

MONTHLY



Review

**FEDERAL RESERVE BANK
OF ST. LOUIS • P. O. BOX 442 • ST. LOUIS 66, MO.**

	Page
Business Conditions	2
Financial Developments	3
What is a Balance of Payments?	6

This issue released on June 28

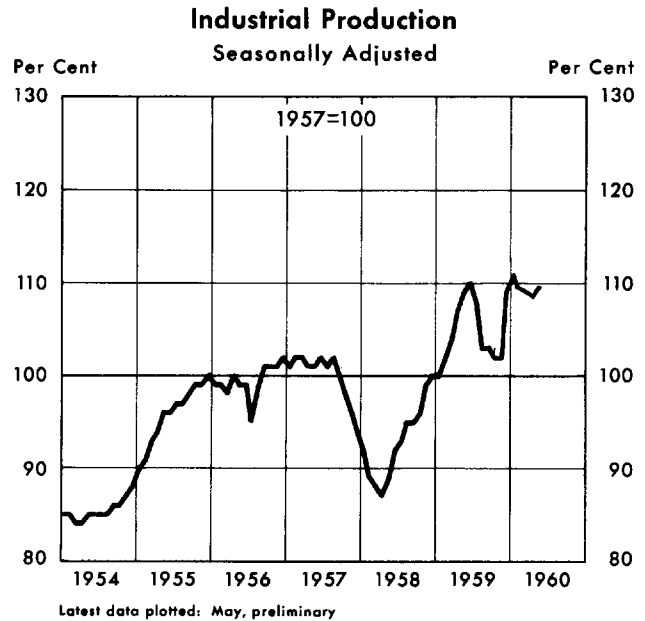
VOL. 42 • No. 6 • JUNE '60

Business Conditions

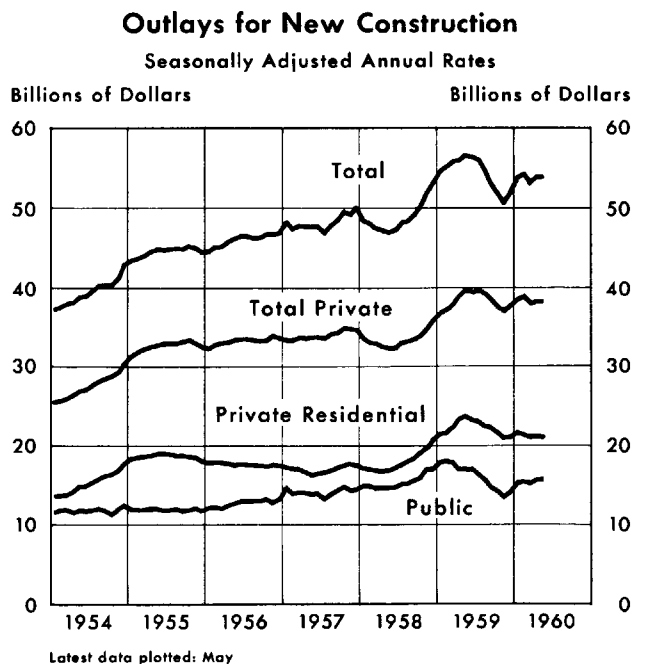
INDUSTRIAL PRODUCTION increased slightly between April and May to 110 per cent of the 1957 average. Production of materials declined, primarily because of reductions in metals inventories, but production of consumer goods and business equipment increased. Strength in consumer goods production was accounted for in part by the apparel, furniture, and television industries. Continued inventory cut-backs on the part of steel users caused a further contraction of steel output, with the production rate declining from 79 per cent of capacity in the last week of April to 66 per cent in the final week of May. Production during the first half of June declined further to an estimated rate of about 62 per cent of capacity. The current level of steel consumption has been estimated to correspond to a steel production rate of about 75 per cent of capacity.

Activity in the automobile industry during May continued to be one of the bright spots in the over-all industrial picture. May output of passenger cars was about 5 per cent above the April volume, and 12 per cent above the May 1959 level. During the first five months of this year passenger car production showed an increase of 17 per cent over the first five months of 1959. Car output has been supported by relatively brisk car sales. Unit sales of domestically produced automobiles in May were about 2 per cent above those in April, while sales for the first five months of this year were about 13 per cent larger than during the comparable period of last year. Retail sales of automotive products, in dollar terms, in the first four months were but 4 per cent higher than a year earlier. That the dollar volume was not greater may reflect this year's substantial sales of the lower priced small-size automobiles.

Construction expenditures in May showed no change from April. Total outlays in May were at an estimated seasonally adjusted annual rate of \$53.9 billion, the same as in April but 5 per cent below the May 1959 rate. Outlays on private residential construction have shown a greater decline since May of last year than have expenditures for any of the other major types of construction and have been the only type of outlays to have declined since the beginning of this



year. Total construction outlays in the first five months of this year were approximately 2 per cent lower than in the corresponding period of 1959, while private residential outlays were about 11 per cent below those in the first five months of last year.



Unemployment has declined little since April. Total unemployment in May was at a seasonally adjusted rate of 4.9 per cent of the labor force, the same rate as in May of last year, and was not significantly different from the April rate of 5.0 per cent. The decline in unemployment from the April level reflected substantial employment gains in farming, construction, lumber, and food processing industries which more than offset a further rise in unemployment in the metal and machinery industries. There was, however, a marked drop in number of workers unemployed for 15 weeks or more. The April-to-May decline in this group amounted to about 300,000, twice the seasonal decline for this time of the year, and caused the total number of long-term jobless workers to fall below last year's level. Initial claims for unemployment compensation and insured unemployment declined from mid-April through early June, with the drop in insured unemployment exceeding the usual seasonal contraction.

Production cutbacks have caused increased layoffs in the primary metals and machinery industries. Jobs in both industries combined were an estimated 59,000 less in May than in April, and about 100,000 less than in February of this year.

Total personal income rose in May, but retail sales declined. Personal income reached a \$399.4 billion

seasonally adjusted annual rate in May. A decline in wages and salaries in the primary metals industry was offset by higher payrolls in the manufacture of transportation equipment, fabricated metals, machinery, apparel, textiles, and leather.

Total sales of retail stores in May were down about 3 per cent from their April level, after adjustment for seasonal variation and trading day differences, but were 1 per cent larger than in May 1959. The April-May declines occurred in most major lines of trade, with the largest relative declines at automotive and department stores. Total sales had risen 4 per cent between March and April to record levels.

Average wholesale prices remained virtually unchanged from May to June. The weekly wholesale price index at mid-June was at an estimated 119.6 per cent of the 1947-1949 average, about the same as in May. Average wholesale prices have remained virtually unchanged since the beginning of last year.

Consumer prices, on the other hand, have continued their gradual climb. Between March and April average consumer prices rose at an annual rate of about 4.8 per cent, the sharpest monthly rise since June of last year. The April consumer price index stood at 126.2 per cent of the 1947-1949 average, about 2 per cent above the April 1959 level.

Financial Developments

Interest Rates

INTEREST RATES ON MARKETABLE SECURITIES declined sharply in the first quarter of 1960, fluctuated widely in April and May, and declined again in early June. The three-month Treasury bill rate averaged 2.57 per cent during the first twenty-one days of June. By comparison, Treasury bills were yielding about 4.50 per cent in late 1959 and early 1960. The average yield on long-term Government bonds for the first twenty-one days of June 1960 was 3.98 per cent, whereas in December 1959 and January 1960 these bonds were yielding about 4.30 per cent.

The current decline in interest rates reflects a weakening in the demand for loan funds relative to the supply. The decline in demand resulted in part from a decrease in the volume of Government financing so far this year as compared with the same period a year ago. Other factors tending to reduce the demand for credit have been a reduced rate of inventory accumulation and a lower volume of housing starts.

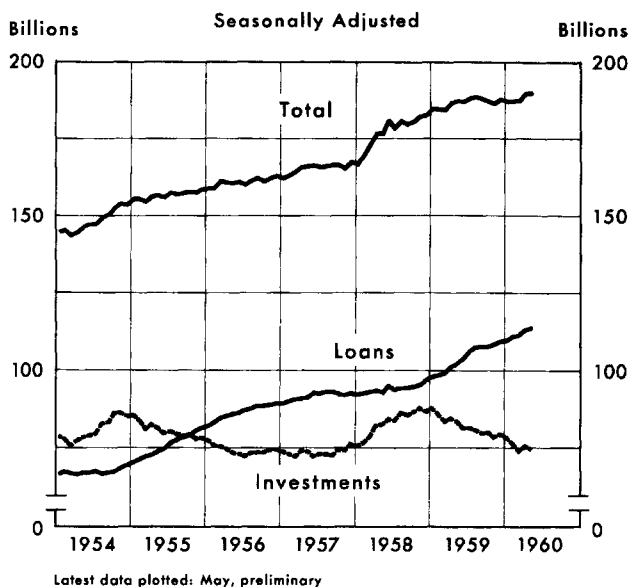
There are indications that the change in the supply of loanable funds has been modest. Information available on personal income and retail sales indicates that the flow of saving has changed relatively little, and total bank credit has remained almost stable.

Discount Rate

The discount rates at the Federal Reserve Banks of Philadelphia and San Francisco were lowered one half a percentage point to 3½ per cent, effective June 3. Shortly thereafter all other Federal Reserve Banks lowered their discount rates; at the Federal Reserve Bank of St. Louis the decrease was effective June 10.

This action brought the discount rates more nearly in line with money market rates and thereby increased the effectiveness with which open market operations can affect total member bank reserves. In early June the discount rates were about 1.20 percentage points above the three-month Treasury bill rates; from 1951 through 1959 this spread averaged .17 percentage points. With the Treasury bill rate substantially below

Commercial Bank Credit



the discount rates (as has been the case since March), member banks may tend to sell short-term securities rather than borrow funds to meet temporary shortages of reserves. Also, they may tend to use any increase in reserves to reduce their borrowings or to lend in the Federal funds market rather than as a base for expanding investments and loans to nonbank customers.

Total Reserves

During the seven weeks April 28 through June 15, total member bank reserves declined by about \$230 million, although seasonally adjusted the decline has probably been somewhat less. During this seven-week period total reserves, seasonally adjusted, averaged about \$18,400 million. This was about \$240 million below the level of early January but \$450 million above the low point reached during the week ended April 13. In the period April 28 to June 15 the

FACTORS AFFECTING MEMBER BANK RESERVES

DAILY AVERAGES OF MONTHLY DATA

In Millions of Dollars

Factors Affecting Member Bank Reserves
(Changes from preceding month*)

	Total Reserves	Total Change	Money Market ¹	Open Market Operations	Borrowing from F.R.
January	18,878	- 54	+1,060	-1,112	- 2
February	18,213	-665	+ 50	- 624	- 91
March	18,027	-186	+ 12	- 17	-181
April	18,101	+ 74	- 89	+ 177	- 14
May	18,228 E	+127	- 79	+ 327	-121
June ²	18,114 E	-114	- 324 E	+ 329 E	-119

¹ Includes gold movements, currency flows, Treasury operations, changes in float, and miscellaneous items.

² Based on first 15 days.

* Sign indicates effect on reserves.

E—Estimated.

Federal Reserve's net purchases of Government securities were \$650 million. These open market purchases during the seven weeks tended to add a corresponding amount to member bank reserves, but they were more than offset by money market drains and a reduction in member bank borrowing.

Commercial Bank Credit

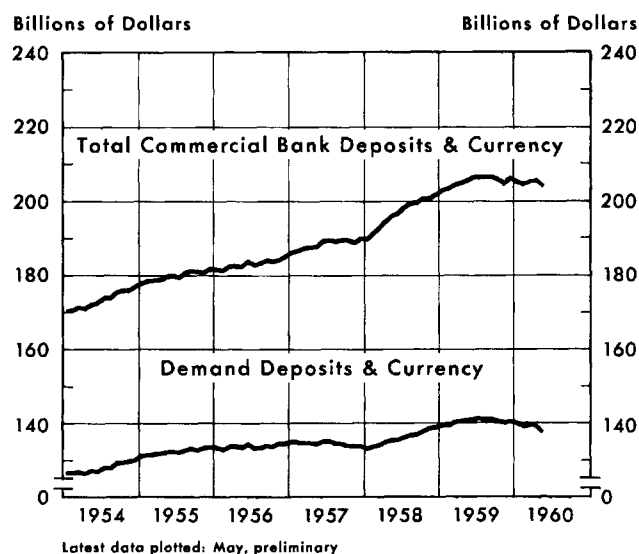
Total bank credit was virtually unchanged during May. Loans, which are generally stable at this time of year, increased moderately. Commercial and industrial loans, which are more directly related to economic activity, increased slightly in May, according to information received from weekly reporting banks. This was in contrast to the slight decline in such loans during April. Investments declined during May as banks sold Government securities, in contrast to the expansion in April when they made large net purchases of new Treasury issues.

Money Supply

The money supply, seasonally adjusted, declined \$1.8 billion or 1.3 per cent during May, despite the relative stability of total bank credit. The reduction reflected in part a large increase in deposits held by the United States Treasury which are not counted as part of the money supply. From the end of December to the end of May the money supply has contracted at an annual rate of 4.6 per cent. Since last July, when the money supply reached its peak, the annual rate of contraction has been 3.0 per cent.

Total commercial bank deposits adjusted and currency (the usual money supply concept plus time deposits) decreased by almost \$1.5 billion in May. The

Money Supply



money supply as measured by this broader concept showed an annual rate of contraction of 2.3 per cent between December and May and an annual rate of decrease of 1.4 per cent between last July and May.

Velocity

The turnover of money was slightly higher in May than in April, following a sharp rise earlier in the year. Velocity (on a three-month moving average basis) has risen almost steadily since mid-1958, and since the first of 1960 the rise has been exceptionally steep. The annual rate of increase over the past two years has been 7.5 per cent, whereas since last December the increase has been at a rate of about 12 per cent.

The velocity of money is influenced by many factors, including changes in the liquid asset holdings of the public and interest rates. Liquid assets holdings, especially of short-term Government securities, rose markedly during the first quarter of 1960 tending to reduce the demand for cash balances. However, indications are that in the second quarter of the year the public's holdings of liquid assets may have leveled off. Lower short-term interest rates have prevailed in recent months, reducing the incentive of holding cash balances.

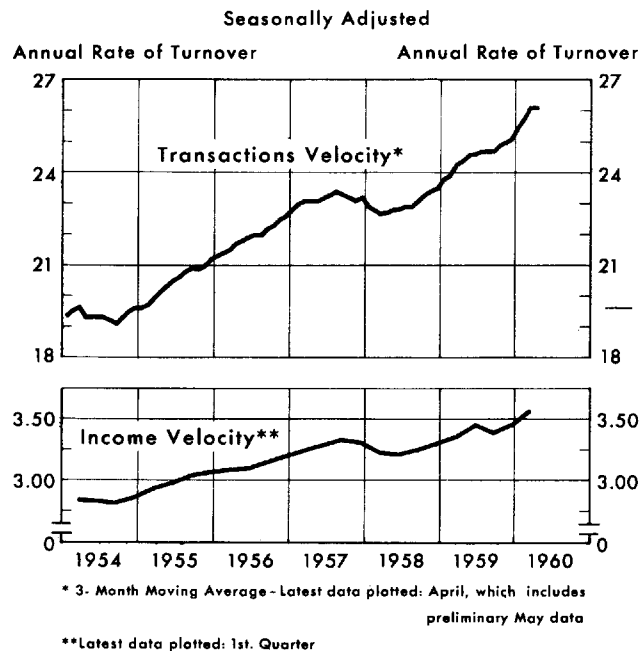
Debt Management of the Treasury

The Treasury's mid-May refunding operation met with success. Maturing issues amounted to \$6.4 billion and total bids for the securities offered amounted to \$5.8 billion, an attrition of \$0.6 billion or about 10 per cent. Of the new issues \$3.7 billion were in one-year 4% per cent certificates and \$2.1 billion in five-year 4½ per cent notes.

On May 16, 23, and 27 the Treasury accepted tenders for more bills than the maturing issues. These increases were in the six-month bill with \$500 million of these being offered each week in contrast to \$400 million in previous weeks.

On June 6 the Treasury announced an advance refunding of some of the bonds maturing in November 1961. Holders of \$4.6 billion of these bonds subscribed for a new issue of four-year 3¾ per cent notes, of which approximately \$3.9 billion were accepted. Holders also subscribed for \$0.3 billion of an eight-year 3¾ per cent bond, which were accepted in full. Since the old bonds have a coupon rate of 2½ per

Turnover of Money



cent, the actual interest costs on the new issues were estimated to be 4.51 per cent on the four-year note and 4.22 per cent on the eight-year bond. This advance refunding was aimed at lengthening the Federal debt and reducing the Treasury's financing problem in November 1961.

In early July the Treasury is expected to raise about \$3 billion new money. Treasury issues maturing in the near future include a \$2 billion one-year bill coming due July 15, and a \$9.6 billion note maturing in mid-August.

Fiscal Operations

The Federal Government operated at a cash surplus of \$3.8 billion in the first quarter of 1960. In the corresponding three months last year the Treasury had a \$100 million cash deficit. According to projections made by the Bureau of the Budget and the Treasury, there should be a cash surplus of about \$3 billion during the April-to-June quarter this year, as compared with a deficit of \$400 million in the like period last year.

The Bureau of the Budget and the Treasury have anticipated a cash surplus of about \$5.9 billion in the fiscal year beginning July 1. However, in view of recent international developments expenditures may be higher and the cash surplus less than expected.



What is a Balance of Payments?

Introduction

THE FLOW OF GOLD out of the United States and the growth of short-term foreign dollar holdings resulting from a deficit in the United States balance of payments have stimulated widespread public interest and concern. The complexities of a balance of payments, usually buried in economics textbooks, are now moving to the front pages of our newspapers.

To provide perspective for consideration of the "payments" problem confronting the United States, this article is designed primarily as an examination of the nature of a balance of international payments, and how changes in its component accounts may produce a balance-of-payments "surplus" or "deficit." Frequent references are made to the past and present payments position of the United States. The article concludes with a brief section on monetary policy implications.

The Nature of a Balance of Payments

Some General Principles

The balance of payments of a country may be described as a statement of the money value of all transactions between the residents, businesses, governments, and other institutions of that country and the rest of the world over a given period of time. Such a statement for the United States presents in summary form those transactions (debits) which give rise to immediate foreign claims on the United States and those transactions (credits) which give rise to immediate United States claims on the rest of the world. A somewhat simplified balance of payments for the United States is presented in Table 1.¹ It will be noted that the numerous international transactions may be consolidated into such major groups as the current account, unilateral transfers, the capital account, and the gold account.

¹ For a more detailed description of the balance of payments, see: United States Department of Commerce, *The Balance of Payments of the United States 1949-1951*, Office of Business Economics, United States Government Printing Office, Washington, 1952, Chapter 2.

Table 1 is based on the example given by: Delbert A. Snider, *Introduction to International Economics*, Richard D. Irwin, Inc., 1954, p. 121. Other helpful sources on balance-of-payments accounting procedures include Charles P. Kindleberger, *International Economics*, Richard D. Irwin, Inc., 1958, Chapter 2; Lorie Tarshis, *Introduction to International Trade and Finance*, John Wiley & Sons, Inc., 1955, Chapter 21; Paul A. Samuelson, *Economics, An Introductory Analysis*, McGraw-Hill Book Company, Inc., 1958, Chapter 31.

Several points concerning a nation's balance of payments deserve emphasis: (1) It is not a balance sheet showing the nation's international assets and liabilities at a point of time. Instead, it shows for

Table 1
UNITED STATES BALANCE OF PAYMENTS
1959¹
(Millions of dollars)

	Debits	Credits	Balance Debit (—) or Credit (+)
I. Current account:			
Merchandise trade	15,335	16,211	
Transportation	1,712	1,717	
Travel	1,575	870	
Income on investments—			
Private	543	2,605	
Government	279	343	
Military transactions	3,134	302	
Miscellaneous services	896	1,289	
Total goods and services.	23,474	23,337	
Balance			— 137
II. Unilateral transfers:			
Private remittances (net)	564		
Government grants, nonmilitary.	1,623		
Pensions and other transfers (net)	213		
Total unilateral transfers.	2,400		—2,400
III. Capital account:			
Long-term—			
United States private capital invested abroad	2,049		
United States government loans abroad (net)	1,394		
Foreign capital invested in the United States		1,224	
Total long-term capital (net)	3,443	1,224	
Balance			—2,219
Short-term—			
United States private short- term capital abroad	96		
United States government short-term capital abroad..	335		
Foreign short-term capital into the United States		3,335	
Total short-term capital.	431	3,335	
Balance			+2,904
IV. Gold account:			
Net movement of gold			
(outflow)		1,076	+1,076
Total of all accounts	29,748	28,972	
Errors and omissions		776	+ 776
Corrected total of all accounts.	29,748	29,748	

¹ Preliminary. Does not include military transfers under grants.
Source: Department of Commerce.

some stated period of time the flow of that nation's receipts from the rest of the world and of its payments to the rest of the world. (2) The procedures employed in the construction of the balance of payments are based on a double-entry accounting method. Each transaction, whether creating or destroying a claim against the rest of the world, is registered both as a debit entry and as a credit entry. Consider, for example, a purchase of a foreign commodity by an American importer. Such a purchase results in an immediate claim against the United States balance of payments, and is consequently registered as a debit entry. At the same time an offsetting credit entry is created indicating how the foreign claim against the United States is settled. If the foreign seller wishes to be paid in dollars he acquires a dollar account in a United States bank. If the seller is to be paid in his own currency the American importer may purchase the foreign currency from an American bank which in turn is required to draw down its balances of foreign currency held abroad. A third possibility is the settlement of the foreign claim by means of a promissory note issued by the American importer to the foreign seller. Whatever form of settlement is decided upon each settlement of a foreign claim against the United States results in a credit entry. Thus, an increase in foreign dollar balances held in the United States banks, a decline in United States balances held abroad, and an export of United States debt instruments are therefore credit entries in the United States balance of payments. In other words, the original debit or purchase transaction is settled or offset by a "sale" of an asset—an American bank's promise to pay, an American-held foreign balance, or an American I.O.U.

The credit entries in a balance of payments are not confined to those merely offsetting debit transactions. Many credit transactions are in a sense "autonomous"—sales of assets which do not reflect previous debit transactions. Generally such credit transactions would include the sale of merchandise items and the sale of long-term securities—items which give rise to immediate claims against the rest of the world but which are initiated for reasons other than settling claims. Such claims against the rest of the world are in turn offset by appropriate debit entries: reduction in foreign-held dollar balances, increase in United States-held foreign balances, or increase in United States holdings of foreign I.O.U.'s. In short, the original credit transaction (a sale or an export of an asset) is settled by the importation or "purchase" of foreign-held assets.

Clearly, if all transactions are recorded accurately, the total of debits is equal to the total of credits. As pointed out later, such a statistical or accounting

equality has little significance. Far more significant is the process by which such an equality is attained.

The Component Parts of a Balance of Payments

The Current Account. The largest section of the balance of payments, the current account, measures the dollar value of all goods and services which the United States purchases (imports) from abroad and sells (exports) to the rest of the world. The "visible" items, consisting of merchandise and representing the lion's share of the current account, make up the "balance of trade."

Imports of foreign merchandise, the purchase of foreign services by the United States, expenditures by United States tourists and military personnel abroad, and interest and dividend payments by the United States to foreigners are all "autonomous" debit items in the United States current account, because they increase the immediate claims of the rest of the world against the United States or decrease United States claims against other countries. United States sales of goods and services abroad, receipts from foreign tourists, and income from United States investments abroad are, on the other hand, autonomous credit entries since they either increase immediate United States claims against foreigners or decrease foreign claims against the United States.

Unilateral Transfers. Unilateral transfers, the second segment of the balance of payments, include gifts and grants, private remittances, and other transfers of funds which do not result from a previous import or export of goods and services. United States government grants, gifts from United States residents to the rest of the world, and pension checks from the United States to Americans or foreigners living abroad are entered in the balance of payments as debit items since all such transfers increase the rest of the world's claims against the United States. Conversely, credit entries reflect gifts and grants received by the United States and by United States residents.

The Capital Account. The capital account in the balance of payments registers all purchases and sales of evidences of debt or ownership between the United States and the rest of the world, or, in other words, registers all capital movements between the United States and the rest of the world. A sale of United States securities abroad will increase the immediate claims of the United States against the rest of the world, and is consequently an autonomous credit item. Such an increase in immediate claims against foreigners is commonly called a "capital import," as contrasted with an import of merchandise or services

which results in an increase in immediate foreign claims against the United States and is therefore entered as a debit item. A "capital export," on the other hand, resulting from a United States purchase of a foreign financial asset, is a debit item since such a purchase causes immediate foreign claims against the United States to rise.

In contrast to the purchase and sale of long-term financial assets, most short-term capital movements are offsetting transactions, or responses to autonomous credit or debit transactions in other sectors of the balance of payments. An increase in United States-owned bank balances abroad is an *offsetting* debit item since it indicates the settlement of a United States claim against the rest of the world which resulted from an original sale of merchandise, services, or securities by the United States. In effect, such an increase in United States balances held abroad may be viewed as a United States purchase of a foreign asset, offsetting an original sale by the United States. Conversely, a rise in foreign-owned balances in the United States is an *offsetting* credit item, reflecting the settlement of an original foreign claim against the United States.

The Gold Account. The final major segment of the balance of payments registers the movements of gold between the United States and the rest of the world. A sale of gold by the United States is usually considered an *offsetting credit* item since it is most often undertaken for the purpose of settling immediate claims against the United States. A purchase of gold by the United States, on the other hand, is an *offsetting debit* item since it ordinarily reflects the settling of immediate United States claims against the rest of the world.

Errors and Omissions. This item, appearing as the final entry in the balance of payments, owes its existence to discrepancies between total debits and credits resulting from incomplete and inaccurate estimates of individual transactions. It is, therefore, a "residual" item which has as its function the equalization of the debit and credit sides of the balance of payments.

The Meaning of a Balance-of-Payments Deficit

In the previous sections it was repeatedly pointed out that original, or autonomous, debit entries are offset by credit entries. Conversely, original credit entries, reflecting the creation of an immediate claim against the rest of the world, are offset by debit entries. If, as a consequence, the debit side of the balance of payments is always equal to the credit side, what then is a balance-of-payments deficit?

A balance-of-payments deficit occurs whenever a country's immediate claims against the rest of the world, resulting from autonomous transactions, fall short of the immediate autonomous claims against the country. Under such circumstances the country is forced to offset the excess autonomous claims against it either by selling short-term securities and/or gold to foreigners or by allowing foreign-owned balances in its domestic banks to increase. Any one of these methods of financing the excess autonomous foreign claims results in offsetting credit entries which, when added to the autonomous credit entries, restore the balance between the total debit and credit sides of the balance of payments.

A United States balance-of-payments deficit is therefore characterized by a net build-up of foreign-owned short-term dollars, either in the form of bank balances or holdings of United States short-term securities, and/or a net decline in the United States gold stock.² Since foreigners are allowed to exchange their dollars for gold whenever they want to do so, any net increase in foreign dollar holdings is a potential net increase in foreign claims against the gold reserves of the United States.

What happens if the United States purchases gold from abroad, thus adding to its gold stock, while at the same time experiencing a build-up of foreign-owned dollar balances? Under such circumstances a deficit will occur only when the net increase in short-term foreign dollar holdings exceeds the net inflow of gold. Conversely, a deficit may occur when the net outflow of gold exceeds the net increase in United States balances held abroad. In general terms, a deficit occurs when:

short-term capital inflows—short-term capital outflows+gold outflows—gold inflows=larger than zero.

A good example of a balance-of-payments deficit is provided in Table 1. In 1959, the United States spent an estimated \$137 million more abroad on goods and services than the rest of the world purchased from the United States. Consequently, immediate foreign claims against the United States exceeded immediate United States claims against the rest of the world on current account. Unilateral transfers show a net total debit amount of \$2.4 billion, indicating that United

² A "net" build-up of foreign-owned short-term dollars indicates the difference between the increase in foreign-owned short-term dollar holdings and the increase in United States short-term holdings of foreign currencies. A "net" decline in the United States gold stock measures the difference between United States gold sales and gold purchases.

States gifts and grants to the rest of the world exceeded gifts received by the United States.

Long-term capital outflows exceeded long-term capital inflows by more than \$2.2 billion in 1959, increasing immediate foreign claims by the same amount. Virtually the entire excess of capital exports was the result of purchases of foreign evidences of debt or ownership by United States residents, which totaled about \$2.0 billion.³ Total loans by the United States government minus repayments of previous loans were almost \$1.4 billion, and were virtually offset by an inflow of foreign capital resulting from foreign investments in the United States.

A look at the balance of payments up to this point shows that in 1959 immediate foreign claims against the United States exceeded immediate United States claims against the rest of the world by the following amounts:

Current account	\$ 137 million
Unilateral transfers	2,400 "
Long-term capital movements	2,219 "
Total	\$4,756 million

It appears from Table 1 that foreigners gained a net total of immediate claims on the United States of \$4,756 million in 1959. However, net purchases of United States gold and short-term financial assets by foreigners, including the build-up of dollar bank balances, amounted to \$3,980 million (\$1,076 million in gold and \$2,904 million in short-term financial assets). The difference between this amount, the "true" balance-of-payments deficit, and the previously determined \$4,756 million is accounted for by the \$776 million in the "Errors and omissions." This credit item is called a "balancing" item, since its sole function is to balance the debit and credit sides of the balance of payments.

Summarizing, it may be said that the United States balance-of-payments deficit in 1959 amounted to a sizable \$3,980 million. As shown in Table 1, the main causes behind this phenomenon were the large United States grants and long-term capital outflows.

Problems Inherent in a Balance-of-Payments Deficit

A deficit in the balance of payments undoubtedly weakens a country's reserve position since it involves

³ Included in this amount are expenditures incurred in the establishment of United States subsidiaries abroad. Such a capital export may consist of an outflow of either dollars and/or equipment.

a decline in short-term balances held abroad, a decline in the gold stock, an increase in foreign-owned short-term balances, or a combination of these three. Conversely, a balance-of-payments surplus strengthens a country's reserve position since it adds to the short-term balances held abroad, increases the gold stock, or decreases foreign-owned short-term balances. Is a deficit therefore a "bad" thing for a country, and a surplus a "good" thing? Not necessarily. No deficit is "bad," as long as it does not force a country to curtail its transactions with the rest of the world. Conversely, a surplus is not "good," if it causes the rest of the world to curtail its transactions with the country experiencing the surplus. A deficit which is offset by a future surplus or a surplus which is offset by a future deficit, will, in all probability, have little impact upon the level of a country's transactions with the rest of the world.

The picture becomes completely different, however, when a country experiences either a persistent balance-of-payments deficit or a persistent balance-of-payments surplus. In either case the country in question has a balance-of-payments *disequilibrium* which will tend to cause the volume of its transactions with the rest of the world to contract. In the case of a persistent deficit the country experiences a continuous drain on its gold and foreign-held balances, and/or a continuous increase in foreign-owned balances in its own currency. The size of the gold reserves, plus the rate at which they decline, will determine when the country will be forced to curtail its expenditures abroad, or to take appropriate action which will restore the equilibrium in the balance of payments.⁴ In the case of a persistent surplus, the country experiences a continuous build-up of its gold reserves and balances held abroad, while at the same time draining the reserves of the rest of the world. Under these conditions, the size of the reserves of each individual foreign country and the rate at which these reserves are declining will determine when the country will curtail its purchases from abroad. Although a country's balance-of-payments surplus rarely causes all other countries to have balance-of-payments deficits, such a surplus does diminish the combined reserves of all its trading partners and may, therefore, cause a contraction of its exports in the long run.

⁴ Artificial measures by which a country can bring its balance-of-payments deficit to a halt include (a) restrictions on merchandise imports through the introduction or raising of tariffs and quotas, (b) restrictions on capital exports, and (c) the devaluation of its currency in terms of other currencies. Such a devaluation will cause foreign goods and services to become more expensive in terms of the devaluing country's currency, thereby decreasing the volume of imports. At the same time, the price of the devaluing country's goods and services will be lowered in terms of the currencies in other countries, thereby increasing the volume of the devaluing country's exports.

Table 2
The Financing of the United States Current Account Surpluses, and Deficits,
Excluding Military Transfers Under Grants

(Millions of Dollars)

Year	Surplus or Deficit (—)	Net U. S. Capital Movements (— = outflow)					Net Foreign Capital (— = outflow)		Net Unilateral Payments (— = outflows)			
		Direct	Private		Official		Long-term	Short-term	Private Remittances	Official Grants ¹	Gold (— = inflow)	Misc. ²
			Long-term	Short-term	Long-term	Short-term						
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	
1946	7,744	— 230	127	—310	—3,262	238	— 347	— 633	—650	—2,274	— 623	220
1947	11,529	— 749	— 49	—189	—6,856	—113	— 98	363	—669	—1,897	—2,162	890
1948	6,440	— 721	— 69	—116	—1,112	88	— 172	524	—683	—3,894	—1,530	1,245
1949	6,149	— 660	— 80	187	— 479	—173	119	— 47	—521	—4,997	— 164	566
1950	1,803	— 621	— 495	—149	— 119	— 37	994	918	—444	—3,484	1,743	— 109
1951	3,721	— 528	— 437	—103	— 153	— 3	— 477	1,055	—386	—3,035	— 53	399
1952	2,345	— 850	— 214	— 94	— 418	— 2	443	1,169	—417	—1,960	— 379	377
1953	437	— 721	185	167	— 229	11	124	1,023	—476	—1,837	1,161	155
1954	1,861	— 664	— 320	—635	201	—108	252	1,210	—486	—1,647	298	38
1955	2,066	— 779	— 241	—191	33	—343	875	579	—444	—1,901	41	305
1956	3,876	—1,859	— 603	—528	— 66	—563	395	1,409	—530	—1,733	— 306	408
1957	5,810	—2,058	— 859	—258	— 334	—624	309	382	—543	—1,616	— 798	589
1958	2,248	—1,094	—1,444	—306	— 625	—341	55	1,109	—525	—1,611	2,275	259
1959 ³	— 137	—1,204	— 845	— 96	—1,394	—335	1,224	3,335	—564	—1,623	1,076	563
1958 I	662	— 155	— 443	— 44	— 125	—121	140	75	—133	— 384	370	158
II	670	— 411	— 446	—168	— 36	—186	— 136	130	—127	— 429	1,075	64
III	199	— 156	— 180	—115	— 226	—106	— 18	442	—123	— 368	483	168
IV	717	— 372	— 375	21	— 238	72	69	462	—142	— 430	347	— 131
1959 I ⁴	— 41	— 267	— 288	172	— 24	— 65	190	629	—140	— 433	96	171
II	— 194	— 450	— 233	— 69	—1,538	—105	245	1,821	—138	— 390	741	310
III	— 290	— 229	— 203	27	— 71	—165	481	755	—131	— 331	167	— 10
IV ⁵	— 388	— 258	— 121	—226	239	—	308	130	—155	— 469		

¹ Excluding military grants.

² Includes Government pensions and other transfers, and errors and omissions resulting from the use of different sources.

³ Preliminary.

⁴ Quarterly data are not seasonally adjusted.

⁵ Preliminary.

Source: U. S. Department of Commerce.

Summarizing, it may be said that neither a persistent balance-of-payments deficit nor a persistent balance-of-payments surplus benefits a nation, since it tends to cause a contraction in the level of its international trade and finance.

The United States Balance of Payments, 1946-1959

It was pointed out in the previous section that a single occurrence of a balance-of-payments deficit is not indicative of either an equilibrium or a disequilibrium. The question whether the United States has, in effect, been experiencing a disequilibrium in its balance of payments is answered in Table 2, showing how in the postwar period the United States has financed its transactions between itself and the rest of the world.

Several observations can be made immediately. In the first place, Table 2 shows that until 1959 the United

States had a persistent current-account surplus; that is, sales of United States-produced goods and services abroad exceeded United States purchases of goods and services from other countries (col. 1).⁵ Therefore, any balance-of-payments deficits which the United States may have experienced since the end of World War II arose from factors outside the current account. Second, the United States Government has continuously made large grants to other countries (col. 10). These grants, although an important dollar source to foreigners, have generally been smaller than the current-account surpluses.

⁵ The current-account surpluses and deficits in Table 2 do not take into account exports of military goods and services which are financed by the United States Government. Such exports, if included, would increase the current-account surplus without creating a claim for payment against the receiving countries. Table 1 shows how such transactions are entered in the official balance of payments. "Military transfers under grants" are included in total "Exports of goods and services," and thus create a credit entry. This entry is offset by a debit entry, "Military supplies and services," which is entered as a unilateral payment by the United States to the rest of the world.

From Table 2 it is apparent that until 1950 the United States experienced generally sizable balance-of-payments surpluses. During those years there was a continuous flow of foreign gold into the United States, sometimes accompanied by additional outflows of short-term capital reflecting the build-up of United States balances abroad and the purchase of foreign short-term securities. Whenever there was a net inflow of short-term capital, as in 1947 and 1958, it was exceeded by an inflow of gold. In other words, the rest of the world's reserves of gold and United States dollars dwindled.

In 1950 there was a radical turnabout, largely as the result of actions undertaken by foreign governments in the fall of 1949. At that time the reserves of many countries had reached a critically low level. Heavy purchases of United States goods and services needed to rebuild the war-damaged economies, coupled with the temporary inability of many countries, especially those of Western Europe and Japan, to pay for these purchases by exporting their goods and services to the United States, forced many countries to use up their gold and dollar reserves. In order to prevent such further drains they decided to devalue their currencies in terms of the United States dollar. This action, as discussed earlier, had a contractive effect upon United States exports and an expansive effect upon imports. The immediate result was a sharp drop in the United States current-account surplus, accompanied by an over-all balance-of-payments deficit.

Throughout the 1950's, except in 1957, the United States had balance-of-payments deficits, as evidenced by the outflow of United States gold (Table 2, col. 11) and the increase in foreign short-term dollar holdings (Table 2, cols. 4, 6, and 8). Among the factors contributing to these deficits, the following three have played a major role: (1) the sudden decline in the current-account surpluses following the 1946-1949 period (Table 2, col. 1), (2) the increasingly large foreign investments of United States private long-term capital (Table 2, cols. 2 and 3), and (3) the continuously large official United States grants (Table 2, col. 10). As a result of these three major factors the United States deficits have taken on a persistent character, and in effect have led to a balance-of-payments disequilibrium.

What are the possibilities that this disequilibrium will continue in the future? No answer can be given to this question for the simple reason that future developments in the balance of payments cannot be predicted. The consensus is that an expansion of United States exports of goods and services, resulting

in the reestablishment of a sizable current-account surplus, offers one of the most advantageous solutions to the current balance-of-payments deficit.

Monetary Policy Considerations

In reviewing the nature and extent of monetary policy measures and their impact upon the United States balance of payments one should clearly distinguish between a) measures initiated by the United States monetary authorities, and b) measures initiated by foreign governments and central banks. Another necessary distinction is that between a) monetary policy measures specifically designed to produce changes in the balance of payments, and b) measures specifically designed to bring about changes in domestic economic conditions.

In the United States, monetary policy measures are typically designed to influence the level of domestic economic activity without regard to balance-of-payments conditions. The absence of measures undertaken for the specific purpose of bringing about changes in the United States balance of payments reflects two particular conditions in the United States foreign trade and payments picture, namely, 1) the very small percentage of total goods and services produced and consumed in the United States which is either sold to or purchased from abroad⁶, and 2) the very large size of United States monetary reserves which can be used for the payment of balance-of-payments deficits.⁷ Given these two conditions, it becomes obvious why United States monetary policy is "dedicated" to the creation of an economic climate which above everything else stimulates growth and stability at home.

Several important questions remain, however, which deserve closer attention. In the first place, do present foreign short-term dollar holdings constitute a threat against this country's monetary gold reserves which may possibly force the United States to introduce policy measures specifically designed to protect these gold reserves? Secondly, what are the chances of future balance-of-payments deficits, causing a further drain on United States gold reserves and/or an increase in foreign short-term dollar holdings?

⁶ In 1959, for example, the combined value of United States imports and exports amounted to about 7 per cent of the value of all goods and services produced in the United States. For the United Kingdom this percentage was approximately 26, and for West Germany 32.

⁷ At the end of 1959, the United States Treasury gold holdings amounted to about 48 per cent of the total monetary gold stock of the free world, and to about 128 per cent of the value of United States merchandise imports in 1959. At the same time, gold and dollar reserves of the United Kingdom were only 31 per cent of the value of its 1959 imports, and reserves of West Germany 54 per cent of its imports.

The threat against the United States gold reserves, mentioned in the first question, reflects the ability of foreigners to exchange their dollar holdings for United States Treasury gold. The most ordinary way in which this occurs is as follows: Foreigners having dollar balances in United States banks decide to withdraw their dollars, and sell them to a foreign Central Bank. The foreign Central Bank, in turn, may either exchange these dollars for gold at the United States Treasury or add them to its existing dollar reserves.

Differences in short-term interest rates from country to country provide an inducement for people to shift funds in search of higher yields. Any decline in United States short-term interest rates, whether from natural causes or induced by the monetary authorities, carries with it the possibility of an outflow of dollars which may or may not be ultimately exchanged for gold. However, the danger may not be as great as it appears at first sight, since by far the largest portion of funds held by foreigners in United States banks consists of working balances needed in the day-to-day transactions between the United States and the rest of the world. On the other hand, foreign short-term dollar balances in United States banks which are subject to interest-rate arbitrage appear to be small. A recent estimate put the amount at \$2 billion to \$3 billion, out of a total volume of short-term dollar liabilities to foreigners, excluding international institutions, of about \$16 billion. Although the exactness of this figure cannot be substantiated, it appears to be in line with some other recent estimates.

On the basis of the foregoing analysis it may be concluded that the present level of United States monetary gold reserves appears more than adequate to support the present level of short-term dollar liabilities to foreigners. However, the second question still remains, namely, whether balance-of-payments deficits will continue in the future, thus further reducing United States gold reserves and increasing foreign short-term dollar holdings in the United States. It is obvious that no definite answer can be given to this question. Present indications are, however, that in the near future the United States balance of payments may be expected to continue to show a deficit. Net capital exports from both private and public sources are likely to exist in sizable amounts, and may prove too large to be offset by a modest current-account surplus.

Under such conditions, monetary policy measures most likely to improve the balance of payments are those which also are most beneficial to domestic economic growth and price stability. A stable price level and increased efficiency in the domestic production of goods and services will foster the ability of American industry to meet foreign competition both at home and abroad. Moreover, in the absence of domestic inflation a sharp increase in demand for foreign goods and services by the American consumer is less likely to occur than under conditions of rapidly rising domestic prices. Thus, a balance-of-payments deficit is best prevented when monetary policy is directly concerned with domestic economic growth and stability.

