Woods Agreement provided for changes in par values to reflect changes in price levels, few important countries changed their currency parities in the first few years after the war. Overvalued currencies—coupled with stringent exchange controls—probably improved the "terms of trade" of foreign countries, enabling them to obtain essential imports for rebuilding their productive capacities at a lower real cost than would have been possible otherwise.

As foreign economic recovery proceeded and improved the ability of foreign countries to export, their overvalued currencies became a competitive burden, hurting their exports. Furthermore, as the need for devaluation became more apparent, payments difficulties of foreign nations were aggravated by hedging and speculative capital flows which occurred despite exchange controls.

In September 1949 leading foreign countries with the approval of the International Monetary Fund devalued as follows: United Kingdom, along with most members of its Commonwealth group, and also Sweden, Norway, Denmark, and the Netherlands, 30.5 per cent; France, 22 per cent; West Germany, 20.6 per cent; Canada, 9 per cent; Italy, 8 per cent; and Belgium, 12.3 per cent.

## Period 1950-56

In 1950 the United States moved from a surplus to a deficit position—an excess of payments over receipts of \$3.5 billion for the single year. The United States continued her deficit position through 1956 with annual deficits averaging \$1.5 billion for the entire period. The cumulative deficit for these seven years amounted to \$10.7 billion, financed by a transfer of gold to foreign ownership of \$2.5 billion and a rise in liquid liabilities to foreigners of \$8.2 billion (Table I).

The balance-of-payments deficits incurred by the United States during this period occasioned very little concern; they appeared to be largely “artificial” in that foreign countries discriminated severely against U. S. goods. Most observers continued to refer to the United States as a “surplus” country and seemed to feel that the rest of the world was doomed to struggle for scarce dollars.

The deficits served an important purpose in enabling other industrial countries to rebuild their monetary reserves to the point where they were able to relax some of their exchange restrictions and to consider the possibilities of a return to full currency convertibility. The United States, in the meantime, had lost little of her large gold reserves, financing her deficits by increasing her dollar liabilities. At this point, the international payments system appeared to be running smoothly.

Factors contributing to U. S. deficits in the early years of this period included the impact of the 1949 devaluations, the sharp rise in U. S. imports induced by the Korean hostilities, a doubling of the annual rate of private capital outflow, a substantial increase in military expenditures abroad, and a continuation of large Government grants through 1951.

Although the merchandise trade surplus increased over its 1950 volume, it continued at a level considerably below that maintained in the period 1946-49. With the growing competitive strength of the European economies aided by devaluation, by sharply rising productivity, by relatively stable labor costs per unit of output (Table II), and by continuing restrictions on imports of American goods, it is not surprising that U. S. exports did not increase more substantially. At the same time U. S. payments abroad for services (including military purchases) were increasing sharply, rising from a level of \$4 billion in 1951 to \$7 billion in 1956 (Table III, Col. 5).

### Payments Surplus 1957

The closing of the Suez Canal in the autumn of 1956, coming near the end of a worldwide capital investment boom period, was accompanied by several shocks to the international payments system. England experienced a capital flight and a loss of reserves which necessitated a drawing of \$561 million from

## II. Output Per Man Hour, Hourly Earnings, and Labor Costs in Manufacturing, Selected Countries

(1953 = 100)

Item	1953	1954	1955	1956	1957	1958	1959	1960	1961
<b>United States:</b>									
Output per man-hour	100	99	106	107	107	109	117	120	124
Hourly earnings	100	102	107	112	118	121	126	130	133
Labor costs	100	103	101	105	110	111	107	108	107
<b>Belgium:</b>									
Output per man-hour	100	109	117	122	126	127	133	139	143
Hourly earnings	100	103	106	115	125	131	133	138	143
Labor costs	100	94	91	94	99	103	100	99	100
<b>France:</b>									
Output per man-hour	100	108	115	121	133	145	149	154	165
Hourly earnings <sup>1</sup>	100	108	116	130	137	132	119	129	139
Labor costs <sup>1</sup>	100	100	101	107	103	91	80	84	84
<b>Germany:</b>									
Output per man-hour	100	105	112	115	122	129	138	148	152
Hourly earnings <sup>1</sup>	100	102	109	119	129	138	145	160	184
Labor costs <sup>1</sup>	100	97	97	103	106	107	105	108	121
<b>Italy:</b>									
Output per man-hour	100	106	115	123	130	138	152	163	167
Hourly earnings	100	104	109	117	123	128	131	137	147
Labor costs	100	98	95	95	95	93	86	84	88
<b>Japan:</b>									
Output per man-hour	100	107	113	119	128	123	150	173	197
Hourly earnings	100	106	109	120	126	125	136	148	162
Labor costs	100	100	96	100	98	102	91	85	82
<b>United Kingdom:</b>									
Output per man-hour	100	104	108	108	110	112	116	122	122
Hourly earnings	100	107	116	124	133	137	142	155	164
Labor costs	100	103	108	115	121	122	123	127	133

<sup>1</sup> Adjusted for exchange rate changes (1957-61 for France, 1961 for Germany).

Source: Bela Balassa, “Recent Developments in the Competitiveness of American Industry and Prospects for the Future,” *Factors Affecting the United States Balance of Payments*, Joint Economic Committee, 1962, p. 36.

the IMF and a stand-by credit of equal amount. France, which had been exposed to sharp reserve declines since early 1956, concluded in October of 1956 a stand-by agreement for \$262 million with the IMF which it subsequently utilized. In August of 1957, France devalued the franc by approximately 17 per cent.

The political uncertainties arising from the Suez crisis led to a heavy volume of imports by European nations and Japan and added to the exchange difficulties of these countries during the 1956-57 period. As foreign nations turned to the United States for heavy shipments of crude oil, petroleum products, and other basic commodities, U. S. exports rose to a record high of \$19.4 billion (Table III, Col. 1). This surge in exports during the first half of 1957 provided a trade surplus of \$6.1 billion and a U. S. balance-of-payments surplus of \$0.5 billion. The dollar liabilities of the United States continued to increase by the small amount of \$300 million, but this increase was more than offset by U. S. Treasury purchases of \$800 million in gold (Table I).

### The Deficits of 1958-62: Dollar Glut

Beginning in 1958, the United States has had a steady sequence of large balance-of-payments deficits, averaging \$3.1 billion for the five-year period 1958-

62. The U. S. was able to finance more than half its cumulative 1958-62 deficit of nearly \$16 billion by incurring liabilities to foreigners in the amount of \$9.4 billion (Table I). The balance was settled by the transfer of \$6.3 billion of gold to foreign ownership.

A study of the distribution of the increased dollar liabilities to foreigners shows that, in this period 1958-62, foreign monetary authorities added about \$4 billion to their liquid assets in the United States, raising their total holdings to more than \$12 billion. Holdings of the IMF rose by \$2 billion, private holdings increased by more than \$2 billion, while holdings of nonmonetary international institutions increased by more than \$1 billion.<sup>4</sup>

What factors contributed to the higher level of deficits in this period? While it may be tempting to single out a particular item—too few exports, too many imports, too much foreign aid, etc.—this procedure is unsound. Various types of transactions are closely linked to one another, and a policy-induced change in one component may lead to a partially offsetting change in another component. In fact during this recent period nearly all of the Government and capital account items showed larger “net outflows”

<sup>4</sup>Federal Reserve Bulletin, April 1963, p. 423.

### III. U. S. Balance of Goods and Services (In millions of dollars)

Period	(1) Merchandise <sup>1</sup>			(2) Services				(3) Total goods and services			(4) Total goods and services (Excluding military transactions)			Period	
	Exports	Imports	Balance	Exports	Imports		Balance	Exports	Imports	Balance	Exports	Imports	Balance		
					Total	Military									Other
1946	+11,707	- 5,073	+ 6,634	+3,028	-1,918	- 493	-1,425	+1,110	+14,735	- 6,991	+ 7,744	+14,735	- 6,498	+ 8,237	1946
1947	+16,015	- 5,979	+10,036	+3,722	-2,229	- 455	-1,774	+1,493	+19,737	- 8,208	+11,529	+19,737	- 7,753	+11,984	1947
1948	+13,193	- 7,563	+ 5,630	+3,596	-2,786	- 799	-1,987	+ 810	+16,789	-10,349	+ 6,440	+16,789	- 9,550	+ 7,239	1948
1949	+12,149	- 6,879	+ 5,270	+3,621	-2,742	- 621	-2,121	+ 879	+15,770	- 9,621	+ 6,149	+15,770	- 9,000	+ 6,770	1949
1950	+10,117	- 9,108	+ 1,009	+3,690	-2,920	- 576	-2,344	+ 770	+13,807	-12,028	+ 1,779	+13,807	-11,452	+ 2,355	1950
1951	+14,123	-11,202	+ 2,921	+4,621	-3,871	-1,270	-2,601	+ 750	+18,744	-15,073	+ 3,671	+18,744	-13,803	+ 4,941	1951
1952	+13,819	-10,838	+ 2,981	+4,673	-4,928	-2,054	-2,874	+ 255	+17,992	-15,766	+ 2,226	+17,992	-13,712	+ 4,280	1952
1953	+12,281	-10,990	+ 1,291	+4,666	-5,571	-2,615	-2,956	- 905	+16,947	-16,561	+ 386	+16,755	-13,946	+ 2,809	1953
1954	+12,799	-10,354	+ 2,445	+4,960	-5,577	-2,642	-2,935	- 617	+17,759	-15,931	+ 1,828	+17,577	-13,289	+ 4,288	1954
1955	+14,280	-11,527	+ 2,753	+5,524	-6,268	-2,901	-3,367	- 744	+19,804	-17,795	+ 2,009	+19,604	-14,894	+ 4,710	1955
1956	+17,379	-12,804	+ 4,575	+6,216	-6,824	-2,949	-3,875	- 608	+23,595	-19,628	+ 3,967	+23,434	-16,679	+ 6,755	1956
1957	+19,390	-13,291	+ 6,099	+7,091	-7,461	-3,216	-4,245	- 370	+26,481	-20,752	+ 5,729	+26,106	-17,536	+ 8,570	1957
1958	+16,264	-12,952	+ 3,312	+6,803	-7,909	-3,435	-4,474	-1,106	+23,067	-20,861	+ 2,209	+22,767	-17,426	+ 5,341	1958
1959	+16,282	-15,310	+ 972	+7,194	-8,032	-3,107	-4,925	- 838	+23,476	-23,342	+ 134	+23,174	-20,235	+ 2,939	1959
1960	+19,459	-14,723	+ 4,736	+7,515	-8,482	-3,048	-5,434	- 967	+26,974	-23,205	+ 3,769	+26,639	-20,157	+ 6,482	1960
1961	+19,913	-14,497	+ 5,416	+8,398	-8,370	-2,934	-5,436	+ 28	+28,311	-22,867	+ 5,444	+27,909	-19,933	+ 7,976	1961
1962 <sup>2</sup>	+20,479	-16,145	+ 4,334	+9,311	-8,819	-3,028	-5,791	+ 492	+29,790	-24,964	+ 4,826	+29,130	-21,936	+ 7,194	1962 <sup>2</sup>

<sup>1</sup> Excludes military transfers under grant.

<sup>2</sup> Preliminary.

Source: U. S. Department of Commerce. 1946 to 1961 data, *Balance of Payments Statistical Supplement*, Revised Edition. 1962 data, *Survey of Current Business*, June 1963.

(Chart 2). These larger outflows were only partly offset by a larger average surplus balance of goods and services. Military expenditures averaged \$3.1 billion as compared with a \$2.1 billion average for the period 1950-56. Private capital outflow averaged \$3.2 billion compared with a \$1.4 billion average in the earlier period. The average of recorded short-term capital outflow was up \$500 million, while the average long-term capital outflow increased by \$1.3 billion. Moreover, net payments on unrecorded transactions have averaged \$700 million during the last three years. Previously, the unrecorded transactions led to net receipts rather than net payments. Finally, foreign aid, net of ordinary repayments, has averaged \$300 million more per year than in the period 1950-56.

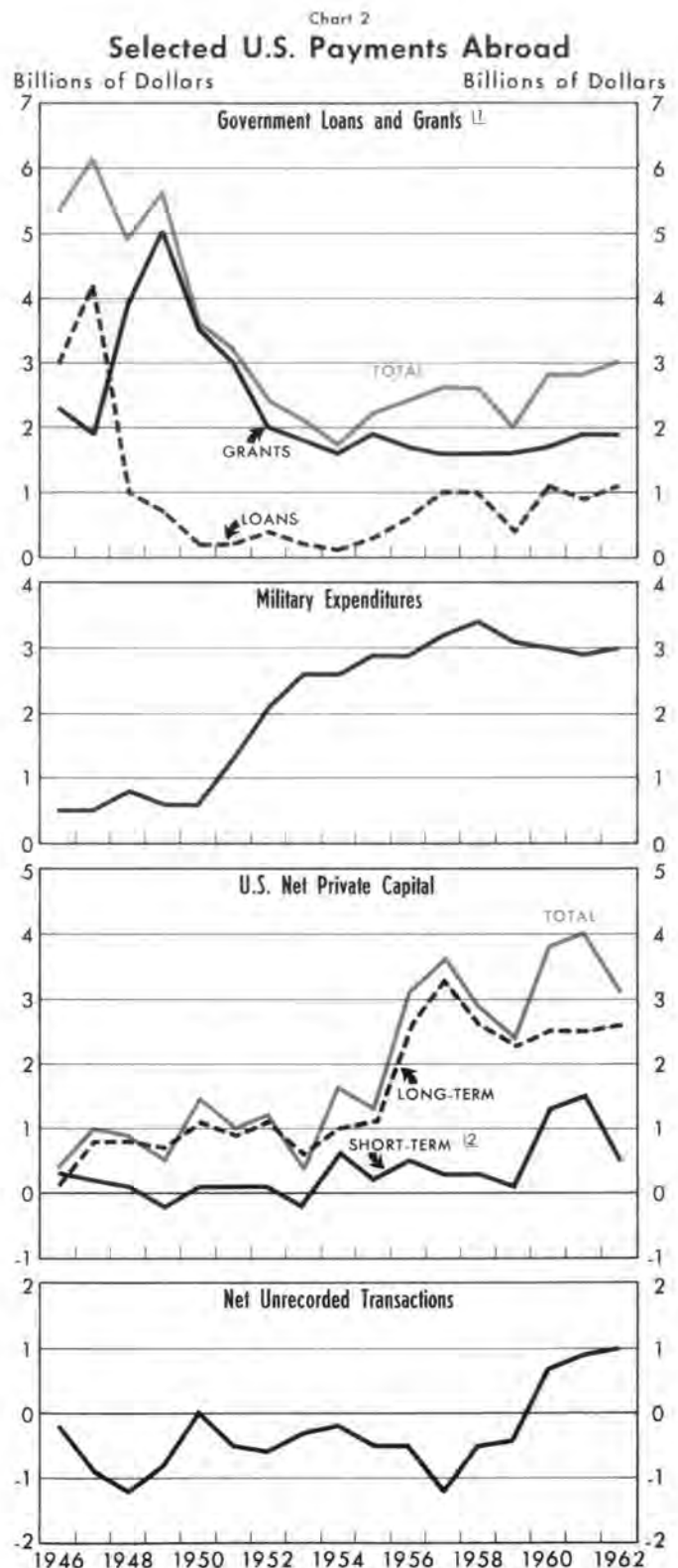
During this recent period the surplus balance on goods and services (excluding military transactions) averaged about \$6.0 billion as compared with an average surplus balance of \$4.2 billion during the years 1950-56 (Table III, Col. 14). Since 1960, the trade surplus has been running at the relatively substantial rate of \$4.8 billion a year which is considerably larger than the average of \$2.5 billion maintained in the 1950-56 period (Table III, Col. 3).

In the 1958-62 period the United States was not the only country struggling with international payments problems. In 1958 France devalued its currency by a further 15 per cent as one part of its rigorous stabilization program. Since then French reserves have grown rapidly, reflecting a continuing large balance-of-payments surplus.

The United Kingdom on several occasions experienced a run on sterling and a loss of reserves. The IMF and central banks provided reserve support in defense of the pound.

In 1962, Canada—which had had a flexible exchange rate for a decade—established a value well below earlier effective rates for the Canadian dollar in order to strengthen a weakened payments position. Doubts about the new par value led to an exchange crisis in mid-1962. Confidence in the new par value was established by a series of policy actions by the Canadian Government supported by financial assistance from the IMF, the Federal Reserve, and the Bank of England.

The U. S. deficits of the 1958-62 period destroyed the general concern over an underlying world dollar shortage which had lingered on even through the period, 1950-56, when the United States was incurring persistent deficits. The large U. S. deficits of the last five years have convinced all observers, here and abroad, of the necessity for reducing the growth of



Note: Since this chart is designed to picture important U.S. payment categories, payments are recorded as plus, receipts as minus.

<sup>1</sup> Government loans net of regular and special repayments.

<sup>2</sup> Excludes unrecorded transactions.

Source: U.S. Department of Commerce

dollar liabilities to foreign nations, particularly the growth in foreign official dollar reserves in the face of declining U. S. gold reserves.

The basis for official concern is that foreign countries hold about \$12 billion of their international reserves<sup>5</sup> in the form of dollar claims which they can use to buy gold from the U. S. Treasury; moreover, under present circumstances, these potential claims on our gold stock could be rapidly enlarged through the conversion of foreign private dollar balances and dollar balances owned by U. S. residents into foreign currencies. The substantial decline in the U. S. gold stock during the last 5 years has spurred United States policy efforts to reduce payments deficits and to join in international actions to moderate short-term capital movements and to cushion the shocks of large changes in foreign official reserves.

Disruptive movements of liquid capital were one of the features of the period 1958-62. International mobility of short-term capital is a useful adjunct to world trade and finance and has been one of the long-standing objectives of the IMF. But in an environment of serious payments imbalances and uncertainties over the stability of par values, speculative capital movements intensify reserve swings—causing large losses for the countries experiencing outflows and excessive accumulations for those gaining capital.

## Adjustments to Balance-of-Payments Deficits

### —Some Alternatives

Countries plagued by continuing payments deficits and reserve losses have resorted in the postwar period to such drastic actions as devaluation, severe restraints on domestic economic activity, and outright import restrictions. The widespread devaluations of 1949, the French devaluations in 1957 and 1958, and the Canadian devaluation in 1962 were official attempts to increase export receipts and reduce foreign exchange outlays for imports. In each of these instances, the policy objective appears to have been attained.

Restraints on domestic demand through tight monetary and fiscal policies have characterized the adjustment policies of the United Kingdom on a number of occasions. The French stabilization program of 1958 incorporated along with devaluation similar counter-inflationary actions. To help defend the new par value of the Canadian dollar, Canada tightened

the availability and raised the cost of credit to borrowers in 1962. Japan, one of the fast-growing industrial nations of the postwar period, employed stringent restrictive policies in 1957 and again in 1961.

The United States has rejected devaluation and extremely tight money as remedies for its payments deficit. Instead, it has chosen to redress the deficit in a gradual and more deliberate fashion. Before proceeding to the nature of specific U. S. policies, it may be useful to outline the reasons why more drastic measures have been rejected.

### —U.S. Policies

#### *Policy of Domestic Restraint — Not Acceptable*

Payments deficits are quite often regarded as cases of domestic inflation spilling over into surging imports and lagging exports. The orthodox prescription for countries in deficit is, therefore, a policy of imposing restraints on the aggregate demand for goods and services.

In its extreme form such restraint amounts to actual deflation—a contraction in demand, income, and employment. Deflation could be brought about by a deliberate and substantial fiscal policy shift toward budget surplus and by an extremely tight monetary policy involving a sharp reduction in bank reserves and a consequent retrenchment in commercial bank lending and investing. Such a policy would reduce the demand for imports and, by forcing a reduction in wages and prices, increase the competitiveness of exports.

Without denying the importance of domestic inflation as a possible cause of international payments deficits, few countries accept actual deflation as the preferred and usual way of adjusting their balance of payments. Most nations are committed to policies of maintenance of incomes and employment. With downward rigidities in wages and prices, any reduction in economic activity short of a large reduction in real income and employment (economically and politically unacceptable to most nations) would probably fail to reduce industrial prices and wage levels significantly.

A more realistic policy alternative frequently employed by deficit countries is one designed to restrain the growth of effective demand for goods and services. Such a policy would normally involve restrictions imposed by the monetary authorities on credit expansion and perhaps some slowing up in the rate of expenditures by the Government sector. The purpose of these actions would be to reduce the possibility of

<sup>5</sup>Excludes U. S. liabilities to the International Monetary Fund.

rising costs and prices in order to protect the competitive position of exports and to curb tendencies toward importing. At the same time the tightening of credit in the face of strong demands for credit would lead to an upward thrust in interest rates. A rise in interest rates would operate to reduce the payments deficit to the extent that it was based on capital outflows attracted to other countries by higher interest rates.

The United States has rejected the policy of domestic restraint as a method of adjusting its balance of payments. For an economy which has been moving rather sluggishly since 1960 with virtually no evidence of inflationary pressures, a policy of restraint appears inappropriate. International comparisons of price-cost relationships (Table II) suggest that the United States during the period 1953-58 may have been at an increasing competitive disadvantage in that unit labor costs in manufacturing rose more rapidly in the U. S. than in Europe. Since 1958 and 1959, however, the competitive position of American industry has shown signs of improvement, as inflationary pressures have developed in Europe while unit labor costs have been relatively stable in this country.

The sizable U. S. deficits from 1958 on reflect the strains of heavy private capital outflows and large Government expenditures abroad for military and foreign aid programs. There is evidence that private outflows have been partly induced by a level of economic activity in the U. S. which appears less attractive than that in Western Europe. Monetary and fiscal policies designed to further restrain domestic economic activity could accelerate the outflow of long-term capital while doing nothing to curb the size of military expenditures and the volume of foreign aid.

In an effort to promote domestic economic activity without worsening the balance of payments, the Federal Reserve has undertaken to provide reserves to banks in sufficient volume to facilitate domestic expansion but without so great an expansion in bank credit as might undermine stability of the price level. The monetary authorities have also tried to achieve an expansion in bank credit with a minimum of downward pressures on short-term interest rates. The authorities have recognized the necessity for improving the international competitive position of our export industries and the importance of minimizing international short-term interest rate differentials, but they have tried to attain these objectives while still encouraging an expansion in domestic economic activity.

It is in this area of policy that the well-known conflict between internal and external objectives has appeared. Since 1960 domestic economic objectives have required monetary expansion to encourage a rise in

the level of economic activity. A policy of monetary ease tends initially to depress interest rates. It was felt by U. S. officials that a drop in U. S. rates relative to the higher rates in foreign money markets would have accelerated the outflow of short-term capital. This fact has imposed a degree of restraint on Federal Reserve actions and more recently has placed the burden of expansionary efforts on fiscal policy.

### *Official Objections to Devaluation*

Some observers have insisted that the U. S. will continue to be at a competitive disadvantage with other nations until she devalues the dollar. Pointing to the devaluations of 1949, the French devaluations of 1957 and 1958, and the cost-price increases in the U. S. during the period of the 1950's, the proponents of U. S. devaluation assert that the dollar is now "overvalued" relative to other currencies.

Raising the dollar price of gold (dollar devaluation) would reduce costs of American goods to foreigners thus tending to stimulate exports, while making imports from abroad more costly to buyers in this country. Those who urge dollar devaluation assume that other nations would not devalue their currencies. Raising the dollar price of gold would also write up the value of all gold holdings, official and private, and increase the value of the annual output of gold. This, according to the devaluationists, would provide more gold reserves to meet what some believe to be a problem of growing world trade pressing against an inadequate volume of international reserves.

In spite of these arguments, the weight of official opinion, both here<sup>6</sup> and abroad, is against devaluing the dollar. In 1949 there was general agreement that the devaluing nations were in "fundamental disequilibrium;" there is no such official agreement today with respect to the United States. The United States is unique in having an international payments deficit in the face of substantial trade surpluses. During the last two or three years, as mentioned earlier, the cost-price environment has changed to strengthen the competitive position of the United States. Moreover, the payments surpluses of Western Europe are no longer continuing at the rate of earlier years. In the face of these developments, it is not likely that the European nations would accept devaluation of the dollar without insisting on similar devaluations for their own currencies. Relationships among currencies would remain unchanged, and the U. S. would lose the export advantage originally sought in the act of devaluation.

<sup>6</sup> Robert V. Roosa, "Assuring the Free World's Liquidity," *Factors Affecting the United States Balance of Payments*, p. 343.

Officials in the United States also believe that devaluation is a practical impossibility in view of the dollar's key position in the international payments system. Dollars now are the most important currency supplement to gold in official reserves. In the event of devaluation, dollar holders would incur losses while gold holders would reap profits. Whatever the dollar's new par value, it would be distrusted. Consequently, the dollar could no longer serve as a usable part of monetary reserves. This would reduce the volume of international reserves just when many observers are expressing concern over a possible inadequacy in the total volume of reserves relative to the requirements of a growing international trade.

### *Rejection of Trade and Capital Controls*

The position of the United States as a major trading nation and a leading proponent of free markets has led to official rejection of proposals to restrict imports and the outflow of private capital through specific controls.

Import restrictions have been used by other countries in payments difficulties but the United States disavows such measures because of its commitments to the International Monetary Fund and the General Agreement on Tariffs and Trade and its conviction that import controls employed by countries in payments difficulty induce retaliatory actions and a general reduction in world trade.

Although private capital outflows from the United States tend to be enlarged because of the network of restrictions now in existence in numerous foreign money markets, the United States also rejects the idea of placing restrictions on her own capital market. Capital controls "... would be inconsistent with our traditional and fundamental objectives of freeing trade and payments between countries..."<sup>7</sup> Instead, official policy strives to persuade foreign governments to open up their capital markets, and at the same time attempts to improve the investment outlook at home.

### *U. S. Adjustments to Payments Problem*

Having rejected the more drastic means of closing the payments gap, the United States has adopted two sets of policies, one directed toward reducing the deficit and the other designed to "defend" the dollar and U. S. gold reserves against pressures likely to develop in the short run.

<sup>7</sup> R. V. Roosa, "Banking and the Balance of Payments," *Factors Affecting the United States Balance of Payments*, p. 335.

**Policies Directed Toward Deficit Reduction**—One line of attack on the payments deficit involves policies to increase the trade surplus by promoting exports. The Government has provided more information to American manufacturers about market potentials abroad. It has expedited the improvement of insurance and credit facilities for exporters. Finally, under the Trade Expansion Act, the U. S. hopes to bargain more effectively for tariff reductions abroad.

The Government at the same time has been pressing for domestic price and wage stability in order to avoid cost-price increases that could weaken the competitive position of the U. S. in world markets. As mentioned earlier, the Federal Reserve System, while encouraging bank credit and monetary expansion to cope with the sluggish pace of domestic expansion, has aimed at avoiding an expansion in bank credit that might undermine stability of the price level.

On another front the United States has been working to reduce the foreign exchange cost of military expenditures and foreign aid outlays. In recent years military expenditures have been averaging \$3 billion annually (Table III, Col. 6). The United States has arranged with a number of countries in which U. S. forces are stationed to make offsetting purchases of U. S. military equipment. In 1961, for example, receipts from military sales abroad amounted to \$400 million; and in 1962, approximately \$600 million. Through restraints on procurement abroad and increased sales of military equipment, the Government hopes to reduce the annual net balance-of-payments burden of military expenditures by about \$1 billion.

Measures have also been taken to tie a growing portion of American foreign aid to purchases in the United States. Government loans and grants for foreign aid amounted to \$4 billion in 1962. The net drain on our payments position was much smaller, however, because \$2.3 billion of our merchandise exports and \$500 million of our service exports were directly financed by the aid program, and some portion of our untied aid probably also led to larger U. S. exports, either directly or indirectly. Eventually, 80 per cent of U. S. foreign aid will be tied to U. S. exports.

In 1962, the Government received approximately \$600 million in regular principal payments on its outstanding loans and another \$600 million in special prepayments, a major portion of which came from France. Negotiations for additional prepayments are continuing.

The large outflow of U. S. private capital has been one of the major factors contributing to recent large

payments deficits. As mentioned earlier, U. S. adherence to free-market principles bars direct limitations on outflows comparable to those imposed by other leading nations. However, investment tax credits and accelerated depreciation procedures—though primarily designed to spur domestic economic growth—may reduce the outflow of long-term capital. Underlying the various tax proposals to stimulate domestic economic activity is the hope that, among other benefits of domestic expansion, investment prospects will brighten sufficiently to induce more of the existing volume of funds into domestic rather than foreign projects. Public officials have tried also to persuade foreign countries to reduce restrictions in their capital markets, so as to shift some foreign borrowing to the capital markets of the surplus countries of Western Europe and away from the U. S. market. In the meantime, the growing receipts of income on foreign investment are likely to be a source of strength in the future. In 1950 receipts from income on U. S. private foreign investment were \$1.5 billion. In 1962 such receipts had increased to \$3.7 billion annually.

The annual outflow of private short-term capital has averaged over \$1 billion in the three years, 1960-62, according to the available statistics. In addition, there were probably large outflows of funds not covered by the existing reporting system. On the assumption that such outflows have been encouraged by relatively low short-term interest rates in the United States, the Federal Reserve and the Treasury have modified their monetary and debt management policies to avoid downward pressures on short-term interest rates.

**Defending the Dollar and the International Payments System**—U. S. policies have also been directed against the threats of instability arising from heavy shifts of liquid capital from one country to another. Such movements can lead to disruptive declines in reserve positions of those countries subject to outflows and uncomfortable reserve excesses for the recipient nations. Sudden shifts of reserves in an environment of persistent payments imbalances raise questions about the future parities of particular currencies. With the existing mobility of short-term funds, this uncertainty may promote additional capital movements that could place great strains on the existing payments system, particularly if they threaten the dollar—the principal reserve currency of the world.

One of the more significant defenses of the dollar developed within the past two years has been active intervention in the foreign exchange market by the Treasury and Federal Reserve, in cooperation with

foreign central banks, to combat temporary disturbances.<sup>8</sup> The Treasury initiated operations in March 1961 with forward sales of German marks in order to reduce the discount on the forward dollar at a time of strong speculation on a further upward revaluation of the mark. The increase in the amount of forward cover available served to encourage the holding of dollars, to reduce demands for spot conversions into marks, and to calm speculative unrest. The Treasury's forward mark commitments reached a peak of \$340 million in mid-June 1961 and then declined rapidly as confidence in the stability of the mark's new par value was established. Forward operations have subsequently been made in other currencies, especially Swiss francs, guilders, and lire. Treasury balances of foreign currencies needed to cover maturing forward contracts have been acquired through spot purchases in the exchange market and through the issuance of special Treasury obligations denominated in foreign currencies.

The Federal Reserve, in March 1962, initiated a program of bilateral reciprocal credit arrangements, or swap facilities, with foreign central banks, enabling the System to acquire foreign currencies to support the dollar in the exchange markets and to reduce the dollar accruals and potential gold purchases of foreign central banks. These arrangements, though specified for a short period such as three or six months, are renewable by mutual agreement. Through May 1963,<sup>9</sup> arrangements totaling \$1.5 billion had been made with ten foreign central banks and with the Bank for International Settlements.

The U. S. has also joined an agreement with nine other leading financial and trading countries providing "supplementary resources" up to a total of \$6 billion (\$4 billion by countries other than the United States) for mutual financial assistance through the International Monetary Fund, to be used particularly in the event of massive shifts of funds from one country to others.

Finally, the United States has undertaken regular consultations with foreign monetary authorities at meetings of the Bank for International Settlements and the Organization for Economic Cooperation and Development. These meetings have provided a useful opportunity for discussion of common problems and have laid the basis for stronger international cooperation in the future.

<sup>8</sup> "Treasury and Federal Reserve Foreign Exchange Operations," *Federal Reserve Bulletin*, September 1962 and March 1963.

<sup>9</sup> Board of Governors, "Press Release," May 30, 1963.

With the aid of these new arrangements the United States has been able to absorb some of the excess dollar holdings of foreign central banks thus reducing the pressure on U. S. gold reserves. Operations by central banks have curbed speculative buying in the London gold market. The support given to the British pound on several occasions and the recent 1962 mobilization of more than \$1 billion within a 48-hour period to stop a raid on the Canadian dollar are evidence of the strength of international cooperation among central banks and the potential of the International Monetary Fund.

### Some General Observations

The existing international payments system places a premium on international cooperation to bring about correction of payments imbalances. While it permits some adjustments in exchange parities for nonreserve currency countries, it rules out such adjustments for the United States—the principal reserve currency nation. Faced with a sizable and persistent deficit, the United States must nevertheless avoid drastic measures; instead, she must balance her international accounts by strengthening her competitive position in world markets through improving productivity, restraining wage and price increases, and actively promoting exports. At the same time the U. S. must negotiate with other nations to reduce trade barriers, barriers to capital flows, and the net foreign exchange costs of military and aid expenditures abroad.

The results to date have been modest but in the right direction. If the United States is successful in guarding against inflationary pressures, and if price increases continue in countries in balance-of-payments surplus, the competitive strength of the United States is bound to improve further. It is worth noting, however, that continued inflationary pressures and resulting price increases in surplus countries may not be taken for granted. The surplus countries can restrain the rise in costs and prices developing out of their surplus payments position through a variety of measures.

There is little doubt that the international payments system can cushion the shocks of substantial shifts in liquid capital and resultant changes in international reserves more easily than was possible a few years ago. The innovations in international cooperation and the strengthened IMF provide the monetary authorities with powerful resources to guard against sudden speculative attacks on one or another of the major currencies. Although the outflow of gold from the United States still continues, there is much more optimism with respect to the ability of the United States,

in cooperation with other nations, to counter future pressures on the dollar and monetary gold reserves.

The international payments system, which has developed since the end of World War II, appears to be working fairly well. World trade has more than doubled since 1950, and industrialized countries have dismantled most of their exchange controls and are moving toward still greater freedom in trade and capital flows. Although the system does not provide for prompt adjustment of payments imbalances and the freedom from concern over reserve shortages and excesses, the most feasible approach, in the light of existing economic and political commitments, is to build on the existing system whenever problems appear.

An important alternative approach, favored by many academic economists, is the adoption of flexible exchange rates. In theory, flexible exchange rates would eliminate reserve problems and would provide more or less automatic adjustments to balance-of-payments disturbances as they arise. But the financial officials throughout the free world believe that the theoretical advantages of flexible exchange rates would be more than offset by practical disadvantages. In particular they question whether speculation in the foreign exchange market would be stabilizing or destabilizing; whether uncertainty about the future course of exchange rates would handicap foreign trade; whether such uncertainty could be offset by improvements in the forward market; whether there is danger that international investment might be restrained by uncertainty over exchange rates; whether exchange rate changes would provoke new restrictions on international trade and throw barriers in the way of international cooperation. Most importantly, they believe that countries would still need gold or currency reserves to smooth out disturbances and to avoid excessive rate fluctuations, and they question whether a fluctuating dollar could continue to serve as a reserve currency.

Having decided to maintain the essentials of the present gold-dollar system supported by the resources of the International Monetary Fund, the nations of the free world must, by continuing negotiation and cooperative arrangements, adjust to payments imbalances. In the years to come, the strength of international cooperation may also be tested by what many believe to be the coming problem of international liquidity: the danger that total international reserves will become so scarce as international trade continues to grow, that the western world will be forced to follow deflationary policies.

This concern is based on the following argument: with annual gold production adding relatively small amounts to the world's monetary gold reserves, the only other source of increasing reserves, apart from credit extended by an international agency, lies in the growing volume of foreign dollar holdings arising out of U. S. deficits. If the U. S. payments position is in surplus, the world's reserve of dollars diminishes.

A suggested solution to the problem of reserve scarcity is a plan for centralizing existing monetary reserves in an expanded and reorganized International Monetary Fund or a new supra-national bank.<sup>10</sup> This central institution would also be empowered to create additional supplies of a new reserve "currency." All subscribing countries would be bound to accept this new "currency" in settlement of any balance-of-payments surpluses they might have. With such an institution the dollar's special role as a reserve currency would end.

Little official enthusiasm has been generated in support of the proposal for a world central bank. In the opinion of most monetary authorities the creation of such a bank would require a degree of international cooperation and integration not yet possible. It should be noted that the leading nations have not objected to an expansion of the resources of the International Monetary Fund in its present form. While international cooperation has developed to the point of accepting new arrangements built upon existing payments procedures, there is little official sentiment in favor of changes that would substantially alter the

<sup>10</sup> For a more detailed explanation by its leading proponent, see Robert Triffin, *Gold and the Dollar Crisis*, Yale University Press, 1960.

payments mechanism to which governments and individuals are already well accustomed.

The possible necessity for providing additional international reserves in an expanding world economy may lead to a modification of the present composition of international reserves. There is evidence of official support for the idea that when the United States again achieves a surplus payments position, it might accumulate official reserves in other convertible currencies so that its surplus would not require reductions in other countries' gold and dollar reserves. The Federal Open Market Committee, in authorizing Federal Reserve foreign exchange transactions, indicated that reciprocal holdings of foreign currencies, as a means of providing more international liquidity, was one of its long-run aims. Mr. Roosa, addressing the monetary conference of the American Bankers Association in Rome, Italy, in 1962<sup>11</sup> indicated that the United States decision to hold foreign currencies as part of its reserves might be a sensible way to provide for any large increase in long-run liquidity requirements.

International cooperation in the last few years has resulted in numerous financial arrangements contributing to the defense of the dollar and other important currencies. Essential as these arrangements are, they cannot take the place of real correction in our balance of payments position. Within the framework of existing international payments procedures, the approach toward better balance throughout the world will necessarily require further cooperative actions by both deficit and surplus nations.

<sup>11</sup> *Factors Affecting the United States Balance of Payments*, pp. 331-32.



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