In our recent discussion of the Common Market we stated that economic and political factors often are just as important as military factors in the struggle with international communism. The difficult part about understanding this situation is that frequently all three elements are involved in a specific problem.

Today I want to discuss with you one of the most pressing problems facing this country. That is our balance of payments problem. This problem has received quite a bit of publicity in the past few years, and I might add, rightly so, for it is the backdrop against which almost all domestic and international decisions must be made. All decisions are weighed, in other words, on the basis of how they will affect our balance of payments.

To put the whole problem in perspective, we have to start with some comments on gold. Gold, as you know, is a rare and precious metal. There are, of course, other rare and precious metals, such as platinum and silver. But gold has been given added importance. Since it is recognized as the base for the international monetary system, its value does not change. If the United States wanted to buy something from Italy, France, or any other country, it could use gold to buy it. By the same token, we could use gold instead of dollars as a medium of exchange here in this country. In other words, gold is the fixed standard or base for the international monetary system.

Why isn't gold used instead of dollars, you might ask. It is cumbersome, and it is heavy. It would be difficult to carry the large (More)
amounts needed for major transactions. So the government keeps the gold and issues dollars, which are in effect, I.O.U.'s backed by gold.

The same thing is true of currencies of other countries. France issues francs, Germany issues marks, and so on. This paper money--currency--while indispensable to keep business moving, is not valuable in and of itself. It is valuable because it represents gold in the international monetary system.

In international trade, gold is not used. The currencies of the various countries are used. When Americans buy something in France, dollars are used. The French would use francs to buy something in this country. This again is simply because it is more practical to use currency--I.O.U.'s--than to ship the gold around the world every time a sale is made between countries.

Periodically, the countries get together to balance the books. The United States uses francs which were spent here to buy back the dollars that Americans spent in France. If Americans spent the same amount in France as Frenchmen spend here, the I.O.U.'s cancel out each other. In other words, it is like someone owing you $5 and you owing the same person $5; you come out even.

In effect, the United States exchanges currencies with all other countries with which it carries on trade. This is just a matter of balancing the international books. The plus or minus we end up with is called balance of payments.

If everything came out exactly even every time, the whole business of balance of payments would be simple. But this is seldom the case. We might owe Germany more than it owes us, or Italy may owe us more than we owe Italy.
When the American people spend, lend, and invest more money in foreign countries than foreigners spend here, we have what is known as a deficit in our balance of payments.

At one time or another, most of us have been in a similar position. That is, we spend more than we make in a week or a month. This is not something to worry about too much because usually the people to whom we owe money will wait until the next week or the next month to get paid. If we pay our debts when the next week or month rolls around, everything is fine.

Countries usually operate this way too. They do not come rushing in demanding that they be paid immediately when the U. S. owes them money. Many countries figure that they may owe us the following year, so they carry a credit—what we owe them—as a buffer.

But what would happen if you continued to spend more than you earned? You could do it on credit only as long as people would let you charge things. Sooner or later these people would want their money. If you had some savings put away, you would have to use some of it to pay your bills. If you didn't, the people to whom you owe money would not let you buy anything more on credit.

It works pretty much the same way between countries. If one country continues to run up deficits, the other country will soon insist on being paid. If the United States keeps spending more in one country than that country spends here, it will want to be paid. Since the dollars spent in that country are, in effect, I.O.U.'s for gold, that country would want to be paid in gold.

With this background, let's look at some facts and figures.
You've heard it said that the United States is the richest country on the face of the earth. This simply means that the United States has more gold--international money--than any other country.

In 1950 the United States had $22.8-billion in gold. That was 61 per cent of all the gold owned by all of the countries of the Free World. In terms of dollars, gold is worth $35 an ounce. The United States Government has pledged that it will sell gold to any government at the price of $35 per ounce. This firm pledge, which we have always kept, has developed the attitude by other countries that the dollar is as good as gold because it can be exchanged for a certain amount of gold at any time. Under these circumstances the dollar is considered as an international currency. In fact, many countries use dollars in addition to gold as backing for their own currencies.

Under this arrangement, the United States is in effect the banker for all the countries of the Free World. This is a tremendous responsibility. It means that our payments deficits and our ability to make good on our pledge to sell gold for $35 an ounce are the concern of the entire Free World. Their interest is similar to the interest you and I have in the bank where we keep our money. We want to be assured that the money will be safe and that we will be able to get it whenever we want it.

Let's look at the record. Between 1950 and 1957, the United States had balance of payments deficits which averaged $1.3-billion per year. These deficits were not cause for alarm. The dollars were being used as reserves by other countries. These countries knew the U. S. had a tremendous gold supply and they didn't have any doubt about our ability
to sell gold for dollars. This is consistent with what I said a moment ago about spending more than you make. We could do it because our national savings—or gold supplies—were very large.

But the situation changed drastically in 1958. In fact, between 1958 and 1961 our deficits were over $13-billion. It wasn't just a case of a series of small deficits. It was a series of big deficits averaging $3.3-billion a year.

As other countries began accumulating more and more dollars, they started to purchase gold with some of the dollars. In the four-year period—1958 to 1961—our gold supply dropped from more than $22-billion to about $17-billion. Preliminary figures for 1962 show that we had another deficit of close to $2-billion in our international balance of payments last year, and our gold supply is now down to about $16-billion—or less than 39 per cent of the Free World's total supply.

What factors influence our balance of payments? What can we do to bring them into balance? Are we showing any improvement?

Let's start with the first question. Anything that causes dollars to leave the United States has an influence on our balance of payments. When American tourists buy perfume in Paris or cameras in Germany or leather goods in Italy, they are adding to the payments deficit. When the United States Government sends foreign aid dollars overseas, it is adding to our payments problem. When American businessmen import goods from overseas, they pay for the goods in dollars and this adds to the outflow. When American investors invest their money in foreign stocks and bonds, this also contributes to the dollar drain. When the Government spends money to maintain troops overseas, it is causing dollars to leave the country.
What is being done to slow down this dollar outflow? Many approaches are being tried. A year or so ago, the dollar amount of duty-free goods that could be brought back into this country from abroad by American tourists was reduced. Americans can still bring back as much as they desire, but they have to pay duties on everything over $100. This was intended to reduce the amount spent by Americans abroad.

The United States has not taken any steps to discourage imports because we have traditionally exported more than we have imported. In recent years we have sold about $5-billion more abroad than foreigners have sold to the U.S. If the United States tried to restrict imports, the other countries would restrict what we sell to them. We do not want to see this because one of the best opportunities we have to improve our balance deficits is to increase our exports. Actually, exports and imports change with the business conditions in a country. If business is good in the United States, Americans are willing to spend more. Consequently, we import more when business is good and less when business is in a slump. The same is true of other countries. If there is a business slump in France, we will not be able to sell as much to the French as we would if their business were booming. During 1962, business was fairly good in this country and we imported more than in previous years. Business in Europe seemed to level off a bit and our sales to European countries dropped slightly. Our trade surplus—the difference between what we make on exports and spend on imports—dropped to about $4-billion last year. Since this was not enough to cover all of the other expenditures overseas by the United States, we ended up with a deficit.

That brings us to military expenditures abroad. We could cut down on the loss of dollars caused by maintaining troops overseas. But

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this would mean neglecting our commitments to defend the Free World and it would be a psychological victory for communism. However, short of bringing home our servicemen from abroad, there are other steps the United States can take to lessen the impact of military expenses on our balance of payments situation. For example, we have worked out what are known as offset arrangements with some of the European countries. Germany, for instance, buys military equipment in this country which balances—or offsets—the amount we spend in Germany to maintain troops. The balance of payments problem explains why the military services have put restrictions on dependents going overseas. The added expense of additional Americans abroad would mean an additional outflow of dollars.

The United States is also asking its allies to shoulder more of the burden of defending the Free World.

Here at home the Federal Reserve—the government agency responsible for monetary policy—has attempted to keep short-term interest rates high so that foreigners will invest their money here. This again is a complicated process; for, when interest rates rise, it costs more to borrow money. The higher rates may discourage some of our own people and businesses from borrowing money and this in turn could cause business to slow down. This is what I meant earlier when I said the deficits must be considered in both domestic and international policies.

To reduce the dollar drain caused by foreign aid, the government is insisting that almost all foreign aid funds be spent in this country. We are also asking other prosperous countries to increase their aid to underdeveloped nations.

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You could sum up most of what I have said so far by simply saying the United States has been living beyond its income as far as international finances are concerned. Just as you or I would do, it is trying to correct the situation by a series of steps designed to either increase income or decrease expenses.

I said earlier that this is one of the most pressing problems facing the United States. Unless we reverse the situation, the consequences could be drastic. We have had eleven deficits in the past 12 years. One deficit— or even several— would not be alarming and would not be serious for a country as rich as ours because the other nations would have confidence in our ability to pay. However, deficits year after year can only cause other nations to question the soundness of the dollar. As they accumulate more and more dollars, the confidence factor becomes more important. If they feel that we are disciplining ourselves and getting our financial house in order, they will continue to maintain their dollar holdings. But if they wonder how safe the dollar is, they may want to use the dollars to buy gold. The fact of the matter is that if foreign governments wanted to convert all their dollar holdings to gold right now we would not have enough gold to go around. It would be like all depositors going to the bank at the same time to withdraw money. The bank, which has many loans outstanding, would not have enough to pay all of the customers. Yet, the bank would have more money owed to it than it owes to depositors. The U.S. is in the same situation. Many nations owe the United States money, which is being paid back gradually over a number of years. In fact, some nations are repaying debts ahead of schedule because of our problems. These nations realize that the

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whole international monetary system—based on gold and the dollar—would suffer if the United States could not continue to sell gold at the fixed rate of $35 an ounce. But the long-term loans cannot help us in the short run. The problem is immediate.

I don't think I have to say anything more about the seriousness of the problem. We have to discipline ourselves to reduce the dollar outflow and bring our payments into balance. Time is becoming an important factor. We must take these corrective steps soon. The longer the deficits continue, the harder it will be to cure our financial ills.

In closing, let me say that this explanation of the problem has attempted to hit only the highlights. But I hope it will give you the background so you will be able to understand the reasons behind the steps the government is taking to solve the problem.

Thank you.