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FEDERAL RESERVE BANK OF KANSAS CITY

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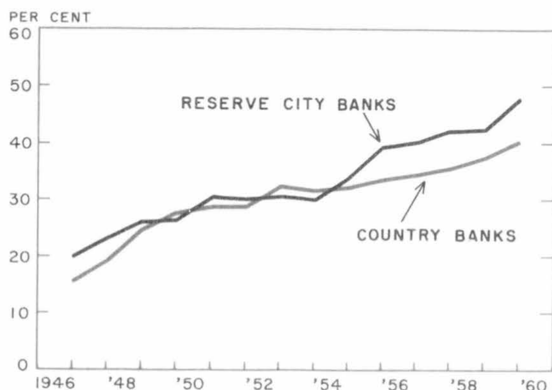
Recent Developments in

District Bank Liquidity

MEMBER BANKS in the Tenth Federal Reserve District since the end of World War II have witnessed an expansion in the dollar volume of their loans about as large as the growth in their deposits. The banks have added little to their ownership of cash and Government securities, which was comparatively high at the end of the war, and the percentage of bank assets held in liquid form has been reduced markedly. Bank loan and investment policies have had to be adjusted to the decline in liquidity. The liquidity problem has presented itself more forcibly at some times than at others, since growth rates of loan demands and deposits have varied from one year to the next, often requiring temporary reductions in liquid asset holdings.

Loan-Deposit Ratios of District Member Banks



In 1959, the problem of operating with reduced liquidity positions assumed larger proportions for District member banks, because the near-record expansion in loan volume was accompanied by a decline in deposit levels. This was the first year since 1946 in which total deposits of all District members were lower on December 31 than at the beginning of the year. The experience was not confined only to member banks in the Tenth Federal Reserve District—total deposits at all member banks in the Nation also were below year-earlier levels on December 31, 1959—nor was the loss of deposits in the District particularly large. It amounted to just $46 million, or about one half of one per cent of total deposits. Developments since the first of the year, nevertheless, have indicated that the 1959 drop in District bank deposits was more than a quirk of year-end statistics. The contraction of deposits which took place in the first quarter of 1960 was much larger than normal seasonal proportions, requiring member banks in the District—as well as banks elsewhere in the Nation—to dip heavily into their secondary reserves of Government securities.

While most of the 1960 decline in District bank deposits is perhaps completed, since bank deposits in this region usually begin to advance seasonally after midyear, the recent

experience suggests the desirability of reviewing loan, deposit, and investment changes at District banks as a means of obtaining a broader perspective on the problem of liquidity confronted by the District banking community. The principal part of this article deals with developments early in 1960, but some attention is given to patterns evidenced in 1959 and earlier years.

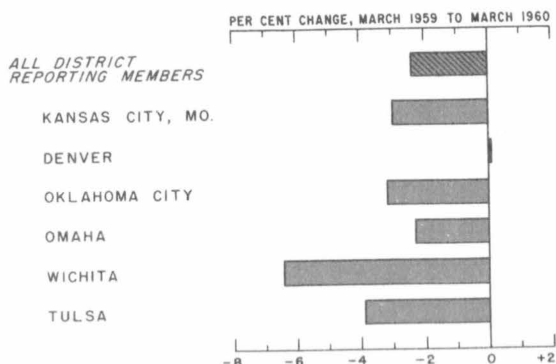
Deposits Decline Sharply in the First Quarter

A seasonal slump in deposit balances from high year-end levels is typical in the first quarter, but the opening 3 months of 1960 witnessed unusually large losses of deposits at District members. On an average daily basis, the decline in total deposits between late December 1959 and late March 1960 amounted to almost $450 million—a reduction of about 5½ per cent – substantially more than is typical of this period. As usual, the loss of deposits centered in demand balances. Time accounts continued to rise, but the first quarter increase was the smallest since 1956. Reserve city and country member banks shared almost equally in the deposit reduction, with each class of bank experiencing the largest first quarter deposit loss of any recent year.

Following the slight decline in total deposits during 1959, the further contraction in the first 3 months of 1960 enlarged the gap from the levels of a year earlier. At year-end 1959, total deposits of all District members were $46 million below the December 31, 1958, figure, as noted previously; by the end of March 1960, the margin from year-ago figures had widened to $170 million—all of which was registered at reserve city banks. At all country members, the first quarter reduction brought the total deposit level for these banks at the end of March 1960 to about the figure of 12 months previously.

The accompanying chart shows the percentage reduction of total deposits in the year ended March 1960 at weekly reporting member banks in the District's six major cities. This group of banks is comprised mainly of those in the reserve city classification. It may be noted that all of the major cities except Denver recorded a deposit attrition over this period, and in Denver—where deposit expansion has been rapid in recent years—the year-to-year percentage gain was fractional. The largest decline, a figure of 6.4 per cent, was registered at weekly reporting members in Wichita.

Changes In Total Deposits
Weekly Reporting Member Banks



Since the decline in deposits at District members in 1959 and in the first quarter of 1960 paralleled deposit trends at all member banks in the United States, it seems reasonable to presume that forces at work at the national level also were important in the District. It is interesting to note, in this respect, that the percentage of total deposits at all member banks in the United States accounted for by District members was only slightly less in March 1960 than in March 1959.

Changing levels of deposits at all member banks in the Nation reflect, of course, the impact of monetary policies in regulating the volume of bank reserves. In 1959, restraint on the growth of bank reserves and bank deposits limited the participation of banks in

financing the unusually large demands for credit expressed in the financial markets. As interest rates rose, owners of bank deposits —and other types of financial assets on which yields were less flexible—were encouraged to channel a large volume of funds directly into the securities markets. Estimates of the Securities and Exchange Commission indicate that individuals' acquisition of securities other than U. S. savings bonds totaled $13.7 billion in 1959, accounting for 43 per cent of gross private financial savings of individuals—the highest allocation of funds to the securities markets of any postwar year. Corporations other than banks and insurance companies also directed the increase in their asset holdings to the securities markets, acquiring $5 billion in Treasury issues during 1959. A continuing corporate demand for short-term Treasury securities in the first quarter of 1960 has been reported by observers close to the national money markets.

It would be surprising, indeed, if this region were insulated from the effects of growing investment in fixed-income obligations by individuals and other investors across the Nation. Direct evidence on this score is confined to comments received from District bankers, but these confirm the view that customers of banks in this area also have expressed an expanding demand for Treasury and other securities. As might have been expected, the influence of changes in investment preferences in the District appears to have affected importantly the growth of time deposits as well as the performance of demand balances. Time accounts at all District members rose 7.7 per cent in the 15 months ended in March 1960; in the preceding 15 months, when bank interest rates were more favorable in relation to yields on open-market securities, the percentage gain in time accounts was more than twice as large.

Another factor of considerable significance in explaining the recent behavior of District bank deposits, however, is to be found in the agricultural sector of the regional economy. Cash receipts from farm marketings dropped substantially below 1958 levels in District states during the second half of 1959 and remained below year-earlier figures in the opening months of 1960. As might have been expected, the slide in farm income, coupled with the increase in farm investments, tended to reduce cash balances of farmers. At a sample of 105 rural banks in the District, where deposits are mainly those of farmers, individual and business demand balances fell 4 per cent during 1959. A recent survey of demand deposit ownership suggests that the reduction in demand balances of District farm operators may have been significantly greater than that. The deposit attrition apparently was particularly large in Nebraska, where demand balances at country members other than banks in Lincoln declined 6 per cent in the year ended March 30, 1960.

The loss of demand deposits at some country members followed a 2-year period during which loan demands in the farming areas were unusually high, and as pressures on the reserve positions of these banks mounted, cash balances maintained with city correspondents were reduced. Consequently, correspondent balances at the larger city banks in the District, already at comparatively low levels early in 1959, were drawn down further in the past year. In the final 2 weeks of March, interbank demand deposits at District reserve city members averaged out to a figure lower than in the comparable weeks of any of the past 5 years.

Loan Volume Growing at a Slower Pace

During the 2 years ended in mid-1959, loan totals of District members swelled by nearly $750 million—a gain of more than one fourth. An eventual slowdown from this feverish pace of expansion was inevitable, particularly in the face of a less favorable deposit perform-

ance, and signs of a relaxation began to appear at the larger city banks during the second half of 1959. The less buoyant performance has continued at these banks during the first quarter of 1960. At country members in the District, loan totals advanced strongly through the latter half of last year, and further growth was evidenced in the first quarter of 1960. The rate of growth in the opening quarter of this year, however, was considerably less than in the same period of 1959.

At the District's weekly reporting member banks, which are concentrated in the larger cities, the second half of 1959 witnessed a relatively mild expansion of loan totals. This reflected, in part, the effects of the steel strike in curtailing business demands for funds. At the same time, demands for nonguaranteed farm loans were moderated, possibly by the declining trend of cattle prices. These loans rose substantially less in the second half of 1959 than in the same period of the 2 previous years. An additional factor in slowing down the pace of loan expansion was the curtailment of loans to the mortgage market, both through reduced purchases of real-estate mortgages and through a cutback in loans to real-estate mortgage companies. Real-estate loans on residential properties actually declined during the second half of 1959, but there was a more than offsetting increase in loans on commercial and other properties.

Real-estate loans of the reporting member banks declined $6 million in the first 3 months of 1960 and consumer and other miscellaneous loans were also reduced somewhat. But the dominant factor tending to reduce loan totals in the quarter was the steep drop in nonguaranteed farm loans as cattle marketings increased. Business loans showed a moderate increase from January through March, although seasonal expectations are for a considerable reduction in this period. The growth in business loans was significantly less than in 1959, however, as borrowing in the tax-payment month of March failed to match the performance of a year earlier. As may be noted in the table, the sum of the major loan components at the District's weekly reporting banks was reduced $28 million in the first 3 months of the year, a performance which is close to the average change for the years 1955-58.

Some of these sources of weakness in loan growth at the larger city banks were instrumental in curtailing the volume of loans at the District's country members. As was true in the case of the larger city banks, the major weakness was in nonguaranteed farm loans, which declined $10 million from the first of the year to March 15. Loans other than money-market loans and loans guaranteed by the Commodity Credit Corporation showed a net decrease of $9.0 million between year-end and spring call dates; in 1959, there was a net increase of $22 million.

First Quarter Changes In Principal Loan Categories

District Weekly Reporting Member Banks
In millions of dollars

Type of Loan	1960	1959	Average 1955-58
Real estate	−6	+5	−1
Commercial and industrial	+4*	+24	−21
Personal and sales finance companies	−1	n.a.	n.a.
Other nonbank financial institutions	−2	n.a.	n.a.
Nonguaranteed farm	−18	+2	−6
Consumer and other	−5*	+6	+7
Total, principal loan components	−28	+37	−21

n.a. — Not Available.

*Due to reclassifications in July 1959, these data are not strictly comparable with previous years. A rough comparison of business loan changes may be obtained by assuming that loans to personal and sales finance companies and to other nonbank financial institutions were included in the commercial and industrial category prior to reclassification. Thus, the 1960 changes in these three categories taken together may be compared with changes in commercial and industrial loans in 1959 and previous years.

Liquidation of Investment Holdings Continues

Ownership of liquid assets – particularly Government securities – was reduced substantially in 1959 as a result of the combined ef-

fects of a large increase in loan volume and a slight reduction in deposits. At the end of the year, cash assets of all District members had been reduced nearly $70 million, and holdings of Treasury securities had declined more than $200 million. Ownership of other securities also declined in 1959—the first annual reduction since the end of World War II.

The liquidation of Government securities accelerated in the early months of this year as a result of the more-than-seasonal contraction of deposits. Treasury security holdings were reduced $143 million between December 31, 1959, and March 30, 1960, and a further reduction of $24 million in other investments also occurred. At the end of March 1960, the ownership of Government securities by District members had reached a postwar low.

The large investment liquidation of the first quarter was primarily a product of the need to make adjustments in the face of an adverse deposit movement. Yet it is significant that District members did not resort to a temporary solution, such as expanded borrowings at the Reserve Bank, in confronting the problem of heightened reserve pressures. Average daily borrowings of all District members were lower in March 1960 than in December of last year. In this respect, the behavior of District members paralleled that of all commercial banks in the United States. An extraordinary volume of Treasury securities was liquidated by banks during the first quarter, but borrowings of all member banks in the United States in March averaged considerably lower than in December 1959 and, in fact, were the lowest for any month since March 1959. The apparent willingness of the banks to part with securities may reflect, in part, a judgment that the sources of reserve pressures late in 1959 were not of a short-lived character and that adjustments to them would have to be more fundamental than through temporary borrowing. It is also important to recall, however, that yields on short-term Treasury securities were below the discount rate during most of the first quarter. Therefore, sales of short-term securities were the more economical means of bank adjustment to the contraction of deposits.

The liquidation of Treasury securities has affected primarily the ownership of short-term issues, but there has been a reduction of bank ownership of intermediate and longer-term issues as well. Figures from a group of District commercial banks (including all reserve city banks and a considerable number of country member and nonmember banks) indicate that market sales during 1959 reduced ownership of 5-10 year issues by an estimated $15 million and holdings of issues with more than 10 years to maturity by $18 million. These market transactions acted to reduce holdings of Treasury securities in the over-5-year maturity range by a bit more than 6 per cent. Reductions in the less-than-1-year range, however, were much more drastic and at the end of December 1959, ownership by these banks of very short-term securities was at the lowest year-end level since 1955, as is evident in the accompanying table. A further decline evidently occurred during the first quarter of 1960. At District reporting member banks, for which reports are available on a week-to-week basis, the liquidation of Treasury securities from January through March was accounted for entirely by a de-

Ownership of Marketable Treasury Securities

At a Sample of District Commercial Banks
Year end, 1955-59

Par values in millions

Securities Maturing in:	Dec. 31 1955	Dec. 31 1956	Dec. 31 1957	Dec. 31 1958	Dec. 31 1959
Less than 1 year	$ 414	$ 692	$ 742	$ 813	$ 664
1-5 years	1,047	1,162	1,194	1,225	1,294
5-10 years	734	367	241	388	324
Over 10 years	111	121	130	146	91
Total	$2,305	$2,342	$2,308	$2,572	$2,372

NOTE: Details may not add to totals because of rounding.

cline in Treasury bill and certificate holdings.

While it is quite clear that sales of short-term securities have impinged on District bank liquidity, the extent of the alteration in liquidity positions cannot be fully appreciated by reference to aggregate figures alone. Some banks entered the period with less ample liquidity cushions than others, and the degree of pressure on reserve positions has varied considerably among banks. Consequently, the decline in ownership of Government securities has drawn down the ownership of short-term securities by some banks to particularly low levels. For example, on March 30, 1960, the District's weekly reporting member banks as a group held Treasury issues with less than a year to maturity in amounts equal to about one fifth of their total Government securities. But among these reporting members is a smaller group of 21 banks which on that date had only 2 per cent of their Treasury issues in the shortest maturity bracket. These 21 banks accounted for 39 per cent of all Government securities held by District weekly reporting members, but less than 5 per cent of the issues in the less-than-1-year range.

Concluding Comments

The problems faced by District banks in adjusting to heightened reserve pressures in 1959 and early 1960 are not new ones. On the contrary, the developments leading to the reduction in bank liquidity have been evident in most of the postwar years, and banks increasingly have become acquainted with methods of adjusting to alterations in the tempo of loan demands and deposit flows. The new element in the picture is the fact that the recent adverse performance of deposits immediately followed a phenomenal expansion of loans in the 2 years ended in mid-1959, and taken together, these two events have served to reduce District bank liquidity to the lowest level of the postwar era. A year ago, loan-deposit ratios of District member banks had reached new postwar highs, and cash assets of country members had been drawn down to comparatively low figures. There was at that time, however, a fairly ample volume of short-term securities reasonably well distributed among reserve city and country banks. The 12 months ending in March 1960 witnessed a continued advance in ratios of loans to deposits, a further decline in cash assets of country members, and deep inroads into District bank ownership of short-term Treasury issues.

Such important changes in bank liquidity are bound to have an influence on bank lending and investment policies, and some of the results of this influence are already evident. The liquidation of intermediate and longer-term Treasury securities by District banks during 1959 is a case in point; in periods when deposits have grown rapidly and loan demands were less ebullient, demands by District members for such issues have been relatively large. The curtailment of real-estate loans on residential properties and the decline in loans to real-estate mortgage lenders are symptomatic of the fact that the banks have begun to ration more intensively a limited supply of loan funds among competing uses.

Whether further intensive efforts in the direction of checking the decline in liquidity will be required of District banks during the remainder of 1960 remains an open question. In a region where bank deposits are dependent importantly upon developments in agriculture, the vagaries of the weather may be sufficient to make the difference between an intensification or some easing of pressures on bank reserves. It is clear, nevertheless, that unless loan demands weaken considerably or the trend of deposits turns favorable, the District banking community will face a larger problem of living with reduced liquidity than has been encountered in recent years.

Liberalization of WORLD TRADE AND PAYMENTS

Excesses of United States payments abroad over receipts from abroad during the past 2 years have attracted worldwide attention. Speculation on the causes of and remedies for these balance of payments deficits has been widespread and highly divergent in character. Views on the matter of remedies have ranged from the relatively complacent one that the deficits will disappear almost automatically with cyclical expansion in foreign demands for U. S. goods and services, and therefore will require no special corrective steps by the Government, to the extreme position that forces contributing to recent deficits are so deep-seated and persistent as eventually to necessitate restriction of U. S. payments abroad or other harsh measures.

Developments since the summer of 1959 have provided some assurance that forces are at work lessening U. S. payments difficulties and have led to a reassessment of the more extreme views. Nevertheless, the United States continues to experience a payments deficit. Primarily as a result of developments during the first half of 1959, the most impressive of which was a sharp surge in imports, the deficit advanced about $300 million, from $3.4 billion in 1958 to $3.7 billion in 1959, excluding the payment of $344 million in gold and $1,031 million in noninterest-bearing notes to the International Monetary Fund (IMF) to cover the increased U. S. quota.

While observers have expressed quite different views on the appropriate remedies to halt the outflow of gold and the increase in foreign short-term dollar assets that financed this deficit, all are agreed that an imbalance of the magnitude experienced over the past 2 years cannot be sustained indefinitely. However, the gold reserves of the United States, comprising nearly half of the estimated free-world stock, provide the United States with both time and latitude in adjusting policies to restore balance or in awaiting foreseeable improvements in the balance of payments position.

In the formulation of judgments concerning the policies to be pursued by this country in correcting the foreign payments situation, careful consideration must be given to developments abroad and to the impact of these upon U. S. deficits. In this regard, it must be recognized that payments gaps experienced by the United States have a counterpart in surpluses abroad that increase foreign gold and dollar reserves. Past deficits in the U. S. balance of payments, by contributing importantly to the redistribution and growth of international currency reserves, have permitted foreign countries to examine critically the whole range of quantitative restrictions on trade and payments that were introduced or maintained during earlier postwar years to deal with payments deficits and serious drains on gold and dollar reserves.

This article is designed to examine the increase in foreign gold and dollar reserves and to describe some of the steps taken abroad to lessen restrictions on international trade and payments. The liberalization of trade and payments promises to ease the adjustment in the U. S. balance of payments as well as to provide a world trading environment more consistent with the objectives to which the United States and most other countries of the free world subscribe through membership in the IMF and as contracting parties to the General Agreement on Trade and Tariffs (GATT).

U. S. Payments and Foreign Gold and Dollar Reserves

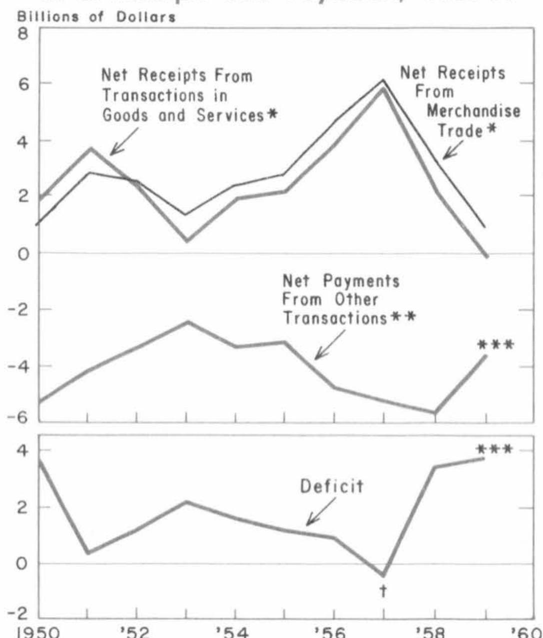
During the past decade deficits in the U. S. balance of payments have by no means been unusual, for they were recorded in every year except 1957. In that year, a $0.5 billion surplus in U. S. transactions with foreign countries—an excess of receipts over payments—occurred in response to a sharp advance in exports brought about largely by supply difficulties stemming from the Suez crisis. During the 1950-56 period, deficits ranged from $0.3 billion in 1951 to $3.6 billion in 1950. Generally, however, the payment imbalances of those years were greatly overshadowed by those of 1958 and 1959, which were roughly 2½ times the average for the 1950-56 period.

Placed in the broader perspective of the past decade, U. S. deficits can be viewed as the product of net private and Government loans and investments abroad, private remittances, pensions, and nonmilitary Government grants exceeding the surplus of receipts over payments from transactions in goods and services. As Charts 1 and 2 show, however, the payments gap widened during 1958 and 1959, primarily as a result of a decline in net receipts from transactions in goods and services. Merchandise exports – excluding military shipments under Government grants – fell $3.2 billion, while merchandise imports rose $2 billion, and the excess of payments over receipts from transactions involving shipping, insurance, travel, military expenditures, and transfers of income from investments increased by $700 million over this 2-year period. In 1959, U. S. purchases of goods and services abroad exceeded sales for the first time during the postwar period. Net payments amounted to $137 million, while in 1958 net receipts from these transactions totaled $2,248 million.

Chart 1.
U. S. Merchandise Exports and Imports, 1950-59

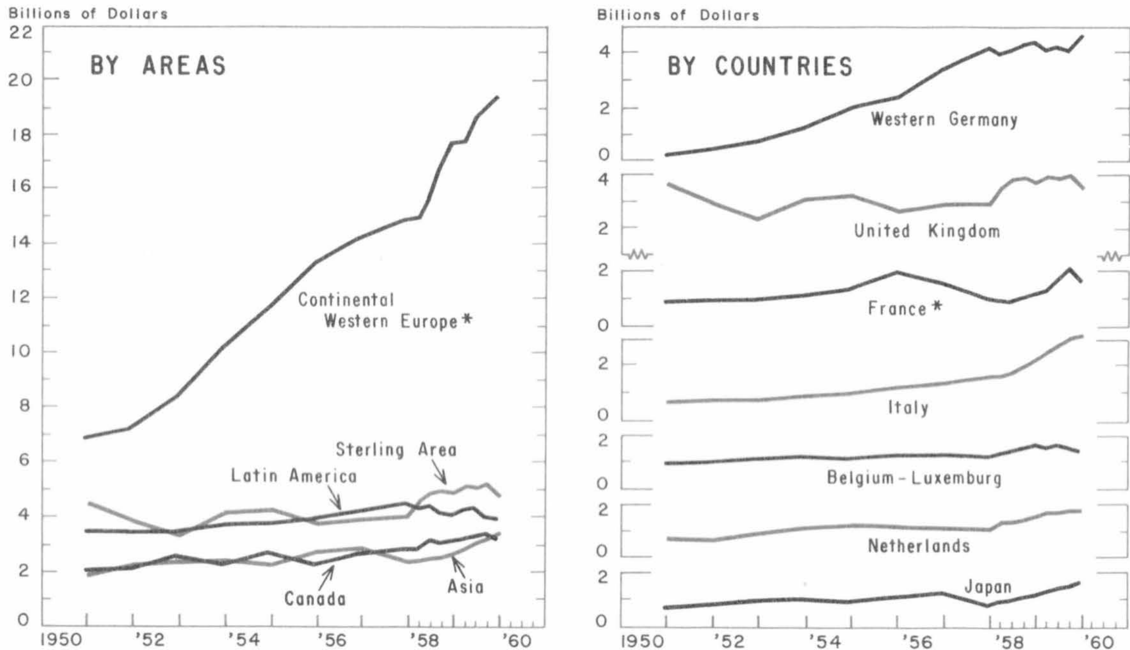
*Excludes military exports under Government grants.
SOURCE: U. S. Department of Commerce.

Chart 2.
U. S. Receipts and Payments, 1950-59



*Excludes military aid transferred under Government grants.
**Includes net capital outflow, private remittances abroad, pensions, and nonmilitary Government grants, but excludes Government military grants.
***Excludes payment of $344 million in gold and $1,031 million in noninterest-bearing notes to the IMF in 1959 to cover the increased U. S. quota.
†Surplus.
SOURCE: U. S. Department of Commerce.

Chart 3.
Foreign Holdings of Gold and Short-Term Dollar Assets, 1950-59



NOTE: Data include holdings of gold reported by foreign governments and central banks and official and private holdings of short-term dollar assets, including bank deposits, Treasury bills and certificates, bankers' acceptances, and other short-term dollar assets.
*Excludes gold holdings of French Exchange Stabilization Fund.
SOURCE: Board of Governors of the Federal Reserve System.

The total payments deficit for the decade was $17.4 billion, excluding the increase in the U. S. quota in the IMF mentioned above. This deficit, combined with production of new gold, and gold sales by the U.S.S.R. and Eastern European countries, swelled foreign official holdings of gold and official and private holdings of U. S. Government securities, bank deposits, and other short-term dollar assets by $21.1 billion to $36.4 billion. During this period, IMF holdings of gold and short-term dollars, which serve as secondary reserves of IMF member countries, rose by $3.1 billion to $6.2 billion.

Foreign countries have not shared equally in this growth of gold and dollar reserves. Chart 3, showing foreign holdings of gold and short-term dollar assets – those with original maturities of less than 1 year, indicates that the most substantial growth in these reserves was experienced primarily by countries in Europe. Over the past 2 years, however, the reserves held by Japan also have risen sharply and some other countries have increased their holdings of gold and dollar reserves or other currency reserves by moderate amounts.

Countries that are producers of primary products, notably metals, have not shared proportionately in the advances in free-world gold and dollar reserves, particularly over the 1958-59 period. This is exemplified by developments in Latin American countries where earnings of foreign currencies commonly are dependent upon shipments of one or a few products such as oil, coffee, or primary metals. Some of these countries found export earnings sagging with depressed coffee prices. Others that are dependent upon exports of minerals to the industrial countries experienced a reduction in foreign currency

earnings when cyclical declines in activity in manufacturing centers led to declining sales volume and to falling export prices.

It is not surprising therefore that many Latin American countries failed to add to their gold and dollar reserves in 1958 when foreign markets were depressed cyclically. A longer-run view of the balance of payments problems of less developed regions also must take account of the fact that the urgency of economic development and ambitious programs to advance living standards have tended to put upward pressures on prices and to increase import demands.

Thus, the growth in international currency reserves and the strengthening in payments positions abroad have been most striking for the industrial countries. The restoration and growth of productive capacity of countries whose industrial plant was destroyed during World War II, and the vigorous anti-inflationary policies pursued in recent years by many of the European countries to preserve the over-all competitive position of producers, have strengthened external payments positions and augmented gold and dollar reserves. Additionally, it is notable that the United States has become a more receptive market for many foreign produced goods, especially for finished manufactured products. Imports of finished consumer goods alone increased $700 million, or by 40 per cent, in 1959, with automobile imports leading the advance.

These longer-run developments undoubtedly were basic to the rise in European gold and dollar reserves over the past decade. Additionally, however, it should be noted that U. S. exports in 1958 and early 1959 were restrained by recession in Europe and have only more recently begun to advance with the recovery of economic activity in Europe, while U. S. imports responded to a somewhat earlier cyclical advance in business activity in this country. These developments provide partial explanation for the accelerated rise in foreign reserves of gold and dollars by some countries over the past 2 years and they are in turn partly responsible for the accelerated freeing of trade and payments from quantitative restrictions.

Progress in the Liberalization of Trade and Payments

During the early postwar period, countries throughout the world were faced with the difficult tasks of reconstruction or with pressing developmental needs. Quantitative restrictions on merchandise imports and systems of foreign exchange controls, designed to ration current earnings of foreign currencies and to conserve available reserves of international means of payment, appeared essential to the maintenance of balance between demands for and supplies of these means of payment. Thus, countries that originally had introduced restrictions on imports or exchange controls, limiting payments abroad, as a means of marshaling financial resources for a maximum wartime effort or as a means of promoting domestic employment during the economically depressed 1930's, commonly maintained or augmented these restrictions in dealing with postwar balance of payments difficulties.

While quantitative restrictions were applied to prevent depletion of gold and dollar reserves during the postwar years, most countries applying these restrictions had as an ultimate objective the removal of most quantitative restrictions on trade and payments and the eventual establishment of a system of multilateral trade and payments. These objectives were responsibilities accepted with membership in the IMF and participation in negotiations under the GATT. However, those individuals and Governments responsible for the development of the IMF Agreement and the GATT foresaw the trade and payments problems that would be inherent

in the postwar distortions of production and distribution. Provision was made therefore for quantitative restrictions for balance of payments reasons—as opposed to protectionist reasons — during the transition from war to normal peacetime conditions.

The seriousness with which many countries have approached the objective of establishing a trade and payments system consistent with the goals set forth by the IMF Agreement and the GATT, once payments positions strengthened, is revealed by the recent accelerated progress in reducing quantitative import restrictions and in freeing payments from exchange controls. Perhaps the most striking evidence of this progress was the headlined announcement at the end of 1958 that external currency convertibility had been restored by most countries of Western Europe and by a number of other countries throughout the world. This did not mean, as it once had meant, that currencies again could be exchanged freely for gold. Nor did it mean generally—Germany being a notable exception — that residents of any one country were permitted freely to convert their own currency for the currency of another country. What it did mean was that residents of one country, say France, were free to convert current earnings of another currency, the pound sterling, for example, into other currencies. (Previously this was possible only in unofficial foreign exchange markets.) Thus, the concept is described accurately as "external" currency convertibility.

Since exchange control systems of many countries formerly had not permitted the conversion of current earnings into dollars, the introduction of external convertibility meant that one aspect of discrimination against U.S. goods or payments to the dollar area had disappeared. The move to convertibility in Europe and elsewhere signified that balance of payments positions had strengthened and that gold and dollar reserves had accumulated sufficiently to permit gradual adoption of principles of nondiscrimination and the removal of general restrictions on trade and payments.

With external convertibility a reality, a balance of payments justification for discriminatory quantitative restrictions on trade and payments by residents of countries that introduced external convertibility required critical survey. If external payments positions had strengthened sufficiently to permit the elimination of discriminatory treatment of nonresident earnings of the domestic currency, what justification remained for the discriminatory restriction of resident payments to the United States — as opposed to over-all restriction of payments? Current earnings of other currencies that had been made convertible could be used to acquire dollars. Thus, a surplus of receipts over payments in pounds sterling, for example, could be used to settle deficits in dollars through the conversion of pounds sterling into dollars in foreign exchange markets. As the IMF noted in the *Tenth Annual Report on Exchange Restrictions,* "The currency moves in Europe at the end of 1958 have special significance for the general level of remaining restrictions and, particularly, for the problem of discrimination." And, after calling attention to the strengthening of reserve and balance of payments positions of Western European countries as a group, the Report continued: "If the present improvement continues, one country after another should cease to have any balance of payments reasons for continuing to maintain restrictions."

Substantial progress has been made since the beginning of 1959 in the reduction of the over-all level of restrictions on trade and payments in Europe and in other parts of the world as well, but the reductions of discriminatory restrictions of imports and other payments to the United States and Canada perhaps have been most striking. Movements

toward freer trade and payments are not, however, entirely of recent origin. Canada abolished all restrictions on payments in 1951. Switzerland long has maintained a practically unrestricted payments system. As early as 1950, member countries of the Organization for European Economic Cooperation (OEEC) adopted a "Code of Liberalization" calling for the elimination of quantitative restrictions on trade with the United States and Canada as well as on trade with member countries. The Code called for the "liberalization" of trade requiring each country to admit commodities either without licensing or with the automatic and immediate issue of licenses for the importation of foreign commodities. Liberalization was to be accompanied by automatic allocation of foreign exchange required for such imports, thus preventing the reduction of commercial restrictions—such as increases in import quotas—from being offset by more restrictive foreign exchange controls. The Code also called for the gradual removal of restrictions on other types of payments by residents, such as payments for travel abroad, insurance, and transfers of earnings from subsidiaries to foreign parent companies.

Reports of earlier progress of OEEC countries in liberalizing imports from the United States and Canada are summarized in the accompanying table, showing that the proportion of 1953 imports from the United States and Canada that could enter the member countries free of quantitative restrictions increased from 44 per cent on September 30,

Percentage Liberalization of Dollar Imports By OEEC Member Countries

Based on 1953 imports from the United States and Canada

	Food and Foodstuffs	Raw Materials	Manufactured Products	Total
September 30, 1954	64	44	27	44
January 1, 1956	71	55	36	54
May 1, 1957	73	67	42	61

SOURCE: OEEC, **Liberalization of Europe's Dollar Trade,** Second Report, June 1957, p. 12.

1954, to 61 per cent at mid-1957. Imports by countries such as Belgium, Luxembourg, and Switzerland were relatively free of restrictions at the end of 1954. Denmark, Germany, and the United Kingdom, among others, took steps to open markets to U. S. goods in 1955 and 1956. From early 1956 to mid-1957, Austria and Germany made substantial progress in liberalizing imports from the United States and Canada. Germany increased the percentage liberalization from 68 per cent to 90 per cent of 1953 imports from these countries with a revision of restrictions in June 1956.

For many OEEC countries, liberalization was slowed during the Suez crisis. Still, none of these countries restored quantitative restrictions formerly withdrawn, partly because they were able to make use of accumulated gold and dollar reserves and to draw upon the credit facilities offered to member countries by the IMF.

The removal of restrictions, established or maintained for balance of payments reasons by European and other countries, accelerated in 1959, following the announcement of external currency convertibility. One country after another announced increases in import quotas, broader participation of the United States in these quotas, liberalization of imports from or other payments to the United States, and more lenient licensing of imports from the United States where restrictions continued in force. The United Kingdom, for example, virtually eliminated restrictions on imports from the United States in two major moves during 1959 and the few products that continued to be subject to restriction were licensed more freely. The moves by the United Kingdom generally were followed by reductions in quantitative import restrictions by other members of the sterling area — countries such as Australia, India, and British dependencies, whose economic ties with the United Kingdom have led them to hold for-

eign currency reserves in pounds sterling and whose gold and dollar reserves are held centrally by Great Britain.

Practically all exchange restrictions on German residents were removed with the move to convertibility and import restrictions were reduced further in 1959. In October 1959, Austria increased the list of liberalized raw material imports from the United States to 99 per cent of the 1953 import base and finished product imports were liberalized to the extent of 93 per cent of 1953 imports. Finland increased quotas for certain import categories and placed imports from the United States on the same basis as imports from OEEC countries, thereby increasing the list of U. S. commodities that can enter license free. Norway opened a global quota to the United States for automobile imports effective on January 1, 1960, and reported that liberalization of imports from the United States amounted to 91 per cent of the total. Italy liberalized imports from the dollar area in June 1959 and again in January 1960, advancing the percentage of liberalized imports from 20 per cent to 60 per cent. France took additional steps to free imports from quantitative restrictions and increased liberalized imports from the United States from 56 per cent to 86 per cent of the 1953 base. Limited reductions in restrictions of Japanese imports were announced late in 1959 and additional measures were taken early in 1960 to open Japanese markets to U. S. goods.

The products covered by these measures included food products, raw materials, and a wide range of consumer and producer manufactured goods. Some countries, while liberalizing trade and payments, have maintained discriminatory quotas or prohibitions on some products of great interest to the United States. Furthermore, high tariffs in some countries continue to serve as barriers to U. S. exports and to the expansion of world trade. Generally, however, the removal of restrictions on imports from the United States must be viewed as a development offering the United States broader access to foreign markets in a wide range of commodities.

Meaning for the United States

Does the accelerated dismantling of trade and payments restrictions that has accompanied improvement in foreign gold and dollar reserve positions portend advances in U. S. exports and improvement in the U. S. balance of payments? Since it is rarely possible to distinguish the effects of trade liberalization from the effects of other forces responsible for a growth in exports, an answer to this question probably can never be given with certainty. One thing is clear, however, namely, that the effects are unlikely to be identified by a sharp surge in a wide range of commodity sales abroad. Liberalization frequently is preceded by freer licensing of restricted imports as a means of testing import responses abroad. Moreover, the adaptation of U. S. producers to new sales opportunities and the fact that foreign consumers must be introduced to or be reacquainted with U. S. products means that the impact of liberalization ordinarily can be expected to be gradual. The attraction of foreign markets must be analyzed in the context of the improved competitive positions of foreign producers, a development suggesting the need for cautious appraisal of the significance of freer trade and payments for expanded U. S. sales abroad.

Clearly, however, the lessening of quantitative import restrictions and the gradual removal of exchange restrictions, particularly those that have discriminated against U. S. goods, have provided access to markets formerly closed to U.S. producers. Liberalization of trade and payments has provided an important lubricant for the easing of U.S. payments difficulties. It has not, however, relieved U. S. producers of the task of competing effectively

with foreign producers. This requires not only the quotation of competitive prices, but it also requires provision of credit facilities, prompt delivery, and supplies of products technically suited to the needs of foreign consumers.

The opportunities afforded by liberalization of trade and payments abroad well may be of crucial importance to the United States in the adjustment of the foreign payments problem. While the expansion of exports is by no means assured by these developments abroad, it is perhaps the most promising route to an improvement in the U. S. payments position. Many alternative means of correcting the foreign payments problem would require sacrifice of other objectives and these sacrifices must be weighed in choosing the appropriate measures to redress the balance of payments. For example, the curtailment of U. S. military outlays abroad and the improvement in the payments position which would accompany such an action must be weighed against the possible sacrifice of adequate defense for the free world. Similarly, a reduced rate of growth and possible political instability in less developed countries of the world are sacrifices which must be considered when examining the improvements in the foreign payments position that might accompany the withdrawal of Government aid to these countries. Resort to restriction of trade and payments, in violation of objectives pursued by the United States in the framing of the IMF Agreement and the GATT, surely would be unfortunate when real progress has been made in the restoration of a system of multilateral trade and payments over the past few years and when there is promise of further progress.

BANKING IN THE TENTH DISTRICT

District and States	Loans				Deposits			
	Reserve City Member Banks		Country Member Banks		Reserve City Member Banks		Country Member Banks	
	March 1960 Percentage Change From							
	Feb. 1960	Mar. 1959	Feb. 1960	Mar. 1959	Feb. 1960	Mar. 1959	Feb. 1960	Mar. 1959
Tenth F. R. Dist.	—1	+6	†	+9	—4	—4	—2	†
Colorado	—1	+11	†	+11	—4	—2	—3	†
Kansas	—2	+2	†	+6	—1	—3	—3	†
Missouri*	+1	+7	+3	+18	—4	—5	—3	+3
Nebraska	—1	+3	+1	+9	—2	—4	—2	—3
New Mexico*	**	**	+1	+12	**	**	+2	+1
Oklahoma*	—2	+4	†	+8	—4	—7	†	+3
Wyoming	**	**	†	+7	**	**	—5	—1

*Tenth District portion only. **No reserve cities in this state.
†Less than 0.5 per cent.

PRICE INDEXES, UNITED STATES

Index		Mar. 1960	Feb. 1960	Mar. 1959
Consumer Price Index	(1947-49=100)	125.7	125.6	123.7
Wholesale Price Index	(1947-49=100)	120.0	119.3 r	119.6
Prices Rec'd by Farmers	(1910-14=100)	240	233	244
Prices Paid by Farmers	(1910-14=100)	300	299	297 r

r Revised.

TENTH DISTRICT BUSINESS INDICATORS

District and Principal Metropolitan Areas	Value of Check Payments		Value of Department Store Sales	
	Percentage change—1960 from 1959			
	Mar.	Year to date	Mar.	Year to date
Tenth F. R. District	+4	+4	—7	—4
Denver	+11	+9	+1	+1
Wichita	—6	0	—18	—14
Kansas City	+2	+4	—11	—3
Omaha	+1	0	—9	—3
Oklahoma City	0	+3	—3	—6
Tulsa	+3	+2	—10	—7