

FEDERAL RESERVE BANK  
OF NEW YORK

[ Circular No. 5622 ]  
[ February 19, 1965 ]

Role of Federal Reserve System, Banks, and Other Financial  
Institutions in President's Balance of Payments Program

*To All Banks and Other Financial Institutions  
in the Second Federal Reserve District:*

For your information, enclosed are copies of remarks and a chart presentation made yesterday at meetings in Washington on the President's Balance of Payments Program, as follows:

Remarks by the Honorable Douglas Dillon, Secretary of the Treasury, at the White House Conference on the Balance of Payments

Remarks of Wm. McC. Martin, Jr., Chairman, Board of Governors of the Federal Reserve System, to representatives of bank and nonbank financial institutions with respect to the President's Balance of Payments Program

Remarks of J. L. Robertson, Member of the Board of Governors of the Federal Reserve System, to representatives of banks and other financial institutions with respect to the President's Balance of Payments Program

Chart presentation, "Salient Developments in the U. S. Balance of Payments"

Additional copies of the enclosures will be furnished upon request.

ALFRED HAYES,  
*President.*



TREASURY DEPARTMENT  
Washington

REMARKS BY THE HONORABLE DOUGLAS DILLON  
SECRETARY OF THE TREASURY  
AT THE WHITE HOUSE CONFERENCE  
ON THE BALANCE OF PAYMENTS  
THURSDAY, FEBRUARY 18, 1965

Today we stand at a decisive point in our drive to end our balance of payments deficits.

Last year, our deficit on regular transactions was \$3 billion -- a disappointingly small improvement over the \$3-1/4 billion deficit of 1963, and far too large a figure for us to accept passively after four years of strong and sustained effort to end that deficit.

But while to cite these overall figures is to throw into bold relief the challenge before us, it is also to obscure the very real and lasting progress that our program of the past four years has achieved.

We have cut the annual dollar outlay for foreign aid by almost \$500 million. Today a full 85 percent of our foreign aid commitments go for American goods and services. We have also trimmed our net military expenditures abroad from \$2.7 billion in 1960 to \$2.0 billion last year -- a saving of \$700 million despite rising costs abroad.

We have made an intensive effort to encourage American exports. Such measures as last year's tax cut, the liberalized depreciation allowances and the investment credit of 1962 -- and above all the maintenance of wage price stability -- have not only helped generate greater incomes, profits and incentives, but have also helped translate them into greater productivity and thus into greater American competitiveness in world markets.

This accomplishment, along with numerous other measures to aid exports directly, has brought rich rewards -- to American business and to our balance of payments. Our commercial exports -- those not financed by the government -- last year reached a level of \$22.4 billion, 28 percent higher than in 1960 -- thus giving us a commercial trade surplus of \$3.7 billion, \$900 million larger than in 1960.



These efforts -- coupled with an increase of nearly \$1.9 billion in our income from foreign investment -- have brought us about \$3.9 billion worth of balance of payments improvement over the past four years -- enough, all else aside, to have brought actual balance in our payments last year.

Instead, we had a deficit of \$3 billion. Why?

One reason is the net rise of some \$400 million in our travel and tourist deficit since 1960. But the major reason is that since 1960 we have also had a rise of \$2.5 billion in annual private capital outflows -- \$2 billion of which occurred last year. Unless we curb these outflows all our other efforts will be nullified. And to curb them we need your help.

The Interest Equalization Tax held last year's outflow of capital into foreign securities under \$700 million -- \$1-1/4 billion, or more than 65 percent, below the rate in the first half of 1963 -- returning it virtually to the 1960 level. But the outflow in other forms of capital has multiplied.

Since 1960, for example:

- the annual increase in outstanding bank claims has grown from \$1.1 billion to \$2.5 billion;
- direct investment has risen from \$1.7 billion to \$2.2 billion;
- and incomplete data indicate that other short-term lending by corporations has grown from \$353 million to somewhere around \$700 million.

These -- plus a \$300 million increase in other long-term capital outflows -- have sent the total outflow of private capital up from just under \$3.9 billion in 1960 to over \$6.3 billion last year, a rise of some \$2.5 billion. What particularly concerns us today is the fact that \$2 billion of that rise occurred last year.

Only a small amount of this capital went to finance our exports, and the great bulk of it went to the other industrial countries -- thus adding to their dollar holdings. It is here that we must make substantial improvement.



Last year

- well over half of the outflow of short-term bank capital went to advanced countries;
- well over half of new long-term bank commitments went to industrialized countries, and only about 15% of them for exports;
- while direct investment in developing countries serves to offset outflows that might otherwise be required in the form of aid appropriations, and will not be affected by our new program, the fact is that in the first nine months of 1964 almost two-thirds of our direct investment outflow went to Europe;
- and virtually all of the build-up in corporate liquid balance abroad occurred in the developed countries.

We recognize that, over the long run, this capital outflow comes back in the form of dividends, interest and loan repayments. We recognize that, over the long run, these outflows of capital become a source of strength and more than pay for themselves. But, in the short run, they cost our balance of payments position dearly, and it is with the short run that we must now be concerned.

The problem is that our capital outflows are simply growing too fast in relation to the inflows they generate, and in relation to the improvements we have been making in other areas of our balance of payments. While we are waiting for the return flows to mount, we look abroad and see an ever rising tide of short-term liquid claims on us -- a rise in claims that if allowed to continue will inevitably lead to further gold outflows.

Since 1957, our gold stock has declined by \$7.4 billion, our liquid dollar liabilities to the monetary authorities of other countries have risen from \$9 to \$14 billion -- and private banks, individuals and businesses abroad hold another \$11 billion. We know that these holdings are simply the essential counterpart of the dollar's position as a reserve currency and of its vital role in world trade. But we must also realize that the willingness of foreigners to accumulate additional dollars is not without limits. It is now perfectly clear that that willingness is nearing an end. The time has come when we must show rapid and clear cut progress in reducing our payments deficit.



I know that you have, in recent weeks, been reading and hearing about a so-called "attack" on the dollar and on the gold exchange system. Indeed, this disparagement of our currency comes from lofty heights -- but it is an isolated view. We need your help to make sure it remains an isolated view.

But this view is indicative of one very important fact. That is, that the power and influence of the United States throughout the world, in a political as well as a financial sense, depends on the continued strength and soundness of our dollar.

We must move now while we can still move from a position of strength. With your help we can make the swift and lasting advance that we need, thus assuring that, as our nation -- and your businesses and your banks -- grow and prosper in the months and years ahead, the dollar will continue to be the strongest currency in the world.

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# FEDERAL RESERVE

press release

For immediate release

February 18, 1965

Remarks of J. L. Robertson, Member of the Board of  
Governors of the Federal Reserve System, to repre-  
sentatives of banks and other financial institutions  
with respect to the President's Balance of Payments  
Program

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Let me discuss more closely what the President's program means for banks and other financial institutions - bearing in mind, of course, that what is asked of them is only part of the over-all attack on the balance of payments problem.

Given the urgent need for a decisive cutback in capital outflows this year, what is an appropriate and realistic target for the banking community? After a great deal of thought, the Federal Reserve has concluded that any expansion of bank lending abroad in 1965 should not be greater - and preferably should be less - than the rate of growth of domestic lending. Last year, in contrast, foreign bank lending rose three times as rapidly as domestic loans and investments.

More dollars are needed abroad day by day, month by month, to finance trade throughout the free world -



but not as many dollars as we have been providing. Hence the need for voluntary restraint on dollar outflows - the need for a curtailment of the rate of expansion of the outflow. Here is a situation in which we can make progress by standing still awhile - as the need for dollars abroad increases.

Therefore, we have asked all banks to restrict credits to foreigners that are not clearly and directly for the purpose of financing exports of United States goods and services. While all exports must be financed, we seek to have outstanding credits to foreigners (including export credits) held during 1965 to a level not over 5 per cent above the amount outstanding on December 31, 1964. In most instances, individual banks should do better - especially the larger ones - to offset the fact that some bona fide export credits to foreigners may be granted by banks that had no outstanding foreign credits at all last year.

This target must apply to all foreign credits - loans and investments, acceptances and deposits. And the target must be aimed at by all banks. The institutions represented in this room account for most of the outstanding U. S. bank credit to foreigners, but of course we



expect the smaller banks also to participate in this program.

This target will take care of any possible increase in bona fide export credits. The National Foreign Trade Council has estimated that U. S. exports in 1965 will be about 5 per cent higher than the rate for the fourth quarter of 1964. Hence, an increase in export credits by 5 per cent of the amount outstanding at the year end should cover the requirements of export expansion, assuming no change in the proportion of exports financed by credit. Thus, even if all credits granted by banks to foreigners were export credits, the 5 per cent target would still be realistic.

Actually, as you know, only a fraction of bank credits to foreigners are used to finance exports of U. S. goods and services. In the case of long-term credits, we know that this fraction is only around 15 per cent. In the case of acceptances, it is about 40 per cent. In the case of other short-term credits, it may well be less than in acceptances, but assuming for argument's sake that the fraction were equally high, this would mean that altogether only \$3 billion of the total of \$10 billion of bank credits to foreigners outstanding on December 31, 1964, was for the purpose of financing exports of U. S.



goods and services. An increase of \$500 million in such credits would thus finance an export expansion, not by 5 per cent, but by more than 15 per cent - an expansion that, unfortunately, is highly improbable.

And in fact, this calculation is still too conservative. All of your short-term credits and a substantial part of your long-term credits will be repaid in 1965. Assuming - quite conservatively - that only half of your total nonexport credits outstanding will fall due this year, an additional \$3-1/2 billion would become available this year to expand your export credits. Although it is unrealistic to expect that extensions or renewals of non-export credits could be cut back to zero, in theory you could (within the Federal Reserve target) increase your export credits outstanding from \$3 billion to \$7 billion - enough to finance an export expansion of 133 per cent!

You will understand, therefore, that I do not intend to lose any sleep about the possibility that our target might prove to be too restrictive to permit the granting of all bona fide export credits. You will have plenty of opportunity to cut down your nonexport credits, if that should prove necessary in order to make room for



any imaginable expansion of export credits. We recognize that in some cases this adjustment cannot be made overnight, especially if the credits granted or committed during the first six weeks of this year have already taken you over the target. But you should be able to get within the limit in a reasonably short period of time. In fact, you will probably be able to maintain your nonexport credits to foreigners at a level which will not impose a serious burden either on you or on your domestic or foreign customers, since the target level will be one-third higher than your outstanding credits were at the end of 1963.

Within the limits set, we must avoid creating more problems than we solve. Hence, it is assumed that while abiding by the target, you will exercise discretion in allocating loans. Since it would be in your own best interest, undoubtedly you will concentrate on credits that are exempt from the Interest Equalization Tax. This would mean that in the medium and long-term field you will give preference to the less developed nations. Moreover, again in your own interest as well as in that of the U. S. economy at large, you will presumably avoid any cutback that would inflict a serious burden on less developed countries, whose



economic growth is especially in our national interest, or on such developed countries as Canada or Japan (both of which are heavily dependent on U. S. finance) and the United Kingdom (which, as we all know, is going through a difficult period in its own balance of payments). But again, I am sure this problem will hardly arise in practice since you will be able to stay within the target limit and still meet the real needs of these countries.

The 5 per cent target is simple and straightforward. It requires a minimum of interference with your operations and no elaborate machinery or detailed supervision. With the understanding that bona fide export financing is to be given priority and met adequately, and that serious cutbacks in other credits may need to be avoided for certain countries, within this 5 per cent target each bank would be free - subject only to any guidelines that may be developed - to use its resources as it thinks best.

We will need some informational reporting, mainly of a kind already supplied to the Treasury. Without adequate information, we could not spot points at which threats to the effectiveness of the program or problems of its equitable execution might arise; we could not gauge



the success of the program and hence the possibility of relaxation; and we could not become aware that an unco-operative institution was taking advantage of the voluntary character of the program to compete unfairly with other banks. But let me emphasize that we have no desire to burden you with unnecessary reporting.

We are aware that a number of difficult problems are likely to arise in carrying out the program. For instance, relationships with your foreign branches will certainly pose complicated questions. Another major problem will be domestic credits which would affect the U. S. payments balance as much as credits to foreigners. I am thinking, for example, of credits to domestic borrowers that the borrower is going to use for financing operations abroad other than those directly connected with exports. Or some of your customers may be eager to increase the amount of their borrowings for export financing so as to free their own funds for uses inconsistent with our program. These are areas in which we will be working closely with you, and with the Department of Commerce in its efforts to limit foreign credits and investments of nonfinancial corporations.



In the case of the so-called Edge Act and Agreement corporations, the guiding principle, of course, is that banks with such subsidiaries be neither favored nor penalized in comparison with other banks. The most equitable solution, as a rule, seems to be to combine the parent bank and its subsidiaries for the purpose of calculating the 5 per cent target. Equity investments abroad, which are not available to banks without Edge Act subsidiaries, may require special treatment, but we are in a position to deal with that problem.

In connection with these investments and with banks' holdings of foreign securities or other foreign assets, problems may arise with respect to the disposition of those assets. It would obviously undermine the program if banks were to sell such assets domestically so as to free more of their own funds for investment abroad.

Transactions of banks for account of their customers and fiduciary accounts will also require attention.

I am sure that you will avoid encouraging customers to extend any credit to foreigners that you could not extend yourself within the target limits, and that you will avoid acting as brokers or intermediaries by diverting to



them credits that you would normally finance out of your own funds in the usual course of business.

We will endeavor to develop, very soon, appropriate guidelines to deal with these and other problems. In doing so, we may request representatives of the banking community to serve on a small technical advisory committee to assist us. In any event - whether or not we issue guidelines or have an advisory committee - officers of our Reserve Banks will be in touch with you on an individual basis to assist in working out problems that you encounter.

As you know, this is not the only group that is being asked to make a strenuous voluntary effort to implement the President's program. You were joined at the White House today by representatives of leading business corporations that are being asked to make similar efforts. But the contribution that the banking system itself can make is crucial. And your economic interest in the success of the whole program and in the consequent continuing strength of the dollar is particularly strong.

The place of nonbank financial institutions in the President's program is somewhat different. To the best of my knowledge - which is admittedly imperfect



in this field - most of these institutions have played a minor role in the recent expansion of credits to foreigners, although some of them have purchased large amounts of IET exempt foreign bonds and also have placed part of their liquid funds abroad. What we must ask from them, at this time, is that their foreign credits and investments in 1965 also be kept within limits comparable to those we are suggesting for the banking community, and that no additional liquid funds be placed abroad.

Obviously, any potential foreign borrower whose credit application must be rejected by a commercial bank on account of the voluntary restraint program will be tempted to tap other credit sources. The pressure on investment houses, finance companies, insurance companies, and pension funds to extend foreign credits not subject to the IET - perhaps even credits that are - will no doubt increase considerably. Many if not most of these potential borrowers will be excellent risks and will offer excellent terms. It is asking a great deal when we request these institutions to resist the temptation. But, of course, we must do so. If such credits were granted, restraint by the banking system would be in vain. From the point



of view of our payments balance, it makes no difference at all whether a credit to a foreigner is extended by a bank or by some other lender.

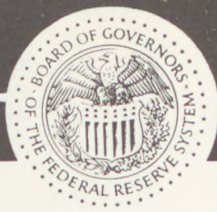
One problem involved in charting a course for non-bank financial institutions is the relative lack of data regarding their foreign lending. Only a few of them have undertaken transactions that are reportable on Treasury foreign exchange forms. We shall certainly have to request additional reports from these institutions.

Moreover, in the case of some nonbank institutions the problem of customer accounts will probably be even more troublesome than in the case of banks. And in the case of insurance companies, obvious exceptions must be made for foreign investments connected with foreign coverage requirements - exceptions that will have to be analogous to those made for the same reason in the IET legislation. But there is no denying that the Federal Reserve is far less conversant with the practices and problems of non-bank lenders than with those of banks. Hence, discussion of doubtful points with us in the System by the representatives of these financial institutions will be particularly important.



As you see, the success of this entire sector of the President's program depends on your acceptance, your dedication, and your unremitting effort to achieve its purpose. Given the present circumstances of our nation's economy - and the desire of all of us to avoid rigid controls - the Government believes that, in this area, it would be in the best interest of all to rely on voluntary restraint - rather than on laws and regulations - to reduce the outflow of dollars on capital account. With your cooperation, the country's balance of payments in 1965 can be leveled in the direction of full equilibrium. Your actions could have a decisive effect, and world confidence in the dollar would reflect it.





# FEDERAL RESERVE

press release

For immediate release.

February 18, 1965.

Remarks of Wm. McC. Martin, Jr., Chairman,  
Board of Governors of the Federal Reserve System,  
to representatives of bank and nonbank financial  
institutions with respect to the President's  
Balance of Payments Program

The Board has invited you here so that we can present in more detail the part the Federal Reserve and the banking system as a whole have to play in helping to achieve the very important balance of payments objectives that President Johnson talked about to you earlier today.

Since you are, for the most part, bankers, let me speak in bankers' terms. As a reserve currency country, the United States occupies a financial position very similar to that of a bank. On the whole, the position is a good one, like that of a very solvent bank, with an enviable capital structure. Over-all, we have international assets amounting to about \$96 billion. Our total liabilities amount to only \$56 billion, leaving an equity position of \$40 billion, or a ratio of more than 40 per cent. Our reserve position also is strong. We have gold reserves of \$15 billion, against liquid claims of about \$32 billion, the equivalent of almost 50¢ of cash in the till for every dollar of "demand" deposits.



On the other hand, we are having a problem that is, basically, one of secondary liquidity. Our loans and investments have increased more rapidly than has the desire of others to hold with us "deposits" or dollar claims. We are therefore faced with "adverse clearing balances," and the international liquidity position of our country has worsened, particularly in the period since 1957. Over the seven years ending with 1964, our monetary reserves declined by \$7 billion and our net position in the International Monetary Fund by \$1 billion. At the same time, our short-term liabilities to foreign central banks and governments--liabilities we must always be ready to redeem in gold on demand--rose more than \$6 billion, while our liquid liabilities to private foreigners rose by nearly \$5 billion.

In the circumstances we, like a bank faced with a similar problem, can do either or both of two things. We can try to increase the willingness of depositors to leave money with us by offering higher interest rates and other inducements, or we can cut back, for the time being, on our lending and investing, or we can do both. We have already done quite a bit to enhance rate and other attractions. Since 1960, U. S. bill rates have moved up from around 2.25 per cent to nearly 4 per cent, and rates paid by commercial banks on foreign deposits and other short-term rates



have increased correspondingly. We have offered foreign central banks the so-called "Roosa Bonds," payable in foreign currencies, to afford them protection against any fluctuation in the dollar's exchange rate.

When it comes to lending and investing, however, we have not so far made any move toward curtailment. The fact is our loans and investments, already at a high level following a long climb, began showing a further marked rise a few months ago. It is a sharp but necessary reduction in the elevation of this rate which the President now proposes, and which we should like to work with you to effect. I think you will all agree that this course would be a sound and prudent one for any bank to follow in similar circumstances.

It is in the interest of all of us to explore new means of dealing with the problem before us so that we can find a correction that is reasonable and workable and that will not start us down a path whose course and end we cannot foresee. Perhaps there is no form of action feasible, including that the Administration is urging, that is without pitfalls. The President's balance of payment proposals, on the other hand, have been chosen in part because they will not impinge severely on the functions of the market as the final regulator of business, and also because they will not burden unduly our domestic prosperity and growth nor be disruptive of international trade.



Under the President's new program, the banks are being asked to assume a central responsibility for restraint. This has not been an arbitrary decision. It necessarily follows from the relationship that bank lending has to the persistent redundancy of dollars in international markets and the consequent deterioration in our international liquidity.

I'm sure that all of you here will agree with me that unless we preserve the integrity and strength of the dollar throughout the world we cannot possibly sustain the prosperous economies here and abroad that depend upon the dollar and the trade it finances. And I'm also sure that we can count upon your aid in our efforts to see to it that confidence in the dollar is maintained the world over.

Let us now come down to some particulars of what the President's program means for your institutions. For that, I am going to turn the meeting over to Governor J. L. Robertson, to whom the Board has delegated responsibility for the day-to-day conduct of our program.



Division of International Finance

Board of Governors of the Federal Reserve System

SALIENT DEVELOPMENTS IN THE U.S. BALANCE OF PAYMENTS

I. Background Up to 1959

For more than a decade after the end of the War, the economic and financial policies of the United States and of other countries were greatly influenced by an over-riding need to get the economic system of the Western World back on its feet. Tremendous progress was made -- in physical reconstruction, in bringing the defeated countries, Germany, Italy, and Japan, back into the currents of world trade, in gradually dismantling much of the prewar and wartime paraphernalia of exchange controls and trade controls, in rebuilding monetary reserves, in reactivating the machinery of private credit. The wartime inflation of money and prices was halted, and the new inflation set off all around the world by the Korean war boom was halted. To help Europe and Japan get into the position of financing themselves internationally by trade instead of American aid, many currencies were devalued in 1949. Later, the French franc was again devalued in 1957 and 1958.

In this earlier period the United States had a balance of payments deficit, but it was not one this nation was concerned about. The deficit may be said to have been deliberately created, to give economic assistance to the rest of the world and to rebuild the monetary reserves of the rest of the world. The great problem for the whole world was the "dollar gap," and we were doing our best to close it.

In the mid-'50's, things were beginning to change, and they were changing more rapidly than many people appreciated at the time. Europe and Japan were rapidly regaining their economic strength. Between the recessions of 1954 and 1958, the United States had a consumption and investment boom during which our price level for metals and machinery rose 20 per cent from the end of 1954 to the end of 1957. That part

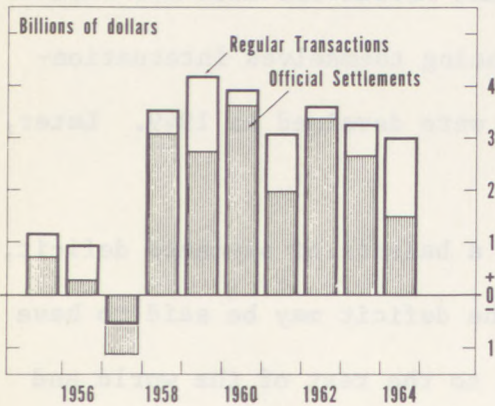


of our price structure -- a particularly important part in determining our international competitive position -- kept on rising in 1958, and by the end of 1959 those prices were nearly one-fourth higher than in 1954. With Europe and Japan steadily increasing their ability to produce goods for export, conditions were being created that were to make it more difficult than before for the United States to achieve an adequate surplus in the current account of the balance of payments -- that is, a current surplus sufficiently large to cover the flows of U.S. private and Government capital to the rest of the world.

## II. Seven Years of Payments Deficits

Chart 1

### U. S. PAYMENTS DEFICIT



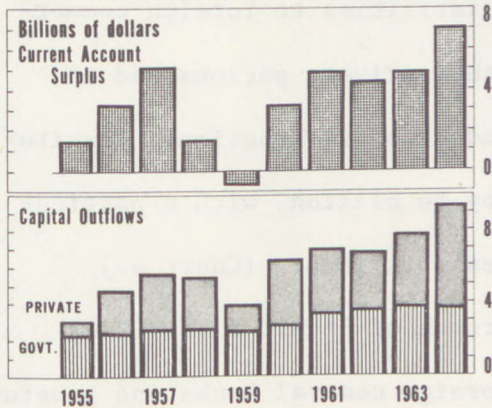
Beginning in 1958, the United States

has had a long series of large international payments deficits. (Chart 1.) Throughout this period, except in 1958 and 1959, the United States has had large annual surpluses on current account. (Chart 2.) The current account surplus as here defined represents exports less imports of goods and services -- including investment income and also including, on the debit side, U.S. military expenditures abroad -- less net payments for remittances and pensions.



Chart 2

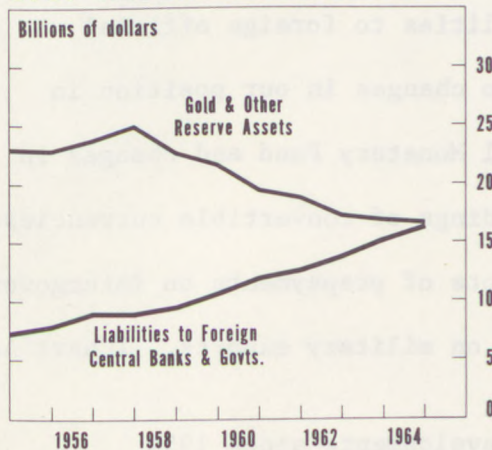
## U. S. BALANCE OF PAYMENTS



But these current account surpluses have been inadequate to cover the large and growing net outflow of capital, private and Governmental. (Chart 2.) Of course, the over-all deficit does not mean that we are living beyond our means; except for Government grants for economic aid (about \$2 billion a year) all Government and private capital outflows do add to our investments in, and other financial claims on, the rest of the world.<sup>1/</sup>

Chart 3

## U. S. RESERVE POSITION



However, the over-all deficits have been eating into our net reserve position. During the past seven years our gold reserves fell by a third, from \$23 billion to \$15-1/2 billion, and our liabilities to foreign central banks and governments increased from \$9 billion to \$16 billion. (Chart 3.)

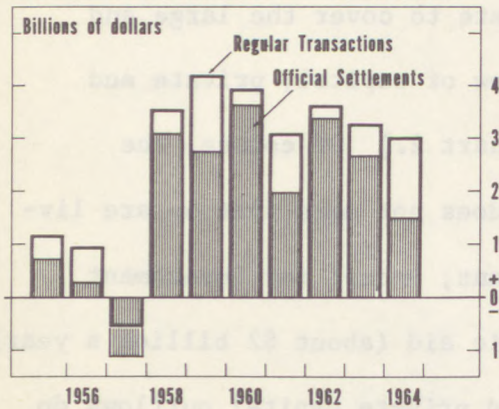
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<sup>1/</sup> "Errors and omissions" cannot be allocated accurately to either the current account or the capital account, and are omitted in Chart 2.



Chart 1

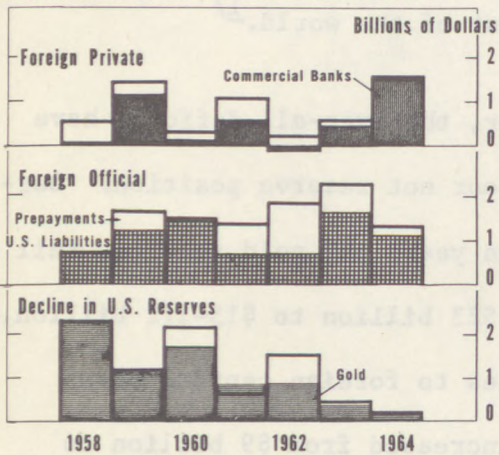
## U. S. PAYMENTS DEFICIT



In addition, our short-term (and other "liquid") liabilities to foreign commercial banks and other private persons and to the World Bank and other international institutions increased by \$6 billion, with a particularly large increase in 1964. (Chart 4.)

Chart 4

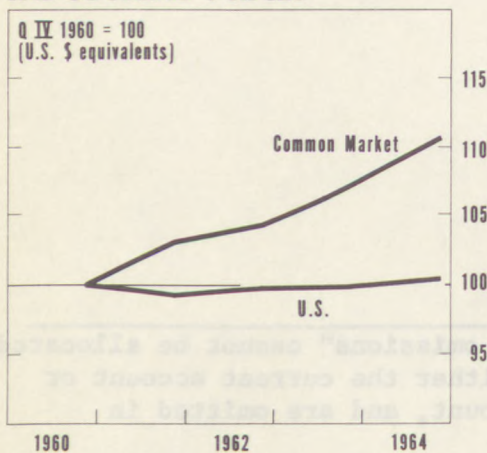
## FINANCING THE DEFICIT



This growth of liquid liabilities to others than foreign central banks and governments served to reduce somewhat the amounts of the deficits that had to be financed by "official settlements." (Chart 1.) The "official settlements" include primarily gold sales and increases in liabilities to foreign official holders, and also changes in our position in the International Monetary Fund and changes in our official holdings of convertible currencies, as well as receipts of prepayments on intergovernmental debts and on military exports. (Chart 4.)

Chart 5

## INDUSTRIAL PRICES

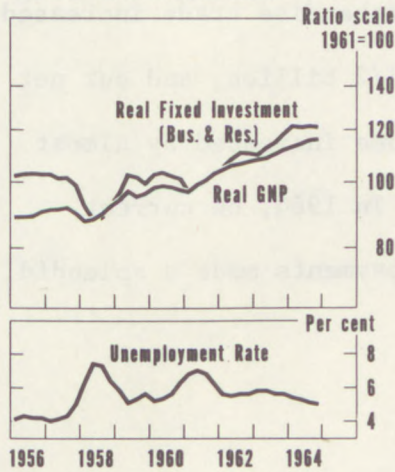


### III. Developments since 1959

Since the end of the long steel strike in 1959 we have had an unprecedented degree of stability in U.S. industrial prices, while creeping inflation has been going on in the rest of the world. (Chart 5.)

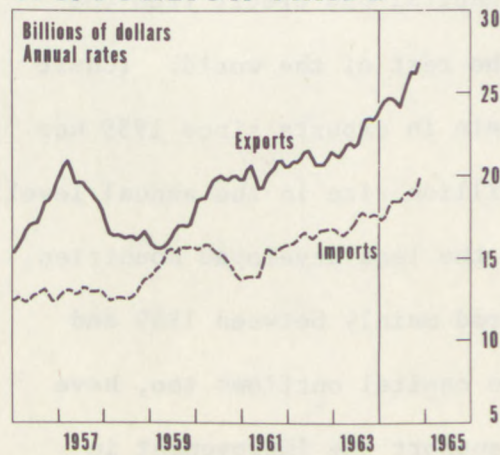


Chart 6  
**U.S. ECONOMY**



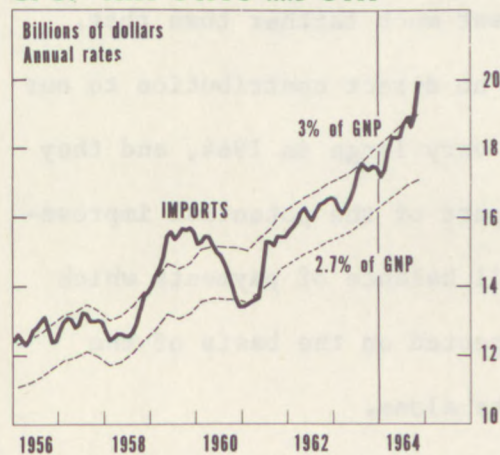
And in the last four years, along with this price stability we have had an unprecedented long period of uninterrupted and generally well balanced economic growth, raising real GNP by 20 per cent in four years. (Chart 6.)

Chart 7  
**U. S. FOREIGN TRADE**



This combination of economic growth and price stability has produced a great expansion of our international receipts and expenditures, with both good features and bad. Our merchandise exports last year were larger by one-third than in 1960. (Chart 7.)

Chart 8  
**U. S. IMPORTS AND GNP**

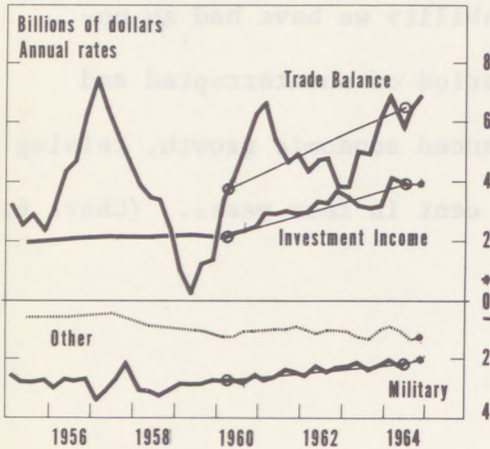


Imports also rose, but in relation to GNP they are now no higher than at the beginning of 1960, before the sharp recession of U.S. imports later that year. (Chart 8.)



Chart 9

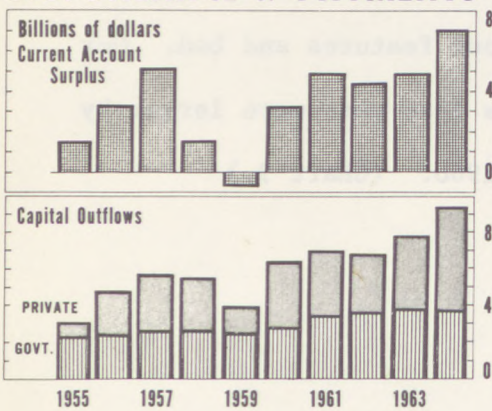
### U. S. CURRENT TRANSACTIONS



Compared with the first half of 1960, our annual surplus on merchandise trade increased to 1964 by more than \$2-1/2 billion, and our net intake of investment income increased by almost \$2 billion. (Chart 9.) In 1964, on current account, our balance of payments made a splendid record.

Chart 2

### U. S. BALANCE OF PAYMENTS

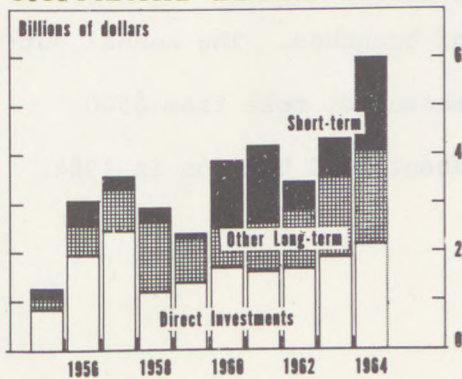


But we have also had a great upsurge in the outflow of capital and credit from the United States to the rest of the world. (Chart 2.) Part of the gain in exports since 1959 has been due to a \$1 billion rise in the annual level of economic aid to the less developed countries, a rise which occurred mainly between 1959 and 1961. Some private capital outflows too, have been essential to support the improvement in the current account. But last year private capital outflows went much farther than that. Outflows that made no direct contribution to our export growth were very large in 1964, and they wiped out a great part of the potential improvement in our over-all balance of payments which could have been expected on the basis of the rise in U.S. exports alone.



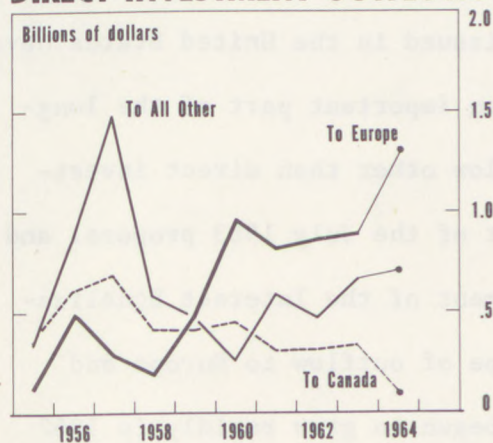
#### IV. Composition of the Private Capital Outflow

Chart 10  
**U.S. PRIVATE CAPITAL OUTFLOWS**



U.S. private capital outflows include direct investments of U.S. corporations in affiliates and branches abroad, other long-term investments and loans, and various types of short-term credits and investments.<sup>1/</sup> (Chart 10.)

Chart 11  
**DIRECT INVESTMENT OUTFLOWS**



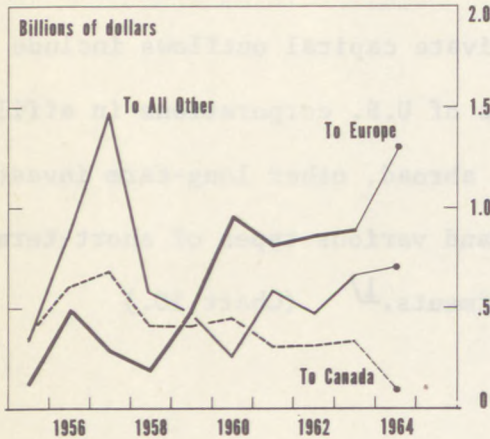
Direct investment outflows as recorded in the balance of payments now exceed \$2 billion a year. An important fraction of the total fixed capital expenditures of American enterprises abroad and of additions to their working capital abroad is financed by internal funds of the enterprises, and an additional part by increases in their accounts payable, tax and other accruing liabilities, and by borrowing from financial institutions and issues of stocks or bonds abroad. What the U.S. balance of

<sup>1/</sup> Chart 10 covers outflows that increase U.S. assets abroad ("U.S. private capital outflow"). The over-all net private capital outflows shown in Chart 2 are smaller than these U.S. capital outflows by the amount of inflows increasing foreigners' assets, other than liquid assets, in the United States.



Chart 11

### DIRECT INVESTMENT OUTFLOWS

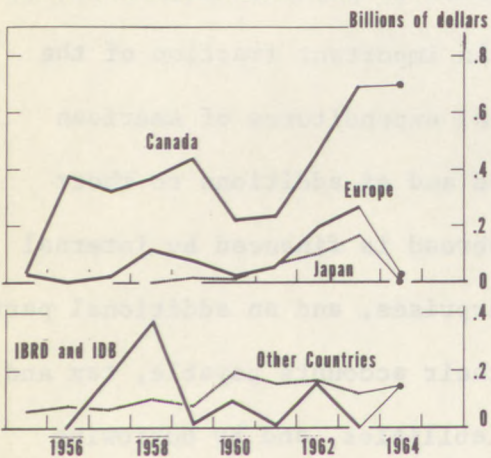


payments registers is the remaining financing, from U.S. owners, including of course any ploughing back of dividends received from affiliates or of profits of branches. The annual outflow to Europe, so measured, rose from \$500 million in 1959 to about \$1.3 billion in 1964.

(Chart 11.)

Chart 12

### NEW ISSUES SOLD TO U.S.



### U.S. residents' purchases of foreign

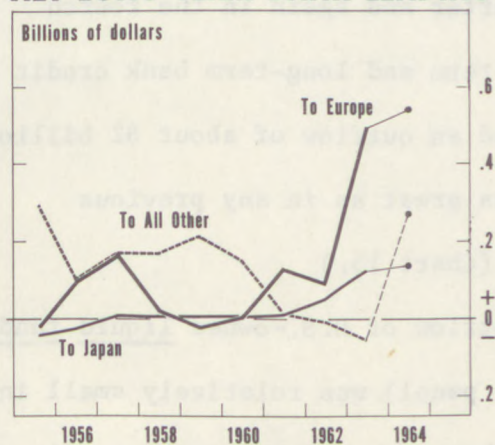
securities newly issued in the United States have long constituted an important part of the long-term capital outflow other than direct investment. As a result of the July 1963 proposal and August 1964 enactment of the Interest Equalization Tax, this type of outflow to Europe and Japan, which had begun to grow rapidly in 1962 and 1963, became negligible in 1964. Following the enactment of the IET, however, a bulge in Canadian new issues in the fourth quarter brought the year's outflow on these issues, which are exempt from the tax, to about \$700 million; this matched the previous year's Canadian total, which had been heavily concentrated in the first half of 1963. (Chart 12.)



The IET also caused a half-billion shift in the flow of dealings in outstanding foreign securities, by reducing gross U.S. acquisitions. The shift was from an outflow for net U.S. purchases, averaging nearly \$300 million a year between mid-1960 and mid-1963, to an inflow through net U.S. sales of outstanding foreign securities of over \$150 million in 1964.

Chart 13

### NET LONG-TERM BANK LENDING



Term lending abroad by U.S. banks began to increase rapidly in the first half of 1963, before the IET proposal. The 1964 net outflow approached \$1 billion, over half of which was to Europe. Toward the end of the year, commitments for loans of one-year term or more were increasing very rapidly, not only for Europe but also for nonindustrial countries. (Chart 13.)<sup>1/</sup>

<sup>1/</sup> Other types of long-term capital flow, included in the totals in Chart 10 if involving changes in U.S. assets abroad and included in the Chart 4 net totals in any case, are: long-term commercial claims of U.S. residents on foreigners and vice versa, foreign direct investments in the United States, transactions in outstanding U.S. corporate securities, and receipts through redemptions of foreign securities.



Chart 10

### U.S. PRIVATE CAPITAL OUTFLOWS

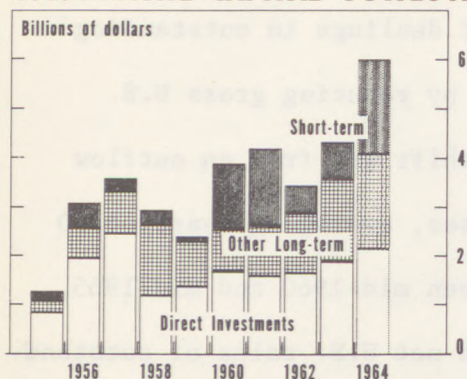


Chart 14

### SHORT-TERM CAPITAL OUTFLOWS

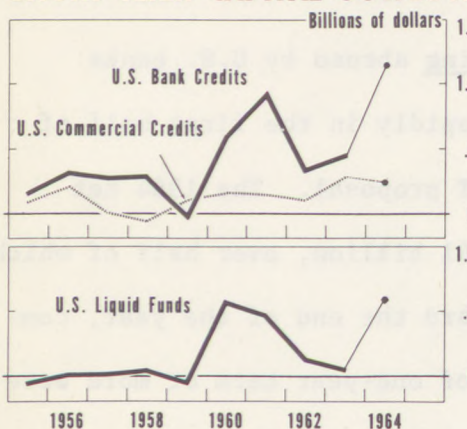
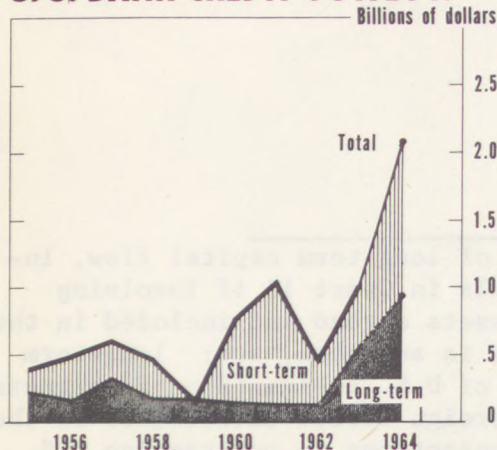


Chart 15

### U. S. BANK CREDIT OUTFLOW



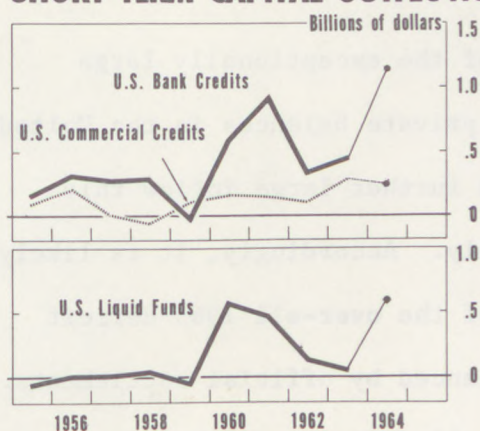
Within the total outflow of U.S. short-term capital (Chart 10), there were large increases last year in outflows of bank credits and in outflows of funds of U.S. corporations, banks, and other U.S. residents into liquid investments abroad. (Chart 14.) The short-term bank credit outflow (including loans and acceptance credits) was moderate in 1962 and 1963, but last year it exceeded \$1.1 billion. Within the year 1964, this outflow was particularly large in the first quarter and again in the fourth quarter. Short-term and long-term bank credit together produced an outflow of about \$2 billion in 1964, twice as great as in any previous calendar year. (Chart 15.)

The outflow of U.S.-owned liquid funds (Chart 14, lower panel) was relatively small in 1962. In 1963 there was a substantial outflow in the first half. After the Federal Reserve raised rediscount rates and also the Regulation Q ceilings for 3- and 6-month time deposits in July 1963, there was a net reflux in the second half, so that in 1963 as a whole there was little net movement. In the first half of 1964 the outflow was again very large. The total for the



Chart 14

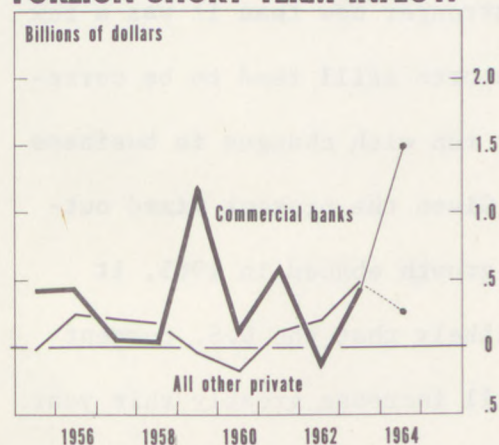
### SHORT-TERM CAPITAL OUTFLOWS



year 1964 is estimated to have exceeded \$600 million, though in the second half the outflow slackened more than seasonally. (Chart 14, lower panel.) The bulk of the net outflow of U.S. liquid funds in most years (1960 excepted) has gone into deposits abroad denominated in U.S. dollars rather than into foreign currency assets.

Chart 16

### FOREIGN SHORT TERM INFLOW



As previously mentioned (see Charts 1 and 4 on page 4) inflows of foreign funds, other than those of central banks and governments, into liquid assets in the United States have been large in some years. These inflows partly offset the outflows of U.S. capital, and reduced the amounts of the deficit that had to be financed by "official settlements." This was the case especially in 1964, when short-term balances due to commercial banks abroad (including branches of American banks) increased by \$1.4 billion. Short-term assets in the United States of other private foreigners increased by \$300 million.<sup>1/</sup> (Chart 16.)

<sup>1/</sup> In Chart 4, unlike Chart 16, increases in liquid assets of "foreign private" include those of international institutions; also in Chart 4 holdings of U.S. Government securities are counted as liquid assets regardless of whether their original maturities are under or over one year.



V. Prospects

Chart 1

**U. S. PAYMENTS DEFICIT**

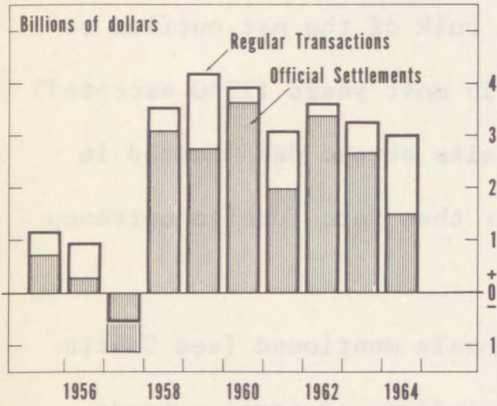
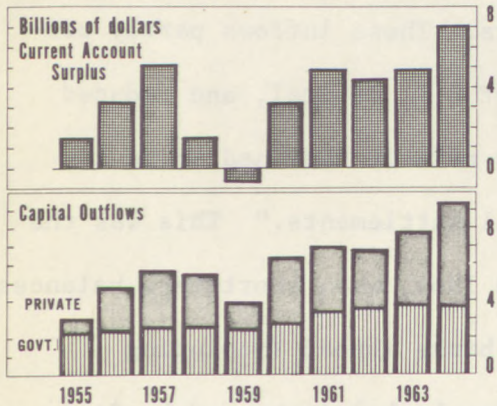


Chart 2

**U. S. BALANCE OF PAYMENTS**



In view of the exceptionally large buildup of foreign private balances in the United States last year, a further large inflow this year appears unlikely. Accordingly, it is likely that a major part of the over-all 1965 deficit will have to be financed by official settlements. How large the over-all deficit will be depends on developments both with respect to capital outflows and in the current account.

While the competitive position of the United States is stronger now than it was a few years ago, U.S. exports still tend to be correlated in the short run with changes in business activity abroad. Given the present mixed outlook for economic growth abroad in 1965, it appears rather unlikely that the U.S. current account surplus will increase greatly this year. Farther ahead, continued growth can be expected. Thus the improvement in the over-all balance of payments urgently needed this year must come principally from a sharp diminution in U.S. private capital outflow.

\* \* \* \* \*

Note. Data for 1964 in the charts were partly estimated on the basis of preliminary information. In some cases later estimates have been used in the text. Both charts and text may require further revision when complete data are published.

February 18, 1965