Chapter 5

Growth and Balance in the World Economy

WORLD ECONOMIC EXPANSION in the first half of the 1960's has been sustained and rapid. The pace has probably been surpassed only during the period of recovery from World War II. Moreover, since the end of the war, the extreme fluctuations of earlier years have not been repeated.

But continued economic progress is not assured. Many problems remain. The most difficult and important is that of overcoming poverty in many of the less developed countries of Africa, Asia, and Latin America. A major problem for the developed countries is to cope with international financial imbalances in ways which do not inhibit sound economic growth.

This chapter records the economic progress in both the developed and less developed countries during the first part of the 1960's and outlines some major issues for international consideration during the remainder of this decade. It deals especially with the policy issues facing the United States and other developed countries in their efforts to achieve a better international balance and to pursue national policies that promote world economic progress. The worldwide economic impact of their national policies places a special responsibility on the major developed countries.

WORLD ECONOMIC GROWTH IN THE 1960'S

Two quantitative goals for economic growth in the 1960's have been fixed by international organizations:

The United Nations has set 5 percent a year as the minimum growth rate for the less developed countries over the 1960's, calling this the "Development Decade."

The Organization for Economic Cooperation and Development (OECD), which includes the countries of Western Europe, the United States, Canada, and Japan, has called for an increase in aggregate output of all member countries combined, amounting to 50 percent over the decade or an average annual growth rate of 4.1 percent.

As can be seen from Table 29, the expansion of real output in the less developed countries, estimated at 4½ percent a year, so far has fallen somewhat short of the UN target on average, and far below it in several
### TABLE 29.—Changes in total and per capita real GNP in OECD and less developed countries since 1955

<table>
<thead>
<tr>
<th>Country</th>
<th>Share of total output (percent)</th>
<th>Total real GNP</th>
<th>Per capita real GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1955 to 1960 to 1965</td>
<td></td>
</tr>
<tr>
<td>OECD countries: Total</td>
<td>100.0</td>
<td>3.2</td>
<td>5.0</td>
</tr>
<tr>
<td>United States</td>
<td>53.3</td>
<td>2.2</td>
<td>4.7</td>
</tr>
<tr>
<td>Total excluding United States</td>
<td>46.7</td>
<td>5.0</td>
<td>5.3</td>
</tr>
<tr>
<td>Germany</td>
<td>8.6</td>
<td>3.0</td>
<td>4.8</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>7.7</td>
<td>2.8</td>
<td>3.3</td>
</tr>
<tr>
<td>France</td>
<td>7.3</td>
<td>3.8</td>
<td>5.1</td>
</tr>
<tr>
<td>Japan</td>
<td>5.4</td>
<td>9.7</td>
<td>9.7</td>
</tr>
<tr>
<td>Italy</td>
<td>4.1</td>
<td>5.5</td>
<td>9.2</td>
</tr>
<tr>
<td>Spain</td>
<td>4.1</td>
<td>4.3</td>
<td>9.2</td>
</tr>
<tr>
<td>Greece</td>
<td>4.1</td>
<td>5.4</td>
<td>8.7</td>
</tr>
<tr>
<td>Less developed countries: Total</td>
<td>100.0</td>
<td>4.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Africa</td>
<td>12.6</td>
<td>(2)</td>
<td>3.3</td>
</tr>
<tr>
<td>Nigeria</td>
<td>1.3</td>
<td>(2)</td>
<td>5.0</td>
</tr>
<tr>
<td>Ghana</td>
<td>1.7</td>
<td>6.1</td>
<td>4.0</td>
</tr>
<tr>
<td>Latin America</td>
<td>30.1</td>
<td>4.9</td>
<td>4.4</td>
</tr>
<tr>
<td>Brazil</td>
<td>11.6</td>
<td>5.3</td>
<td>3.3</td>
</tr>
<tr>
<td>Argentina</td>
<td>10.7</td>
<td>2.6</td>
<td>3.0</td>
</tr>
<tr>
<td>Mexico</td>
<td>10.7</td>
<td>6.1</td>
<td>5.9</td>
</tr>
<tr>
<td>Asia</td>
<td>37.4</td>
<td>4.5</td>
<td>3.9</td>
</tr>
<tr>
<td>Middle East</td>
<td>6.4</td>
<td>6.1</td>
<td>6.1</td>
</tr>
<tr>
<td>Other Asia</td>
<td>31.0</td>
<td>4.2</td>
<td>3.4</td>
</tr>
<tr>
<td>India</td>
<td>16.3</td>
<td>4.4</td>
<td>2.9</td>
</tr>
<tr>
<td>Pakistan</td>
<td>3.7</td>
<td>3.5</td>
<td>5.4</td>
</tr>
</tbody>
</table>

1 Share in 1963 for OECD countries and in 1960 for less developed countries.
2 Excludes Saar and West Berlin.
3 Includes Saar and West Berlin.
4 Estimates.
5 Not available.

**Note:** Totals include countries not shown separately. Detail will not necessarily add to totals because of rounding.

**Sources:** Organization for Economic Cooperation and Development (OECD), Agency for International Development (AID), and Council of Economic Advisers.

of the largest of these countries. However, the table also shows that output in the OECD countries has been exceeding the growth rate of the OECD target.

### DEVELOPED COUNTRIES

In the first half of the 1960's, real output in Western Europe and Japan increased by more than 5 percent a year. Contributing to the rapid expansion were government policies directed toward achieving and maintaining high levels of employment with reasonable price stability, stimulating the movement of labor from low to high productivity employment, reducing barriers to foreign trade, and encouraging the more efficient utilization of resources in other ways.

A high rate of capital formation helped to achieve this rapid growth. Investment averaged 18 percent of gross national product (GNP) in the OECD countries other than the United States; it ranged from almost 30 percent in
Japan to less than 14 percent in the United Kingdom. While much of the increase in output comes from investment in physical capital and from the incorporation of technological advances, a good deal also comes from investment in human capital—in raising the education, skills, and health of the population.

The growth of output is also benefiting from the movement of labor out of activities of low productivity to those of higher productivity. There has been a large-scale movement of labor from Southern Europe to Northwestern Europe—from areas of low productivity, low incomes, and high unemployment to areas where productivity and incomes are high and unemployment low. Within countries, the major shift has been out of employment in agriculture. The OECD estimates that this latter shift alone accounted for between 10 and 15 percent of the increase in productivity during the first half of the 1960's in France, Germany, Italy, and Japan. The United Kingdom, which by 1960 already had only a small agricultural sector, did not have this source of expanding productivity.

Internal shifts of labor have been stimulated and facilitated by the expansion of foreign trade, which has far exceeded the growth of output. The rapid growth of trade has resulted, in part, from the reduction of trade barriers, especially within the two regional groupings—the European Economic Community (EEC) and the European Free Trade Association (EFTA).

For a number of European countries and Japan, a rapid rise in exports has also directly stimulated the growth of GNP. In addition, when domestic expansion is led by export growth, the resulting rise in imports can be readily financed; there is less chance that the government will need to apply the breaks to reverse a developing balance of payments deficit.

LESS DEVELOPED COUNTRIES

The achievement of an adequate rate of self-sustaining growth in the less developed countries remains an urgent world economic problem. Over half of the 4½ percent annual growth of total output for the less developed areas has been needed just to maintain their low level of living, since their populations have been rising by 2½ percent annually. The yearly increase in per capita output has been only 2 percent, or barely $3 a person.

Achieving rapid and sustainable growth in these countries is by no means a hopeless task, however. Self-sustaining growth has been attained in certain less developed countries—including Israel, Malaysia, Mexico, Taiwan, Venezuela, and some Central American countries. Others—such as Pakistan, South Korea, Thailand, and Turkey—are approaching that objective.

But the problems are formidable. Further efforts by both the developed and the less developed countries are required. The rapid growth of population in many less developed countries, already over-populated in relation to their economic resources, must be slowed. A number of these
nations have adopted measures to induce their citizens to limit the size of their families. Some of these programs—in Hong Kong, Singapore, and Taiwan—have already shown signs of success. Nevertheless, the growth rate of population in the less developed countries as a group is still rising.

Another major problem area is agriculture. Agricultural output has grown so slowly that food output per person in many countries is below pre-World War II levels. Unless a vigorous effort is made to redress the situation, it is likely to deteriorate further as population and need for food continue to grow rapidly. Moreover, in at least some of the less developed countries, agricultural development may be a key to general economic growth. The application of improved farming techniques can substantially improve agricultural productivity with relatively small increments of capital; increased agricultural output can be a major substitute for imports; rising farm income can provide an expanding market for domestic industrial output.

The developed countries can do much to help by providing technical assistance, food, fertilizers, agricultural equipment, and financing. But the basic responsibility rests on the less developed countries themselves. They must, among other things, improve the incentives for farmers to increase output.

Education also is a major field in which improvement is essential. Economic progress requires literacy. A modern and expanding economy needs much more—people trained to operate farm machinery, run a lathe, operate a retail store, and keep accounts. In recognition of the importance of education, the less developed countries have in recent years increased their education budgets by 15 percent annually. This effort has long been supported by the United States. More Agency for International Development (AID) technicians working abroad are employed in educational projects than in any other field. Moreover, beginning in fiscal year 1967, AID is sharply increasing its educational aid effort, as well as its work in agriculture and health. The educational efforts of our Peace Corps workers are also welcomed throughout the less developed world.

The Need for Capital

The developing countries also need capital. About one-fourth of their domestic investment is financed by capital imports. From 1961 to 1965, the net amount of this capital inflow rose by only 5 percent a year in money terms and less in real terms. Some increase continued into 1966. Since 1963, the entire increase from abroad has been in private capital flows.

This investment, to be sure, benefits the recipient countries, and the United States has taken steps to encourage it. But it has gone mainly to the extractive industries, particularly oil. Thus, it is unevenly distributed among countries. Further, investment in technologically advanced, some-
times highly automated, extractive processes does not have the same stimulating effects on general economic activity as does investment in local manufacturing. It does, however, provide much needed foreign exchange and technological know-how for those countries fortunate enough to be well-endowed with minerals.

For many developing nations, a growing burden of interest and amortization payments on external debt absorbs a large and rising proportion of gross aid receipts. In 1960, debt service charges amounted to 13 percent of the official bilateral aid receipts of less developed countries; today the figure is 19 percent. India's debt service charges on government assistance for the period of its Third Plan amounted to 26 percent of its foreign aid. In Turkey, debt service during 1963-66 was more than half as large as gross foreign aid.

For the net inflow of aid merely to remain constant, the gross inflow must rise to cover growing debt service. In fact, the gross flow of government aid from the developed countries has been rising just enough to keep net aid inflow on a plateau since 1963. Future prospects are even less encouraging. Bilateral aid commitments—pledges of actual aid disbursements to be made in the future—declined in 1965. This could foreshadow a decline in net and even in gross official aid disbursements in the years to come.

The stagnation in the net flow of official capital to the less developed countries has come at the very time that the industrial countries have reached new heights of prosperity. And it comes at a time when the pace of economic expansion achieved by the less developed countries as a group is encouraging. They are developing the skills required for a modern economy. They are capable of using more capital than they can raise domestically or borrow abroad on commercial terms. For this and other reasons, foreign aid, both bilateral and multilateral, should have a high priority claim on the resources of high-income countries.

One of the most fruitful avenues for increased aid to the less developed countries is through the multilateral lending agencies—the World Bank family and the regional development banks. The United States firmly supports these agencies as mechanisms for mobilizing both external capital and domestic resources of the developing countries themselves. Replenishment of the resources of the International Development Association (IDA), which lends on easy terms, ought to be high on the agenda of the developed countries. The IDA's resources should be substantially increased in ways which take into account the balance of payments situation of the contributing countries. The recently established Asian Development Bank represents a new stage in Asian economic cooperation, in which the United States is participating with other non-Asian countries. For Latin America, the United States continues its strong support of the Inter-American Development Bank, which serves as the financial arm of the Alliance for Progress and is helping to draw funds from inside and outside the hemisphere into the United Nations Development Program (UNDP).
Latin American development. The African Development Bank, which has recently begun operations, will perform similar functions in its area.

Foreign aid and private foreign investment finance only one-fifth of the foreign exchange expenditures of the developing countries. The remaining four-fifths is financed by their own export earnings. After near stagnation in the late 1950’s, these earnings rose by about 6 percent a year during the first half of the 1960’s. The increase was produced by many factors, including strengthened prices for many primary commodities, the growing ability of the less developed countries to supply these commodities, and the rapidly expanding markets in the United States, Western Europe, and Japan. Only with continued vigorous growth in the developed world and improved access to its markets can the less developed countries earn the foreign exchange needed to support their own continuing growth.

TRADE POLICIES

The less developed countries obviously have much to gain from reductions in tariffs, quotas, and other barriers to trade in primary products, since such products constitute 85 percent of their exports. Over the longer run, satisfactory growth in the export earnings of the less developed countries will require relatively less reliance on sales of primary products and continuation of the sharp expansion in exports of manufactured goods. Such diversification will also be important for their internal growth. Reductions in tariffs and other trade barriers in developed countries can contribute much to the needed growth of manufactured exports from developing countries.

In most of the less developed countries, internal markets are too small to support efficient modern industrial plants. It is not geographic size or population but effective purchasing power that determines the size of a market. Regional cooperation can create larger markets so that the enterprises of the developing countries can benefit from the economies of scale and of specialization on which growth and efficiency depend.

Encouraging progress toward regional integration is being made in a number of areas. The Latin American Free Trade Association, despite handicaps, can form the basis for a true Latin American common market. Particular progress has been made in the Central American Common Market. The United States supports outward-looking regional integration.

The importance of trade expansion as a factor in economic growth in all countries argues strongly for more rapid trade liberalization. This proposition is effectively demonstrated by the recent experience in the new free-trade areas of Europe, just as it was earlier demonstrated in the great common market of the United States. Thus, it is essential that success be achieved in the current multilateral trade negotiations, by far the most comprehensive in history.
Kennedy Round

This success is important to both the developed and less developed countries. The substantial reduction in tariff barriers which the United States and other countries are seeking to achieve in the Kennedy Round negotiations should make an important contribution to increased world trade.

Expanding world trade encourages capital and labor to move out of those economic activities which are better supplied from abroad and into those fields which provide higher real income through greater productivity. By permitting countries to produce efficiently and on a large scale, freer trade makes a contribution to higher incomes everywhere. And through reduction of artificial shelters to laggard domestic industries, the lowering of barriers to imports spurs innovation and efficiency.

In the Kennedy Round, the major reductions in barriers to world trade are expected to be made by the developed countries—the United States, EEC, EFTA, and Japan. EFTA has now virtually eliminated barriers to industrial trade among its members while the EEC will do so for both industrial and agricultural products by July 1968. The reduction of barriers to trade with nonmember countries would now help these groups to continue their rapid pace of growth, and would avoid distortion of the normal pattern of European trade in particular and world trade generally. The less developed countries are not being asked to grant tariff concessions that would endanger their economic development programs.

Longer-Run Tasks

A successful Kennedy Round will be a great achievement, and will promote rapid and healthy economic expansion throughout the world. But the Kennedy Round cannot be the end of the road for the liberalization of world trade. In the year ahead, further study and international consultation should be directed at four remaining tasks in the trade field:

(1) Continuing efforts to liberalize those tariff and nontariff barriers which will remain after the Kennedy Round;

(2) Developing a better international pattern of agricultural production and trade to speed economic growth;

(3) Achieving more stable export prices and raising the export volume of developing countries;

(4) Improving economic relations between the countries of Eastern Europe—including the Soviet Union—and the United States.

President Johnson has emphasized the importance of this last task on several occasions. In his recent State of the Union Message, he noted that the Export-Import Bank can now extend commercial credits to Bulgaria, Czechoslovakia, Hungary, and Poland, as well as to Rumania and Yugoslavia. He called again for legislative authority to extend most-favored-nation—i.e., nondiscriminatory—tariff treatment to the countries of Eastern
Europe and the Soviet Union. Their trade with Western Europe has increased steadily in recent years, while U.S. trade with these countries has been stagnant, and constitutes less than 1 percent of all U.S. foreign trade.

U.S. BALANCE OF PAYMENTS

A country's foreign trade and payments are its main points of economic contact with the rest of the world. The balance of payments of any nation is intimately dependent on policies and developments in the outside world. U.S. exports depend heavily on European, Canadian, and Japanese growth and the foreign exchange receipts of the less developed countries as well as on U.S. growth and price stability. The flow of capital from the United States depends on profit opportunities and monetary conditions abroad as well as on those in the United States.

For most of the decade following World War II, U.S. balance of payments deficits provided needed international currency to support the rapid expansion of world trade and economic growth. Other countries were eager to hold more dollars; indeed, it was commonly known as a period of "dollar shortage." Recently, however, as foreign reserves have increased, U.S. deficits have been less welcome.

These deficits do not, of course, contradict the unmatched strength and productivity of the U.S. economy; neither do they mean that our competitive position in world markets is weak. The United States is not living beyond its means, increasing its net debt to foreign countries, or using up its international capital. U.S. ownership of assets abroad continues to grow faster than foreign ownership of assets in the United States. U.S. assets abroad, net of foreign assets in the United States, increased from $7 billion in 1935 to $14 billion in 1950; by 1961 they had risen to $28 billion; and in 1965 they were $47 billion.

The deficits have, however, resulted in a steady erosion of the U.S. stock of reserve assets, which are needed to maintain a stable value of the dollar in international transactions. At the same time, there have been steady increases in U.S. liabilities to foreigners that may be considered potential claims against our reserve assets. This combination implies a continuing decline in liquidity; it is clearly not indefinitely sustainable if confidence in the safety and stability of the dollar is to be maintained.

The U.S. balance of payments performance is now evaluated in terms of two alternative accounting definitions. Both measure an over-all U.S. deficit or surplus in terms of what is currently happening to (1) U.S. reserves and (2) certain types of claims against the United States. Both count as an increase or decrease in reserves any change in the sum of U.S. holdings of monetary gold, U.S. "gold tranche" claims on the International Monetary Fund (IMF), and U.S. official holdings of convertible foreign currencies.