MEASURING THE BALANCE OF PAYMENTS DEFICIT

Since 1958 the deficit in the United States balance of payments has been an increasingly serious problem, not only for this country but for foreign countries as well. The annual deficits have significantly influenced domestic and international economic policies, and the period has been marked by lively discussion of the problem both at home and abroad. The discussion has implied that continuing deficits are undesirable and should be eliminated, but there has been a decided lack of agreement among various Government departments, and among economists generally, on how a deficit or surplus should be measured.

In April 1963, a Committee headed by E. M. Bernstein, former research director of the International Monetary Fund, was appointed by the U. S. Budget Director to review the adequacy of balance of payments statistics and to evaluate various ways of measuring surpluses or deficits in the balance of payments. The report of this Committee, recently made public, recommended significant changes in the method of computing the net balance in our international accounts.

What is a Deficit or Surplus? It is sometimes said that the deficit is measured by the excess of payments to foreigners over receipts from foreigners, but this statement is not very meaningful. A double-entry system is used in recording a nation's international transactions, so each payments item is associated with a receipts item (or combination of items) of equal magnitude. Consequently, aside from problems of obtaining complete and accurate statistical information, total payments must equal total receipts for any given period of time.

But equality in the two sides of the balance of payments does not mean that there is no surplus or deficit. To determine the net balance, the items in the balance of payments are divided into two groups, with those in one group placed "above the line" and the remainder placed "below the line" and classified as "financing" or "settlement" items. If the receipts and payments listed above the line do not balance, a deficit or surplus exists which is equal to the total of the settlement items below the line.

Ways of Computing Deficit or Surplus It is possible, therefore, to compute the net balance in a nation's international accounts in numerous ways, depending upon which items are listed above the line and which included in the settlement category. The method of classification depends partly upon the purpose for which the net balance is computed. Items frequently included in the settlement category are:

(1) Changes in U. S. monetary reserves. These include changes in the gold stock, in holdings of convertible foreign currencies by U. S. monetary authorities, and in the U. S. position at the International Monetary Fund.

(2) Changes in liquid liabilities to foreign official holders. These include foreign official holdings of deposits in U. S. banks, United States Treasury bills and other money market instruments, and most U. S. Government bonds and notes.

(3) Changes in liquid liabilities to foreign private holders. These include the same types of short-term claims enumerated in (2), but the holders are private foreign individuals and businesses, foreign commercial banks (including foreign branches of U. S. banks), and certain international organizations.

(4) Special Government transactions. Included are prepayments of debts by foreign governments, advance payments on military exports, and sales of nonmarketable, medium-term, nonconvertible securities to foreign governments. Sales of nonmarketable, convertible securities are sometimes included in this category, but they are shown as liquid liabilities to foreign official holders in the accompanying table and chart.

The Balance on "Regular Transactions" The table on page 9, based on preliminary balance of payments data for 1964, illustrates three ways of measuring the net balance. The balance on "regular types of transactions," the summary figure most frequently encountered, is considered by some to be a rough measure of the long-term balance of payments problem that eventually must be resolved. Thus, it treats as settlement items not only changes in U. S. monetary reserves and liquid U. S. liabilities to foreigners, but special Government transactions as well. The latter are undertaken primarily for the purpose of preventing our reserves from being reduced as much as they would be from the normal play of market forces. Thus, it is argued, to show them above the line, and hence as reducing the deficit, would understate the magnitude of the deficit that needs to be corrected.

The "Liquidity" Balance Another view is that the figure representing the balance of payments surplus or deficit should measure changes in the ability of the United States monetary authorities to defend the external value of the dollar. Consequently, it is argued, it should measure changes in our net liquidity position. But this leads to the problem of deciding which of our claims against foreigners and which of our liabilities to foreigners are liquid. A relatively minor problem concerns the classification of the special transactions described above. One approach includes all of these transactions above the line on the grounds that they all tend to reduce the effect of a deficit on our liquidity position. Others would include all except the sale of nonmarketable, medium-term, convertible United States Government securities to foreign monetary authorities, arguing that the convertible feature makes these bonds liquid liabilities.

A more serious problem, and one giving rise to considerable controversy, concerns the treatment of private liquid assets and liabilities. The present approach, and that illustrated in the "liquidity" balance, treats increases in our liquid liabilities to private foreigners as reductions in our international liquidity but does not consider increases in privately-held United States claims against foreigners as increases in liquidity. Thus, an inflow of foreign short-term capital, such as an increase in U. S. bank deposits owned by private foreigners, is treated as a settlement item, but an outflow of short-term U. S. capital is considered a regular transaction that increases the deficit.

Critics maintain that this asymmetrical treatment of liquid assets and liabilities is misleading and unjustified. It implies that the motivations affecting the behavior of private individuals are not the same for residents of foreign countries as for residents of the United States. Moreover, it implies that each dollar held by private foreigners requires as much reserve protection as each officially held dollar, despite the differing motivations of the two types of holders and despite the necessity for transfer of the privately held dollar claims to official holders before they become reserve liabilities of the United States. Finally, it is argued that none of these measures adequately express the international liquidity position of the United States because the tremendous volume of liquid assets held by United States residents may well pose a greater threat to our international reserves than dollars held by foreigners.

Those who favor the asymmetrical treatment of liquid assets and liabilities point out that our liabilities consist largely of highly liquid bank deposits and short-term Treasury obligations, while our foreign assets are mainly in the form of much less

UNITED STATES BALANCE OF PAYMENTS, 1964[1]

			Regular Balance		Liquidity Balance		Official Settlements	
	Payments	Receipts	Net Balance	Settlement Items	Net Balance	Settlement Items	Net Balance	Settlement Items
Merchandise Trade	18.6	25.2	+6.6		+6.6		+6.6	
Military Sales and Expenditures	2.8	0.8	−2.0		−2.0		−2.0	
Non-Military Services	6.9	10.5	+3.7		+3.7		+3.7	
Remittances and Pensions	0.8		−0.8		−0.8		−0.8	
U. S. Government Capital								
Grants and Loans	4.3		−4.3		−4.3		−4.3	
Scheduled Repayments		0.6	+0.6		+0.6		+0.6	
Foreign Gov't Nonliquid Capital		0.2	+0.2		+0.2		+0.2	
Private Long-Term Capital	4.3	0.3	−4.0		−4.0		−4.0	
Private Short-Term Capital	2.1		−2.1		−2.1		−2.1	
Errors and Omissions	0.9		−0.9		−0.9		−0.9	
Special Government Transactions		0.3		+0.3	+0.3		+0.3	
Liquid Liabilities to Private Foreigners		1.5		+1.5		+1.5	+1.5	
Liquid Liabilities to Official Foreigners								
Marketable Holdings		0.7		+0.7		+0.7		+0.7
Nonmarketable Convertible U. S. Treasury Securities		0.4		+0.4		+0.4		+0.4
U. S. Monetary Reserves								
Gold		0.1		+0.1		+0.1		+0.1
Convertible Currencies	0.2			−0.2		−0.2		−0.2
IMF Gold Tranche Position		0.3		+0.3		+0.3		+0.3
Total	40.9	40.9	−3.0	+3.1	−2.7	+2.8	−1.2	+1.3

Figures may not balance because of rounding.

[1] Preliminary.

liquid bank loans, acceptances, and commercial credits. Moreover, in many countries private holdings of foreign assets, especially those of commercial banks, are very closely controlled by the central bank, and thus differ very little from official holdings. Finally, it is argued that as a reserve currency the dollar is used as money throughout the world and that United States monetary authorities must consider total foreign liquid claims as potential claims on our international reserves.

The "Official Settlements" Balance If inflows of foreign private capital in the form of increases in bank deposits or other liquid claims are treated the same as outflows of U. S. short-term capital, i.e., as ordinary transactions above the line, the resulting net balance is financed through changes in international reserves and in foreign official holdings of liquid claims on the U. S. The net balance thus calculated is called the "official settlements" balance.

The Bernstein Committee recommended an offical settlements concept only slightly different from that just described. The Committee approach treats advances on U. S. military exports as regular transactions, but classifies nonconvertible U. S. Government securities sold to foreign official monetary institutions as settlement items.

Comparison of Various Deficits The accompanying chart and table show the differences in the size of reported deficits using the various balance of payments concepts discussed. The table shows, for example, that in 1964 the deficit on regular transactions was $3.1 billion, the liquidity balance $2.8 billion, and the official settlements balance $1.3 billion. The Bernstein Committee concept yields a deficit of $1.5 billion. The difference between the liquidity balance and the official settlements balance was unusually large in 1964, as foreign banks added greatly to their U. S. assets.

The chart, which permits a rough comparison of the variously defined deficits over the 1958-1964 period, indicates that our international position has changed in recent years. From 1961 through 1964, for example, the official settlements deficit averaged only slightly more than half its average in the 1958-1960 period, and except for 1962, losses of monetary reserves were small. Losses of reserves in 1965 have been very large, however. Finally, special transactions reduced the effects of the deficits on our international liquidity position, but these declined sharply in each of the last two years.

No single figure can adequately show the international position of the United States at any given time. An understanding of the complex factors affecting that position requires a thorough analysis of all of the major sectors of the balance of payments. Nevertheless, in public reporting and discussion, the tendency is to look upon one summary figure as the measure of the deficit or surplus, and it is a matter of some importance which measure is used.