INTERNATIONAL FINANCIAL PROBLEMS OF OUR ECONOMY

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In our international as well as in our domestic economy we are witnessing a readjustment from deficit to surplus conditions. This readjustment is an aftermath of our inflationary postwar boom. Crippling bottlenecks in production and annoying scarcities of consumers' goods have now largely disappeared. The problem we currently confront is one of sustaining a high level of economic activity without the questionable benefit of inflationary supports.

Decline in U. S. Export Surplus in 1948

In the domestic field, the readjustment has been reflected in a softening of prices, a slight decline in industrial production, and some increase in unemployment. The backlog demand of the immediate postwar period has largely spent its force. The country's plant and equipment have been expanded and improved to meet peacetime needs. Inventory pipelines have been filled. The excess of effective demand over available supply at prevailing prices and incomes has largely disappeared. Reduction in the level of prices without substantial decrease in consumers' incomes may be essential to avoid accumulation of supplies in excess of effective demand.

In the international field, readjustment is indicated by a sharp reduction in our export surplus. During the early postwar period the problem of backlog demand had been much more acute than in the United States; in countries more directly affected by the war, goods had been far more scarce and a sufficiently large and rapid increase in production was far more difficult to achieve. Foreign countries were anxious, therefore, to receive any amount of exports, but were unable to supply their former customers with corresponding quantities of imports. In 1948, however, the output of many war-devastated countries rose sufficiently to make it possible for them to replace shipments from the United States with domestic commodities, and at the same time to send increasing quantities of their products to us as well as to other markets. As a result, our exports declined and our imports rose.

In 1948 we exported goods and services valued at $16.8 billion, or $3 billion less than in 1947; on the other hand, we imported goods and services valued at $10.5 billion, or $2 billion more than in 1947. Our export surplus thus declined by $5 billion, from $11.3 billion in 1947 to $6.3 billion in 1948.

This decline becomes even more significant when we consider that it took place despite an increase in our average price level of about 9 per cent. In terms of volume--that is to say, in terms of constant prices--our exports of commodities declined by about 18 per cent and our imports increased by about 13 per cent. Should similar changes occur in 1949, our export surplus would virtually disappear.

The most important single factor influencing our international economic relations in 1948 was the recovery progress in Western Europe. Countries in this area received in 1948 about one-third of our total commodity exports. Production in most countries which are members of the Organization for European Economic Cooperation has now reached or surpassed the prewar level. Industrial reconstruction, hastened by assistance under the European Recovery Program, has progressed to the point where the most important gaps in the need for capital equipment and raw materials have been filled. Agricultural rehabilitation, together with U. S. aid, has so improved living standards that the productivity of labor has risen almost to prewar level. As a consequence, production of five important goods, namely, foodstuffs, textile products, ships, motor cars, and coal in these European countries has increased so much that our exports of these goods declined by a total of more than $1.6 billion in 1948. At the same time our imports of machinery, motor cars, and textile products rose by $300 million. Moreover, the rehabilitation of the merchant marine of seafaring nations brought about a decline in our net revenue from transportation from $1 billion in 1947 to less than $500 million in 1948. Altogether, we find that at least $2.4 billion, or almost one-half of the total decline in our export surplus, can be traced directly to the success of our assistance to Western Europe.

Increased production in Canada, Latin America and the Middle East, together with the large volume of output in the United States, was responsible for the sizeable rise in our imports of raw materials--like oil, metal ores and metals, textile fibers, lumber and wood pulp, meat, coffee, cocoa, tea, and other semi-luxury foodstuffs. The increase in these imports amounted to about $1 billion, or one-fifth of the decline in our export surplus. The improvement in the international economic situation is, therefore, responsible for about 70 per cent of the drop in our 1948 export surplus.

The remaining 30 per cent of the decline in the export surplus, however, may be ascribed mainly to effects of the war that have not yet been completely overcome. The continuing poverty of a large part of the world is reflected in the so-called dollar shortage, namely, the progressive exhaustion of dollar reserves of most foreign countries. For instance, this shortage holds down our exports of industrial and electrical machinery although virtually all countries are still badly in need of further modernization and expansion of their capital equipment. In fact, the entire output of such machinery in all industrial nations could not satisfy the over-all demand if the purchasing power of foreign countries were equal to their needs.

In particular, the decline of more than $700 million in our exports to Latin America probably was due to the depletion of their dollar resources during the early postwar years rather than to a reduction in their need for our products. Countries like Venezuela which still had ample dollar reserves have actually increased their purchases in this country. A decline of $400 million in our exports to the sterling area outside of Europe, while in part attributable to the recovery of the United Kingdom, was in part due to the "dollar shortage".

Another part of the decrease in our exports can be attributed to the unsettled political situation in the countries bordering on the Soviet Union and in the Far East. The unwillingness to remain dependent upon the West, coupled with our prohibition of exports of strategic materials to the area dominated by the Soviet Union, resulted in a drop in our exports to Eastern Europe of about $300 million. Continued strife in the Far East reduced our exports to that area by about $200 million.

These developments account in the main for the sharp decline in 1948 in our export surplus. They indicate substantial progress toward more stable economic conditions. In the financing of the export surplus, however, we continue to find evidence of the decisive role of the aid given by the United States. Not less than $5.1 billion, only about 20 per cent less than in 1947, was covered by Government loans and grants and by advances by the International

Monetary Fund and the International Bank for Reconstruction and Development. An additional $600 million, or about the same amount as in 1947, was financed by private remittances, occasioned mainly by the continuing sorry plight of the European relatives and friends of our citizens. Private capital invested abroad totaled $900 million (net), a small increase over 1947. Sales of gold to the United States amounted to $1.5 billion, or almost 50 per cent less than in 1947. This decline probably reflects the heavy liquidation of foreign gold holdings prior to 1948. Sales of gold in 1948 were largely offset by an increase in foreign holdings of short-term assets in this country.

Prospective Changes in Export Surplus

From the point of view of our international relations, the decline in our export surplus is welcome, especially insofar as it indicates progress of rehabilitation abroad. In 1948, when inflationary pressures still prevailed in this country, it was also welcome from the point of view of our domestic financial policy. An export surplus is financed--apart from private relief contributions--either out of U. S. Government funds, private extension of credit, or an inflow of gold. All three methods have inflationary effects. The largest international expenditure--Government grants and loans--made it more difficult to achieve a budget surplus of decisive anti-inflationary proportions. Credits extended to finance purchases by foreigners contributed to further expansion in the volume of our money. Gold inflow provided additional bank reserves which could become the basis of a multiple expansion of credit.

A further decline in our export surplus, however, might have less desirable consequences if downward pressures developed in the domestic economy. When domestic demand contracts, a strong foreign demand is beneficial because it provides a market for goods.

It has been argued, by opponents of the joint program of European reconstruction, that our aid was intended less to help Western Europe than to benefit our own economy by opening otherwise unavailable markets for our goods and services. This contention does less than justice both to our motivation and to the actual situation in 1948. In that year domestic demand could have absorbed virtually all our exported products, and the export surplus was a drain upon our economy. Moreover, the possibility that we might benefit in the future from increased sales abroad would not mean that foreign countries would be harmed by them: our aid--unless grossly mismanaged--would in any case continue to be a positive contribution to foreign economies. In fact, the needs of foreign countries for additional goods and services are so immense that they could not be satisfied for a long time to come by the output of their rehabilitated productive systems and all our aid combined.

Our assistance to foreign countries could harm their economies only if we insisted on exporting goods that would compete with their industries and if these nations were unable to shift their production to other, more advantageous activities. Actually, our aid consists overwhelmingly of foodstuffs, raw materials, and capital equipment and the most biased protectionist could not truthfully maintain that such shipments diminished the opportunities for employment in the recipient countries. On the contrary, they make it possible for these countries to increase employment, production, and consumption at the same time.

In any case, our export surplus probably will not decline as rapidly from 1948 to 1949 as it did between 1947 and 1948. We may hope that imports will continue to increase, both because of large demand at home and because of increased supply abroad. We also can expect exports of a number of commodities to decline further. Our foreign responsibilities, however, will make it necessary for us for some time to come to ship a certain amount of "unrequited" exports--that is, exports not paid for by imports.

The first of these responsibilities concerns the areas occupied by our armed forces. In 1948, contrary to the general trend, our exports to Germany, Austria, and Korea were considerably larger than in 1947. While it is hoped that no further rise in aid will become necessary, it would be unrealistic to count upon too rapid a decline in the needs of these countries.

The second responsibility relates to countries threatened by foreign aggression. In 1948, that responsibility resulted in increased exports to Greece and Turkey. Under the North Atlantic Pact, further increases may be necessary to enable the European members to fulfill their treaty obligations.

A third responsibility exists in respect to countries which have entered into long-term plans for reconstruction and development in connection with the European Reconstruction Program. It would be wasteful, as well as contrary to our economic and political interests, to leave that work unfinished by reducing our assistance below the amount required by the participating nations at their current state of recovery. We have just started to deliver capital goods rather than foodstuffs, and a decline in domestic demand for capital goods may make possible an increase in deliveries without deprivation of our own industry.

A fourth responsibility may arise in connection with our new program of technical assistance to undeveloped areas. While this project does not contemplate substantial shipments immediately, it probably will lead eventually to a greater demand for capital goods. Such a development would be most beneficial to our own economy if it were timed so that increased demand for undeveloped areas would coincide with declining needs of the Western European countries.

These considerations do not imply, however, that we should artificially create an export surplus not warranted by the needs of the recipient nations in order to provide markets for our goods. Even if drastic anti-deflationary actions should become necessary here, the Government would have ample opportunity to take domestic measures that would expand incomes and expenditures among the low-income groups. Moreover, the sums involved in any prospective export surplus probably would not be large enough to be decisive in anti-deflationary policy.

Outlook for Foreign Trade

A healthy international economic system requires equilibrium in our balance of international payments, apart from those commodities sent to foreign nations as relief. Equilibrium does not mean equality of exports and imports but rather equality of our export surplus--apart from the relief shipments just mentioned--and the amount of our voluntary foreign investment.

Such an equilibrium, however, would not restore satisfactory international relations unless it accompanied a high and expanding level of world trade. Equilibrium as such could be achieved any day by cutting out Government grants and loans and permitting trade to decline to the low levels of the depression years. However, progress in rehabilitation of war-devastated areas and in development of backward areas would be halted, our exports would drop violently, and our imports from these areas could not increase further. This would mean that foreign countries as well as the United States would have to forego the benefits of buying and selling goods in the most advantageous markets.

At a high level of world trade, however, equilibrium would be reached not so much by reducing exports as by increasing imports. Such a development would benefit all parties by making it possible for them to enjoy fully the fruits of the international division of labor.

Consumers generally welcome the added quantities of goods and services that become available for domestic consumption through an increase in imports. Producers, however, frequently favor additional imports only if they are confined to raw materials or other producers' goods or to such consumers' goods as do not compete with domestic products. It so happens that the greater part of our imports is of that type. In 1948 our largest import items were industrial materials like oil, rubber, wool, wood pulp, copper and tin, and foodstuffs like coffee, cane sugar, and cocoa; these nine commodities alone accounted for about 40 per cent of our entire trade. If we maintain our high level of economic activity, we can probably absorb ever-increasing quantities of the commodities that producers favor, including high-quality goods which could be manufactured at home only at prohibitive costs because of the large amount of highly specialized labor necessary for their production.

It is unlikely, however, that we can maintain a high level of trade by importing only those commodities and services which do not compete with domestic products. In fact, progress in synthetic production has reduced our demand for some raw materials, especially silk and rubber, which before the war formed a large part of our imports. We must face the fact that our imports will also have to include some consumers' goods which could be produced domestically but which are produced at greater advantage abroad.

An increase in such imports will, of course, be resisted by competing domestic producers. The resistance will become more stubborn as the comparative advantage of the foreign exporter increases. In some cases, an increase in such imports might actually lead to hardship. Even in those cases, however, the effect upon individual industries would not be more drastic and the over-all effects on the economies abroad and at home less severe than the damage that would result from failure to maximize foreign trade. An example will illustrate the point.

If we were to reach equilibrium by <u>reducing exports</u> to the 1948 level of imports, our export industries would have to curtail sales by about $6 billion; if, however, we were to reach equilibrium by <u>raising imports</u> to the 1948 level of exports, domestic industries would have to curtail sales by the same amount. In both cases, it is assumed for simplicity's sake that other domestic sales and purchases would remain unchanged. If we used the method of cutting exports, it would hit those producers that have proved to be more efficient than their foreign competitors. However, the method of cutting sales of domestic goods competing with imports from abroad would curb those enterprises that are less efficient than foreign producers. From the point of view both of the world economy and of the domestic consumer, the second solution would be far preferable to the first.

If we may hazard a forecast on the basis of past experience, we may expect equilibrium to be reached after the end of the European Recovery Program period, at a point somewhat in between the two extremes posed by our illustration. Unless our economy should suffer serious recession, a level of imports (including services) of 10 to 20 per cent above 1948 would seem feasible. Since the bulk of these imports would be in the fields of crude materials, producers' goods, and other commodities and services which do not compete with domestic products, such an increase would not involve appreciable hardship for domestic producers. At the same time, the recovery of the rest of the world would make an export* level of 10 to 20 per cent below 1948 seem attainable. The resulting export surplus of about $2 billion, or almost 70 per cent below 1948, probably could be covered by private investments alone, or even more easily by investments plus moderate relief contributions. Such a level of foreign trade would represent about the same proportion of our gross national product as in 1947, but a somewhat lower ratio than prevailed either before the first world war or during the inter-war period.

The hope for achieving such a balance is based primarily upon the expectation that we shall not repeat the mistake of the last interwar period, when we believed we could expand exports and at the same time restrict imports. Past experience--that in the long run foreigners can buy from us only as much as we permit them to sell to us--is already repeating itself since our exports everywhere are restricted by the so-called dollar scarcity.

Fortunately, the main trading nations of the world are ready to join with us in an international program which would help us expand foreign trade to maximum volume. The regional commissions set up by the United Nations for Europe, Latin America, the Near East, and the Far East, as well as the Pan-American Union and the Organization for European Economic Cooperation, are all working toward this end. In addition, the International Bank for Reconstruction and Development has started to grant credits to undeveloped nations, which will enable them to expand their production and to participate more actively in international commerce. The International Monetary Fund is tackling the problem of adjusting unrealistic exchange rates so that the main trading nations can gradually lift some of their most irksome exchange restrictions. Finally, the proposed International Trade Organization should become an important forum in which nations operating at different stages of economic maturity and struggling with varying problems of balance-of-payments disequilibrium can reconcile their divergent interests and substitute cooperation for international economic warfare.

All these organizations, however, can work successfully only if we solve our own international economic problems in a manner designed to expand rather than to restrict commerce. Our economy, which has become the largest source of international supplies of goods and services, cannot escape being at the same time the most important international market. Neither regional organizations,

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* From the United States

nor adjustment of exchange rates, nor prohibition of unfair exchange and trade practices can restore equilibrium in international economic relations if we abruptly cease to make our financial resources available to our customers or exclude again their goods from our territory. It is fortunate indeed that a credit and trade policy aimed at international cooperation will also be best adapted to meet the future requirements of our domestic economy.